ENTERTAINMENT LAW: Product Placement, Reality TV, Digital Downloading, and more

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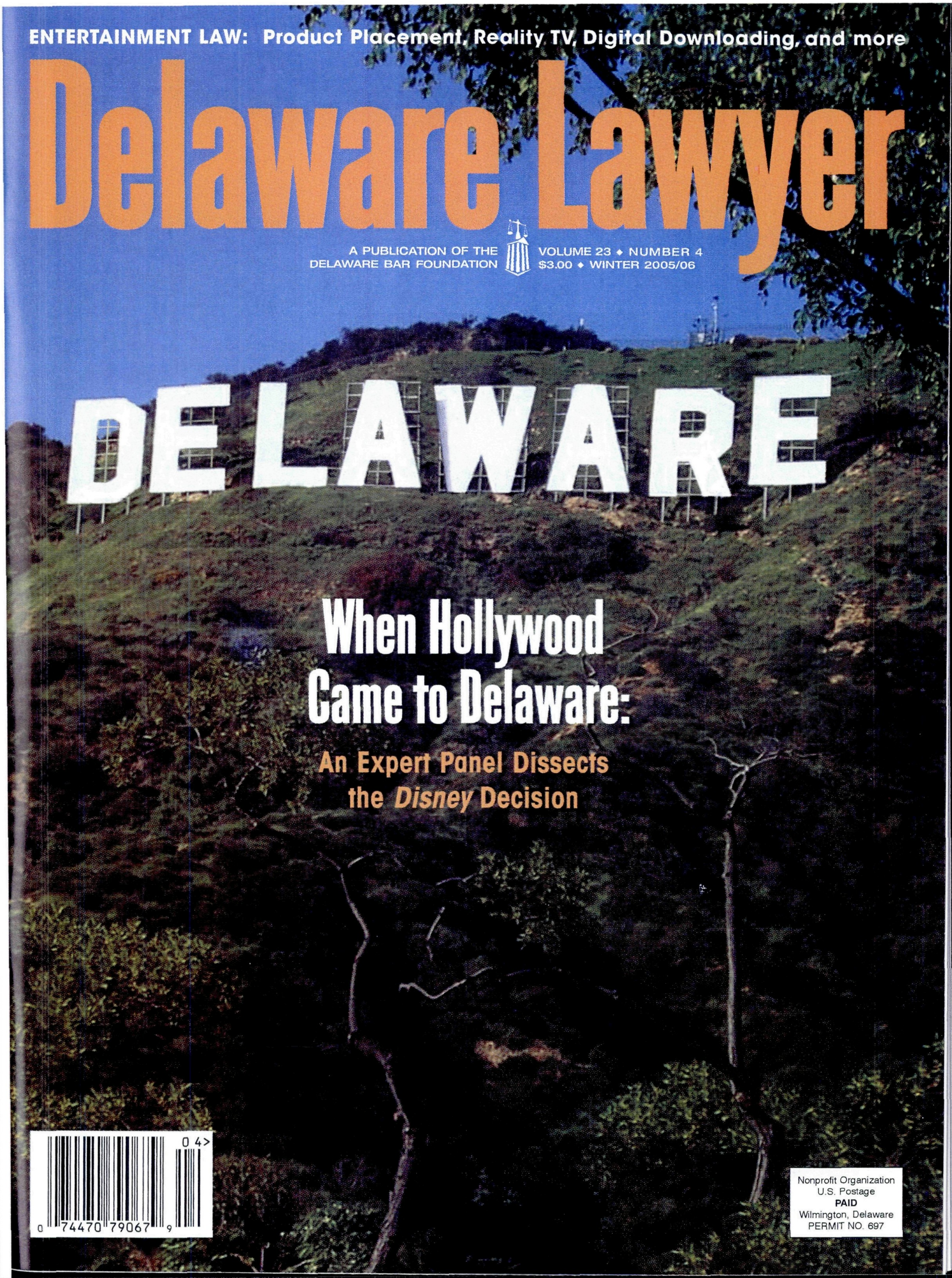

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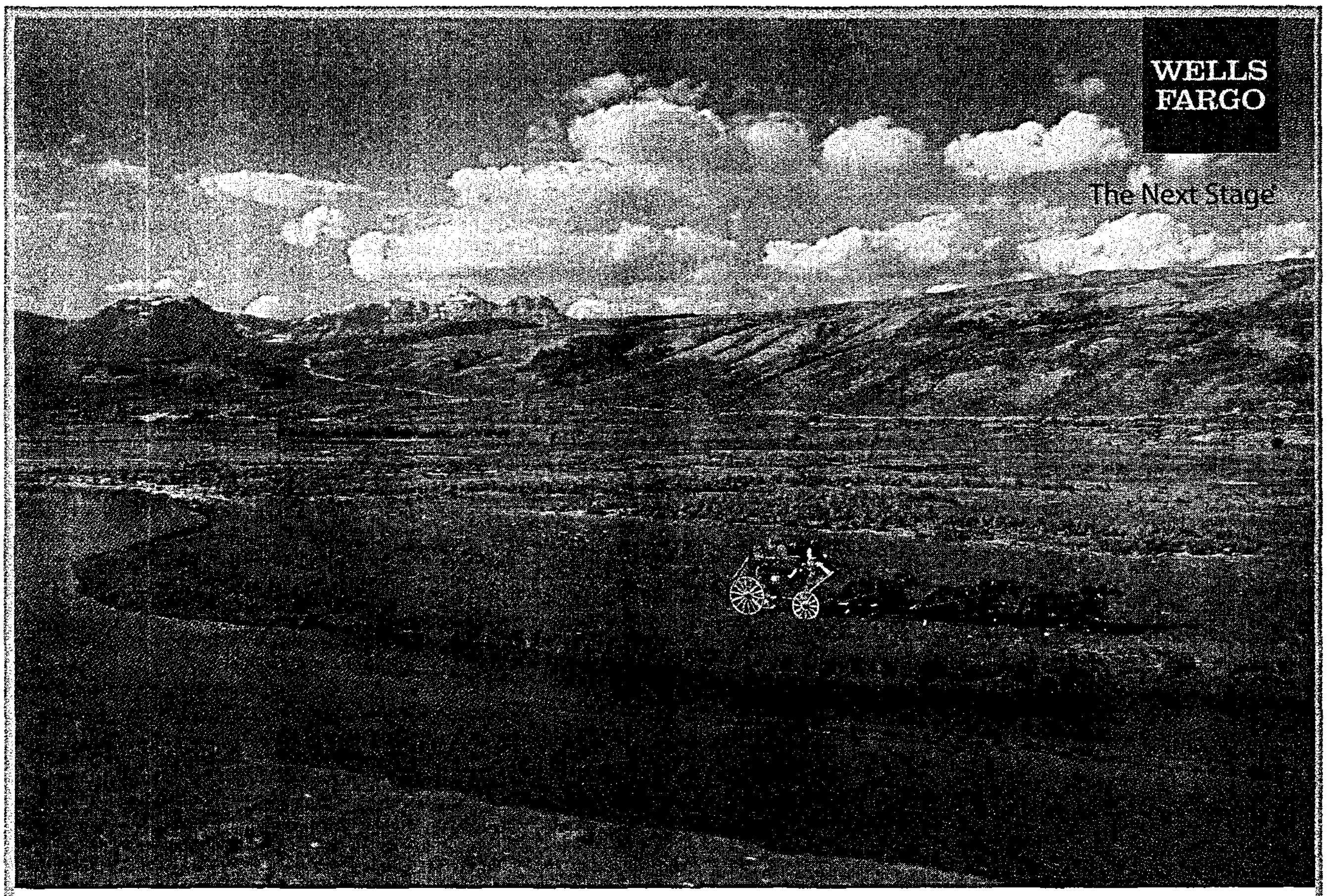

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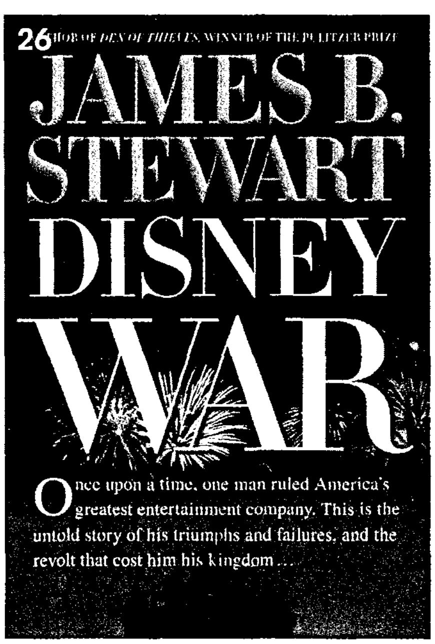

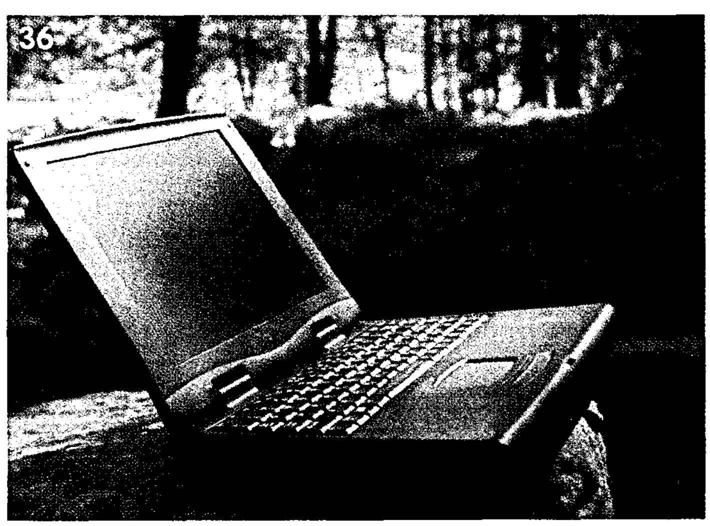

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John W. Anderson

I recently had drinks with a business affairs attorney who works for one of the biggest film and TV agencies in L.A. She and I were talking about the role entertainment lawyers play for their clients. It's her belief that entertainment lawyers rival all other areas of the law when it comes to being advocates for them. That's because, according to her, most entertainment lawyers have professed to be, or continue to be, entertainers themselves. She was a dancer. I'm a screenwriter. In my firm, we also have a professional photographer and an aspiring novelist.

The arts are very important to us as entertainment lawyers, not just to protect, but to enjoy. A passion for the arts is shared by many, if not most, lawyers. I remember getting a special behind-the-scenes tour of the U.S. Supreme Court, thanks to a friend who was clerking for one of the associate justices. As I entered the hallowed chamber of Chief Justice Warren Burger, what stood out to me was his artwork — a half-finished oil painting of a law book — perched prominently on an easel next to his desk.

A friend of mine, Mark Bryan, claims that we are all artists. In his book *The Artist's Way at Work*, Mark writes: "Creativity is not dangerous, not volatile, not limited to a select few. It is a universal, not an elitist, gift." Warren Buffet once said: "I am not a businessman. I am an artist."

There's a lot to cover here in the "art" of entertainment law. Mark Litwak explains the steadily (and stealthily) growing phenomenon of "product placement." Edward Copeland examines the past and future world of digital downloading, as seen through the lens of the Supreme Court's recent *Grokster* decision. Frank Dehn surveys the legal minefields presented by the incredible growth of "reality TV." Peter Thall offers a unique perspective on the illegal downloading crisis by looking to the ancient Greek philosophers for guidance.

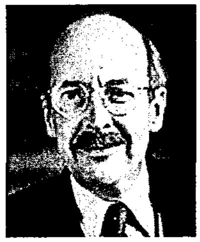
We also examine the Court of Chancery's recent decision in the Disney shareholder derivative action involving the $140 million-plus payout to Michael Ovitz. Our esteemed "virtual roundtable" panel includes best-selling author James B. Stewart *(Disney War)*; Professor Lawrence A. Hamermesh of the Widener University School of Law; Columbia University law professor John C. Coffee; and William T. Allen, former chancellor of the Delaware Court of Chancery, now a law professor at New York University.

Speaking of "virtual," I was asked by the folks at *Delaware Lawyer* to write "The Virtual Law Firm," a piece about my own firm and how we practice entertainment law from all parts of the country and the globe in order to make our personal lives more enjoyable while offering better service to our clients. The "virtual" trend, I believe, is not unique to the field of entertainment law, and all lawyers need to be aware of its opportunities and challenges.

I hope you have as much fun reading this issue as I had putting it together. I want to thank Karen Pascale of Young Conaway Stargatt & Taylor LLP for serving as my editorial liaison, as well as all the other board members of the *Delaware Lawyer*, for the opportunity to create this issue for you.

John W. Anderson

William T. Allen



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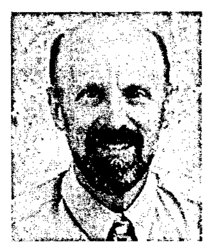

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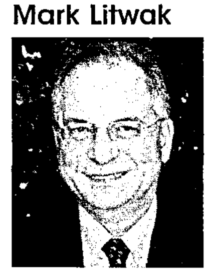
Mark Litwak



is a veteran entertainment attorney and producer's representative based in Beverly Hills, California. He is the author of six books, including the recently published *Risky Business: Financing and Distributing Independent Films* (Silman-James Press, 2004). He is the author of the CD-ROM program "Movie Magic Contracts," and the creator of the Entertainment Law Resources Web site (marklitwak .com). He can be reached at law@marklitwak.com. Mr. Litwak thanks his law clerks Jahnavi Goldstein and Ryan Pastorek for their assistance in researching his article.

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FEATURE

Mark Litwak

When Products Become Stars

By tying licensing and merchandising opportunities directly into movies and TV shows, product placement blurs (and, some would argue, eliminates) the line between entertainment and advertising.

What do the blockbuster movies *Star Wars* and *Mr. & Mrs. Smith* have in common with television shows such as *American Idol*? They are classic examples of product placement — the practice of advertisers inserting their products in movies and television shows in order to build brand awareness and increase sales. The product placement market is projected to grow at a compound annual rate of 14.9 percent from 2004 to 2009, reaching an estimated $6.94 billion.[1]

By tying licensing and merchandising opportunities directly into movies and TV shows, product placement blurs (and, some would argue, eliminates) the line between entertainment and advertising. As a result, it is becoming increasingly difficult to distinguish commercial speech (i.e., speech that proposes a commercial transaction) from noncommercial speech (i.e., speech with artistic or political content).[2] Traditionally courts have extended greater protection to noncommercial speech, although restrictions on commercial speech may be invalidated if they unconstitutionally limit dissemination of information to the public.[3] This article explores the legal implications of the increasingly intertwined relationship between advertising and entertainment.

How Product Placement Came To Be, and Where It Is Today

The intermingling of commerce and entertainment is nothing new. Advertisers played an important role in the early days of television by sponsoring programs. The J. Walter Thompson advertising agency produced *Kraft Television Theatre*, a popular program during the Golden Age of television, which aired on NBC from 1947 to 1958.

Likewise, selling movie-related products is not a recent phenomenon. Walt Disney built an empire marketing Mickey Mouse ears and other toys, not to mention the enormous revenue generated from theme parks. While merchandising has been around a long time, there has been a resurgence of activity since the release of *E.T. — The Extra-Terrestrial* in 1982. You may recall the scene in which the young boy, Elliott, shares some of his Reese's Pieces candy with the friendly alien. As a result of exhibiting that product in the film, sales of Reese's Pieces reportedly increased an incredible 65 percent. This bonanza delighted the makers of Reese's Pieces, but was much to the chagrin of M&M's execs. They had denied Steven Spielberg's request to use their candy after their marketing guru figured that having an alien eating M&M's would reflect badly on the product — one of the greatest marketing blunders of all time.

After the *E.T.* incident, many product marketing managers began to make more of an effort to place their products in films. They realized that insertion of their product in a successful film could boost sales, and cost less than the cost of advertising. Studios also took notice and made more of an effort to promote products in their movies, as well as look for spin-off products that could be marketed.

Traditionally, studios have entered into two basic types of agreements:

- Product placement deals where a manufacturer has its product shown in a film or television program; and
- Merchandising deals where the studio licenses, to a manufacturer, the right to use names, characters, and artwork for spin-off products such as toys, clothing, novelizations, and soundtrack albums. Such arrange ments are no longer limited to motion pictures — they now expand into music, video-games, and print media.

Initially, advertisers didn't seek out product placement opportunities. Producers approached manufacturers asking permission to show a product in a film or show. Even as product placement became more popular and widely used, paid placements were uncommon.[4] Most placements were barter arrangements with the manufacturer offering some freebies for use in filming. Expensive goods, such as jewelry and cars, would be loaned to the producer. Cash payments were rare, and when made, they were often part of a back-end promotion deal.[5]

That is no longer the case. Today we live in the golden era of paid and brokered product placements. Manufacturers hire agents to seek out and negotiate film and television deals. Bidding wars for placement of products are commonplace. Stars demand a piece of the action as well (wanting, at minimum, to keep the clothing and props used in a show or film).

There are several reasons why product placement has become so popular.

After *E.T.*, many product marketing managers began to make more of an effort to place their products in films.

The remote control is a primary cause. With hundreds of channels to watch, viewers routinely click to another channel to avoid commercials. Then there are the Digital Video Recorder (DVR) devices such as TiVo, which allow viewers to easily skip advertising. Add all this to the fact that consumers have become much more sophisticated in their television viewing, thanks to a daily onslaught of advertising claims which some experts estimate total up to 3,000 per day.[6] Marketers are attracted to product placement for all these reasons because, if done correctly, it appears more natural and closer to a true endorsement rather than a blatant hard-sell pitch.

The growth of reality television has provided many more opportunities for product placement.[7] Shows such as *Survivor* and *American Idol* actively partner with brands, and the entire show becomes a product placement forum. Likewise, the growth of specialized cable networks such as the Food Channel and The Learning Channel enable their producers to deliver niche audiences of great interest to certain manufacturers.[8] The show *Trading Spaces*, for example, integrates sponsors such as The Home Depot directly into the shopping and building experiences of its stars.[9]

Digital technologies such as "virtual placements" permit film and television library owners to offer up-to-date product placements in older programs when they are rerun or syndicated to television stations, or when released as a DVD collection. Princeton Video Image, a company best known for its digital yellow "first down yard line" in college and pro football game broadcasts, provides this "virtual placement" technology to eager advertisers.[10] This technology allows advertisers to seamlessly replace old products digitally with new ones. On a rerun of a *Seinfeld* episode, for instance, Jerry might drink a PepsiOne even if his character originally drank a Diet Coke.

At the extreme end of the product placement world is something referred to as product integration, a concept that automakers embrace. Unlike traditional product placement, which features a product in a movie or television show, product integration goes one step further by creating a movie or TV show around the product. Ford Motor Company recently signed a deal with Revolution Studios that allows Ford to write its cars and trucks into movie scripts. Ford marketing executives play an active role in the scriptwriting and approval process.[11] The producers of the film *Are We There Yet?*, starring Ice Cube and a tricked-out Lincoln Navigator, ensured Ford that the Navigator would appear in 75 percent of the film. Ford has also paid hefty sums for vehicles appearances in *Alias* and *24*, and the James Bond movie *Die Another Day*. It's estimated that in 2004, automakers made up 40 percent of all product placement spending.[12]

As product placement, merchandising and other forms of stealth advertising multiply, attorneys need to carefully consider the legal issues that arise to protect their clients' interests.

Product Placement Releases and Permissions

Almost every time a viewer can identify a brand name, logo, or product appearing in a major studio film or network television show, the manufacturer has given the producer a release or license to depict it. Sometimes companies refuse permission, or the production company neglects to obtain a release, so producers ask their prop department to create a pseudo-looking product that does not exist. If the footage has already been recorded, brand names can be blurred out or virtually removed from a scene.

If the product is shown in a neutral or positive light, of course, a manufacturer is unlikely to complain. Indeed, most of the time they will be thrilled to obtain such exposure. But if they are not pleased, their legal counsel will advise them that it can be difficult, if not impossible, to prove damages (as will be explained later), since the legal basis for a recovery is murky at best.

Manufacturers will usually give a release if asked, provided they are assured that their product will not be depicted in a derogatory manner. Coca-Cola is happy to have a character in a television show drink its soda, but will not be if the character goes into convulsions and vomits after drinking Coke. Some companies may attempt to negotiate restrictions on use, but the majority of manufacturers are pleased to have their product shown because it is free publicity, and much less expensive than buying a 30-second spot. Even low-budget independent producers are often able to secure permission to include products in their films.

There is little case law concerning the unauthorized use of products in motion pictures, because most disputes are settled out of court. Attorneys for product manufacturers have contended that a nonapproved use of a product in a motion picture, even if nondisparaging, could be a violation of the Lanham Act. In *Wham-O, Inc. v. Paramount Pictures Corp.*, the manufacturer of the Slip 'N Slide toy slide brought suit and sought a temporary restraining order against Paramount Pictures for its unauthorized use of the toy in the movie *Dickie Roberts: Former Child Star.*

In *Dickie Roberts*, David Spade plays a former child star seeking to reenact the childhood experiences he missed while busy working in the entertainment industry. In an amusing sequence, the character misuses the toy slide to comic effect and suffers injuries. Paramount said the film used the Slip 'N Slide to convey an image of childhood fun, but Wham-O argued that in a world where consumers know about product placement "the viewing public ... has come to expect, that trademarked products featured in movies ... are there because, in fact, the trademark owner is associated with or has endorsed the movie through such product placement arrangements."[13]

The court determined that Wham-O was not likely to succeed on the merits of the case because Paramount's use of the product amounted to a nominative use that did not create an improper association in consumers' minds between the product and the trademark. Wham-O's trademark infringement and dilution claims were likewise rejected and the request for injunctive relief was denied.[14]

Giving it Away

Even though cash-induced placements are increasing, many companies prefer in-kind donations in exchange for product exposure in films and television shows. Some manufacturers donate generous numbers of samples. For independent filmmakers, donated products can reduce the cost of a movie by supplying products that might otherwise have to be purchased. If lunch on the set is an eclectic mix of green jello, peanut butter and pickles, the reason may not be an incompetent caterer, but a producer relying on product placements to feed the crew.

Stars, producers and studios also benefit from the flow of freebies. They like to retain props, costumes and products, sometimes auctioning them off to collectors for considerable sums. The designer or manufacturer reaps a benefit from this largesse if young women visit stores with a picture of Jennifer Aniston in her latest movie and ask to purchase the clothing, shoes or jewelry she is wearing.

Drafting a Product Placement Deal

When drafting a product placement agreement, it is important to ensure that 1) product placement requirements do not conflict with other production contracts related to the film or television show; and 2) there are clear examples of authorized and nonauthorized product uses. The more positive the light, and the greater the level of celebrity use/endorsement, the more willing the manufacturer will be to cooperate. However, attorneys also need to understand that some directors will refuse to allow insertion of products in their scripts, and stars may refuse to use such products. Robin Williams is renowned for not accommodating product placements,[15] and Pamela Anderson refuses to be shown with any fur or meat products. It is common for a star's employment contracts to require that promotional tie-ins and merchandising deals will be subject to the star's approval.

Merchandising

Merchandising is when studios license the right to sell spin-off products to manufacturers of products such as toys, T-shirts, and posters. Studios usually do not manufacture film-related products themselves. In most instances there is no risk to the studio because the manufacturer bears all manufacturing and distribution expenses. The studio typically receives an advance payment for each product, as well as royalty payments, often between 5 and 10 percent of gross wholesale revenues from sales to retailers.

If the movie flops and the products don't sell, the manufacturer, not the studio, incurs the loss. On the other hand, a hit film can generate huge amounts of revenue from the sale of such merchandise. Since its debut in 1977, *Star Wars*-themed merchandise has generated $9 billion in retail sales — far outpacing the nearly $3.4 billion the film series has generated at the global box office. These figures were calculated before release of the latest episode, *Star Wars: Episode III — Revenge of the Sith*, which is expected to generate an additional $1.5 billion in merchandise sales.[16]

With the 1995 release of *Toy Story*, the incestuous relationship between products and movies has come full circle. Here is a story about toys — some new and some old favorites — which serves as a vehicle to promote its toy characters whose sale, in turn, promotes the film they star in. Rarely has such synergy between movies and products been so fully realized.

Whether you view *Toy Story* as nothing more than a thinly disguised commercial hawking toys to youngsters, or as a creative masterpiece that smartly capitalizes on spin-off opportunities, there is no doubt that movie merchandising has become big business. Licensed products generate more than $73 billion dollars a year, of which $16 billion is derived from entertainment such as movies.

In drafting a merchandising agreement, the scope of the license needs to be carefully defined. Since hundreds of different licenses may be granted, and each is typically exclusive for that kind of product, care must be taken to ensure that the licensed rights do not conflict with any other license granted.

Merchandising efforts can also conflict with product placement. McDonald's may be discouraged from signing a deal for an upcoming movie whereby it would sell toys as part of its Happy Meal if a scene in the movie takes place in a Burger King.

Regulatory and Legal Issues Regarding Product Placement

Section 317 of The Federal Communications Act and the Rules promulgated under it[17] require radio and television broadcasters to disclose paid sponsorship to viewers. The Federal Communications Commission (FCC) requires that when a broadcast station "transmits any matter for which money, service or other consideration is either directly or indirectly paid or promised," the station must, at the time of broadcast, announce that the matter is sponsored, paid for or furnished, and by whom such consideration was paid. These regulations apply only to broadcasters using the public airwaves, and do not regulate sponsorship of films or shows exhibited in theaters or over cable television. The broadcast industry has been criticized for not disclosing integration of products into the plots of television programming. International regulation of product placement in some countries has been more restrictive than what has been allowed in the United States. European countries have traditionally restricted product placement. Great Britain and Germany prohibit it, especially in television.[18]

Recently, however, some countries such as Italy, Spain, and Austria, and the European Commission (the executive body of the European Union) have considered relaxing their tight restrictions on integrated branding, merchandising and product placement.[19] By the end of the year, the commission is poised to propose clear rules authorizing and regulating product placement. Among the options, the commission will allow advertisers to utilize product placement, but it must be disclaimed in the show's ending credits. At present, marketers and studios still have to abide by the rules of individual nations due to the lack of uniformity on the product placement question in Europe.

The broadcast industry has been criticized for not disclosing integration of products into the plots of television programming.

As product placement has increased, especially on television, U.S. consumer groups have noticed and taken offense. Recently, a group called Commercial Alert brought a petition to the Federal Trade Commission (FTC) requesting that it become mandatory for all television shows containing any paid product placements to carry a label identifying that the show contained such a paid form of advertisement.[20] Commercial Alert lobbied to have in-show disclaimers pop up on screen during the actual product placement. In a positive decision for product placement, the FTC denied Commercial Alert's request, finding that the FCC and false advertising laws already offered enough protection to consumers. Commercial Alert now plans to bring the issue before Congress.[21]

Another issue raised by product placement is potential liability to consumers from an inaccurate representation of products. In traditional advertising, there are regulations to protect consumers from misrepresentations, and advertisers may be required to substantiate their claims or add disclaimers.

Due to the potentially lethal effect of car crashes or malfunctions, automotive advertising is heavily regulated. For instance, many television car commercials require a disclaimer stating that a professional or stunt driver is operating the vehicle on a closed course and such maneuvering in unsafe if undertaken by the general public.[22]

Such disclaimers serve multiple purposes. They assure compliance with FCC and FTC rules and regulations, they serve to enable the companies to keep the ads on the air when competitors make false advertising or cease and desist claims, and also — most importantly — they serve to help eliminate corporate liability by immunizing the company from lawsuits from potential viewers who drive the car carelessly and harm themselves or others as a result.

Movies and television shows, however, have no such disclaimers. When Pierce Brosnan (or, soon, Daniel Craig) flips his Jaguar in a James Bond flick, or Matt Damon gets his Mercedes G500 to outrun every policeman and bad guy in *The Bourne Supremacy*, the automotive manufacturers are getting tremendous exposure and publicity, and are able to demonstrate their cars performing in ways divorced from reality that would not be permitted in a commercial. At some point, an injured consumer run over by a movie fan imitating James Bond will bring suit and the question will arise whether the studio and/or auto company can be liable. Constitutional issues may arise because, in the past, entertainment has been treated differently from the commercial use of media. Should disclaimers and liability be predicated on the medium in which it appears? This debate has been the subject of several law review articles.[23]

Product placement has always been a popular form of marketing with the heavily regulated cigarette and liquor industries.[24] Neither is allowed to advertise to younger viewers, and until recently only print advertising was allowed for liquor. Although liquor may now be advertised on cable television, it is still limited.[25] So while a cigarette company can't advertise on a Nickelodeon TV show aimed at 13-year-olds, they can reach this audience by showing an idolized teen figure smoking in a movie. Movie studios and producers must make sure that product placements within the movies are not in violation of federal regulations. Failure to do so can result in negative publicity and regulatory sanctions. For instance, Budweiser is under close scrutiny by watchdog groups and the FTC for its recent paid product placement in the blockbuster hit, *Wedding Crashers*.[26]

Breach of Contract and Remedies

What happens if the studio and the advertiser strongly disagree regarding the manner in which a product is used or shown, or was "promised" to be depicted? Of course the circumstances of the product placement (unauthorized, used with permission, paid or unpaid) will have implications here. If a director or studio portrays a product or brand in an unfavorable light, does the advertiser have a legal remedy? The outcome of any dispute is likely to become a matter of contract interpretation. Thus, even for informal off-the-cuff product placement deals, it is imperative to have some sort of contract, even if it is just a letter of intent to show the interests and agreements of the parties regarding such matters.

Reebok brought suit against TriStar Pictures, claiming that TriStar had failed to honor its oral product placement deal with Reebok for the movie *Jerry Maguire*. Reebok alleged that it had paid more than $1.5 million in products and cash in return for the producers' promise to feature a Reebok commercial in the closing credits of the film, and the commercial was ultimately edited out.[27] In addition to being excluded from the ending, Reebok was snubbed in the movie by Cuba Gooding Jr.'s character. The case was settled out of court on confidential terms, after both parties spent considerable sums in a dispute that could have been avoided if the parties had expressed their understanding in a clearly written agreement.

Because publicity about such disagreements can damage a motion picture and the product, the parties often include provisions for terms to be kept confidential and disputes to be resolved by arbitration. The parties may also want to agree upon an amount of liquidated damages for a breach, rather than leave such questions to a third party who may have difficulty quantifying such speculative injuries to a brand. Some agreements specify that the manufacturer's obligation to pay a fee is conditioned on the product actually appearing in the motion picture a certain amount of times, with certain prominence and with clear prohibitions about how the product will not be portrayed. For instance, Ford will not allow its vehicles to be shown driven by a drunk driver, criminal, or drug dealer, nor can the producer show the car running out of gas, not starting, getting a flat tire, or even being sprayed with mud.[28]

Even if a product is included in a motion picture, and is portrayed positively, the advertiser may be disappointed for reasons outside the control of the producer, such as when a film performs poorly at the box office. Mercedes had agreed to pay $30 million for inclusion of its vehicles in the *Jurassic Park* sequel *The Lost World*, with $15 million paid upfront. The film was a flop. While Mercedes didn't pay the second $15-million-dollar installment, it didn't have much to show for its financial contribution.[29]

Conclusion

The legal implications of product placement are many and complex. Product placement is only going to get bigger in the years ahead, as are the contractual, constitutional, and free speech issues surrounding it. As product placement increases, so will the need for attorneys familiar with its legal implications. ◆

FOOTNOTES

1. PQ Media LLC, Report, "Product Placement Spending in Media 2005," March 2005, *available at* http://www.pqmedia.com/ppsm2005-es.pdf.

2. Protection of commercial speech is relatively new. At one time, the U.S. Supreme Court held that commercial speech was not protected under the First Amendment. In 1942, in *Valentine v. Chrestensen*, 316 U.S. 52 (1942), the Court found that the Constitution allows states to limit commercial speech as they see fit, but subsequent decisions changed course. The Supreme Court first held that commercial speech is entitled to constitutional protection in *Bigelow v. Virginia*, 421 U.S. 809 (1975), and later in *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748 (1976).

3. *See Central Hudson Gas & Elec. Corp. v. Public Service Comm'n*, 447 U.S. 557, 563 (1980); and *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996).

4. Kate Burnett , *World: Media Analysis – Product placement thrives as advertisers look for subtlety*, CAMPAIGN, Nov, 21, 2003, at 23, *available at* 2003 WLNR 4471551.

5. David Drum, *Branded: Bartering cameos for promotions, the business of placing products in movies has grown from a whimsy to a science*, HOLLYWOOD REP., Sept. 26, 1994, at S1, *available at* 1994 WLNR 3481382.

6. Lee Ann Gjertsen, *Insurers Cut Marketing, But 3 Campaigns Shine*, AM. BANKER, March 11, 2004 (Vol. 169, Issue 48), at 11, *available at* 2004 WLNR 4062609.

7. Amy Johannes, *TV Placements Overtake Film*, PROMO MAGAZINE, May 1, 2005 at 7.

8. *Id.*

9. Steve Rogers, *The Home Depot to take over the sponsorship of TLC's "Trading Spaces" from Lowe's*, REALITY TV WORLD, Aug. 11, 2003, at http://www.realitytvworld.com/index/articles/story.php?s=1548

10. Wayne Friedman, *Eagle-eye marketers find right spot, right time*, ADVERTISING AGE, Jan. 22, 2001 (Vol. 72, Issue 4) (Midwest Region Ed., at S2), *available at* 2001 WLNR 9681673.

11. Amy Wilson, *Ford woos Hollywood partners; Agreement assures product placement in Revolution Studios' films*, AUTOMOTIVE NEWS, Feb. 23, 2004, at 1.

12. Jason Stein, *Automakers go Hollywood*, AUTOMOTIVE NEWS, Mar. 22, 2004, at 42 (Vol. 78, Pub. No. 6085), *available at* 2004 WLNR 175832.

13. *Wham-O, Inc. v. Paramount Pictures Corp.*, United States Court of Appeals for

the Ninth Circuit, Appeal No. 03-17052, Appellant's Reply Brief, May 18, 2004.

14. *Wham-O, Inc. v. Paramount Pictures Corp.*, 286 F. Supp.2d 1254 (N.D. Cal. 2003).

15. *See* fn. 5, *supra.*

16. Candice Leone, *"Star Wars" merchandise invades commercial galaxy*, THE SHREVEPORT TIMES, May 5, 2005, *available at* www.shreveporttimes.com/apps/pbcs.dll/article?AID=/20050505/LIVING/505050302/1004/LIVING

17. 47 C.F.R. § 73.1212.

18. Eric Pfanner, *Product Placements Cause a Stir in Europe*, INTERNATIONAL HERALD TRIBUNE, Oct. 3, 2005, *available at* http://www.nytimes.com/iht/2005/10/03/business/IHT-03products03.html.

19. Leo Cendrowicz, *EC May Bend on Branded TV Fare*, HOLLYWOOD REP., April 26, 2005.

20. Brooks Boliek, *FTC: No need to label products. Commercial Alert's request rejected by the Federal Trade Commission*, HOLLYWOOD REP., Feb. 11, 2005 (Vol. 397, Issue 43), at 3, *available at* 2005 WLNR 3102455.

21. *Id.*

22. Jere Beasley, *Ford To Pay $51.5 Million Over Ads for SUVs*, THE JERE BEASLEY REPORT, January 2003, at 23, *available at* www.beasleyallen.com/jlb_report/JBR_Jan_03.pdf.

23. *See* Rebecca J. Brown, *Genetically Enhanced Arachnids and Digitally Altered Advertisements: The Making of Spider-Man*, 8 VA. J. L. & TECH. 1 (Spring 2003). *See also* Matthew Savare, *Where Madison Avenue Meets Hollywood and Vine: The Business, Legal, and Creative Ramifications of Product Placements*, 11 UCLA ENT. L REV. 331 (Summer 2004).

24. Robert Adler, *Here's Smoking at You, Kid: Has Tobacco Product Placement in the Movies Really Stopped?*, 60 MONT. L. REV. 243, 247 (1999).

25. Gail Schiller, *Movie, TV tie-ins often sobering for liquor firms*, HOLLYWOOD REP., Aug. 1, 2005.

26. *Id.*

27. *Reebok Int'l, Ltd. v. TriStar Pictures, Inc.*, Civ. No 96-8982 SVW (C.D. Cal.) (Complaint, filed Dec. 23, 1996).

28. *See* fn. 5, *supra.*

29. *See* fn. 12, *supra.*

Francis X. Dehn

Reality TV and the New Reality of Media Law

Skilled media lawyers play a critical role by working with their clients to head off legal issues before they arise.

The progressive blurring of the line separating television news from entertainment, not so long ago the stuff of earnest debate, has by now become a dog-bites-man story. Edward R. Murrow may or may not have actually spun in his grave at the first use of a schmaltzy music track behind a treacly network newsmagazine piece, or the first time a local news director punched up a tabloidy graphic to tease the audience before a commercial break. (We can only guess what Mr. Murrow might have thought about the "missing white female" trend, in which runaway brides and missing blonde teenagers rival the Iraq war for attention on national newscasts.)

Spinning or not, Murrow is dead and gone, as are Huntley, Brinkley, Howard K. Smith, and Peter Jennings. It's been 25 years since Walter Cronkite performed his "Most Trusted Man in America" role, and Ted Koppel has just closed the door behind him. The news biz long ago went show biz, and all evidence indicates there's no going back.

New Occupation: "Reality Lawyer"

But even if it is no longer a secret that TV news has become more like entertainment, it is nonetheless quite relevant and noteworthy to the legal community that such a large proportion of televised entertainment has become more like news. We live in an age in which the young adult demographic is said to get as much of its news from Jon Stewart on Comedy Central as from any other source — a trend volubly decried by no less an expert than Mr. Stewart himself. But from a lawyer's perspective, the big story is not just the emergence of "fake news" programs like *The Daily Show*.

Rather, it is that a wide spectrum of programming now presents legal issues once limited to news programs. Not so long ago, the category of "factual" or "reality" programming was virtually synonymous with news (except perhaps for *Candid Camera* and Art Linkletter's cute chats with precocious kids). Now, however, the TV listings groan with programs that share critical elements with traditional news shows: "real" and normally non-newsworthy subjects suddenly thrust into the public eye; the partial or complete lack of scripts; interviewees who often express judgments or state purported facts about third parties that such parties might deem false, offensive, and objectionable; reliance, in varying degrees, on intrusive information-gathering techniques; and the use of methods for gaining the confidence and cooperation of individuals who may later come to view such tactics as misleading or even deceptive.

The evolution of reality television has created an entirely new world within the universe of media law. Traditionally, of course, the community of attorneys practicing libel defense law was quite small, because with rare exceptions, the defendants were all news organizations whose sole purpose was to practice journalism. The job of lawyers representing the "press" was to make sure that newspapers, magazines, and television news operations didn't fall prey to libel claims. These attorneys knew, of course, that if the potential plaintiffs were public figures, their clients would remain immune from liability as long as they did not publish defamatory articles knowingly or recklessly. When issues of invasion of privacy arose, the press would almost always prevail, since by definition just about anything that was reported would meet the standard of what was newsworthy and/or in the public interest, and thus qualify for First Amendment protection.

Similarly, their counterparts in the entertainment world, who dealt daily with scripted comedies and dramas, typically had little to do with questions of libel, privacy, trespass, or intrusion. Those issues were limited to news gatherers and the attorneys who represented them.

With the dawning of the reality TV era, all that changed in a hurry. Out of nowhere emerged a new type of client — one that creates, shoots and sells "reality" shows about bounty hunters, ASPCA enforcement agents, rehabbing C-list celebrities, performance artists posing as Kazakh journalists, or toxic couples supposedly "testing" their existing relationships by seeking casual hookups with others, all the while flinging sexually based accusations at their "competitors" and even their mates.

Increased competition resulting from a proliferation of cable channels, the consequent fragmentation of the viewing audience, and the spiraling costs of producing scripted programs have all contributed to the exploding demand for economical shows that employ few or no writers and feature unpaid or barely paid "real" people. But the ways in which such "real" people are treated on such shows — whether or not they ever appear on camera — often prompt the emergence of legal issues for which producers may be completely unprepared, unless they have retained skilled media counsel.

The ways in which such "real" people are treated on "reality" shows often prompt the emergence of legal issues for which producers may be completely unprepared.

Consider the following hypotheticals, which, though perhaps whimsical, assuredly do not fall far from the tree of actual problems confronted by producers and networks in today's television environment:

1) A woman is featured on a program in which two hosts savage her present style of dress and take her on a spending spree to replace her wardrobe and upgrade her image. She blames her dumpy duds and lack of motivation to shop on a painful breakup with a longtime boyfriend who later turned out to be bisexual. As it happens, the ex is completely straight. The bitter woman, it is learned after the episode airs, merely said this to lash out at him.

2) In a documentary-style show about cute, fuzzy animals and the people who love them, a Cincinnati resident beams as she talks about her five-year-old cat named Oliver Q. Morganstern, who was just adopted from a neighbor who could no longer care for her pet because of her battle with an aggressive form of cancer. In fact, the neighbor is now in remission and has never disclosed her affliction to anyone else.

3) The subject of a slice-of-life series about a fabulously wealthy beachfront community is interviewed on camera. In an attempt to convey the affluence of the man who is being questioned, the producers set up in his home office and hang on the wall behind his desk some of the home's most valuable paintings, propping up some highly collectable framed photographs on the adjacent credenza.

4) A documentary about the exploits of three highly successful repo men supplies some details of their lives, including a few facts dug up by the producers from sources other than the men themselves. One of the men is discovered to have pleaded guilty to a misdemeanor charge of illegal sexual conduct for having nonconsensually fondled a girl's breast when he was a senior in high school 30 years ago. His record has been clean ever since. The conviction is reported on the air. Now married with four teenaged daughters, the man is especially furious that the show runs on a cable channel that repeats its programming relentlessly.

Now imagine that in each of the above examples, the programs are produced by mostly young people who have never worked in the field of journalism (which, by the way, is often the case). In each instance, they accomplish exactly what they set out to do: namely, to tell a coherent story about their subjects, complete with the sort of detail that elicits a laugh, a bit of outrage, a tear of sympathy, a shred of identification with the interview subject. In each example, legal issues are created by an element of the story that may seem so insignificant or immaterial to the main point of the show that many producers would not even begin to recognize the potential source of trouble.

The first example illustrates the extent to which offhand comments about actual persons (particularly non-public figures) can land producers and broadcasters in hot water. In that case, one can readily imagine that the show's creators failed to perceive the risk because they were happy to have the humorous anecdote about the bisexual ex. Even if the producers thought for a moment about the risk, they no doubt took comfort in the fact that he was never named on air. It turns out, however, that the young woman has only had one longtime boyfriend, and most of her friends, neighbors, and co-workers can identify him. As the charge is false, and harm to his reputation is likely, he would have a cause of action in libel.

In the second example, the producers are focused on the warmth of the kitty adoption. How nice that the dying woman found her pet a loving home! Yet by publicly disclosing her serious health condition without permission, both the production company and the network may have opened themselves up to an invasion of privacy/disclosure of private facts claim. Although the woman is not named in the show, chances are that many people would recognize her by her city of residence and her unusually named pet.

The third problem highlights the perils of using copyrighted works as props in reality programming. It is not clear whether this series would be deemed "newsworthy/public interest" by a court, but even if it were, the producers would still have the burden of showing that their use of these works was a "fair use." Yet this would be a stretch, since the works did not just appear incidentally in the course of a First-Amendment-protected interview, but were used as props to enhance the interview environment. One could expect that one or more of the works' creators would seek damages for copyright infringement, and they would probably be so entitled.

In the final example, the repo man argues that whatever minimal newsworthiness may once have attached to his conviction, it has long since dissipated, and will dissipate further over the long period of time during which the show will air in repeats. Consequently, he contends, the harm to his legitimate privacy interests substantially outweighs whatever legitimate public interest there may be in his long-ago conviction. Fortunately for the producers, in *Gates v. Discovery Communications, Inc.*, 106 Cal. App. 4th 677, 692, 131 Cal Rptr. 534, 545 (2003), *aff'd*, 34 Cal.4th 679, 21 Cal.Rptr.3d 663 (2004), the California courts reaffirmed the principle that no right of privacy attaches to public, official court records, and thus (at least to the extent that other states follow the California precedent) the repo man would have no viable cause of action. Anecdotal evidence suggests, however, that many laypersons still embrace the sentiment that people should be entitled to some sort of "statute of limitations" regulating the period of time during which old, nonfelony convictions may be disclosed by the media.

Many laypersons feel that people should be entitled to some sort of "statute of limitations" regulating the period of time during which old, nonfelony convictions may be disclosed by the media.

Indeed, misconceptions about the nature of libel and privacy law frequently lead to lawsuits by individuals seeking to redress what they consider to be a personal affront. Such claimants are often represented by personal injury attorneys with little specialized knowledge of media law, or by other lawyers who cynically view media companies (or their insurers) as "deep pockets" likely to reach quick nuisance settlements even when not at fault. In such cases, the role of the effective media lawyer is to react forcefully and quickly to threatened claims, to nip potential lawsuits such as this one in the bud if possible, and to achieve early dismissals where the plaintiff's attorney cannot be dissuaded from commencing an action.

Protections and Procedures

Skilled media lawyers, as noted, can play a critical role for television clients in the business of reality programming, not only by helping to clean up the mess when unanticipated problems crop up, but by working with their clients to head off legal issues before they arise. A media specialist can be counted on to supply a number of important tools that serve a critical prophylactic purpose:

An artful appearance release. Virtually every state, whether by statute or common law, prohibits the commercial use of a person's name or image without that person's authorization. Newsworthy, nonfiction programs are excepted from this general rule, however, either by the specific language of the applicable state statute or simply by application of the First Amendment. However, the more staged or scripted a program is, the greater the risk that it will be construed by a court to be primarily for entertainment purposes rather than newsworthy ones, and thus subject to the state law restrictions rather than exempt from them. It is thus critical, to the extent that any doubt exists over whether a program would qualify as newsworthy/public interest, to obtain signed authorizations from anyone appearing in a program in more than an incidental way. (An example of an "incidental" appearance would be that of a passerby or person in a crowd; a person who is briefly interviewed or heard speaking would likely be deemed to have made more than an incidental appearance.)

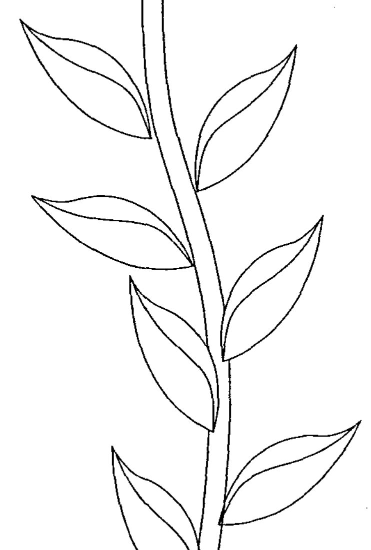
Appearance releases can and should be as beneficial to the producer and its designees, including the network, as circumstances will allow. Where there is the potential for significant gain to the individual consenting to appear on the program — such as in the reality show *Survivor*, where a $1 million prize awaits the winner — there is a corresponding opportunity to induce the participant to waive many rights, such as the right to sue for defamation, invasion of privacy and related torts. The participant may also be compelled to pledge complete confidentiality, subject to a liquidated damages provision.

Where there is no potential for such an outsized reward, it can be much more difficult to induce participants to execute such broad and detailed releases. To be sure, practitioners need not always heed the complaints of their clients that they will never be able to get people to sign seemingly one-sided releases. Many people instinctively understand that as a practical matter, the threat of lawsuits could prevent some reality programs from ever being made. They conclude that they would probably never have a reason to sue anyone, and that in any event the very small odds of ever doing so are considerably outweighed by the much more tangible opportunity to be on television and have fun doing so.

That said, the lawyer must work in partnership with the production staff, and at times the network, to ensure that appearance consents are not needlessly encumbered with heavy-handed language that achieves no particular goal for the client, yet could drive potential participants away. It is often important to equip the production staff with a variety of more or less detailed release forms, such as a version meant to be executed by a parent or legal guardian on a minor's behalf, or a very short version intended for minor players, which demands little except an acknowledgment that they are consenting to the use of their appearance. It is critical, however, that every version of an appearance release authorize the producers to use their footage in any medium whatsoever. What is televised today may be on DVD tomorrow, and on the Web the day after that. In this day and age, to obtain the rights to use the material in some media but not others would be inherently disastrous for the producer.

Producers should also be aware that even where a program would clearly qualify for protection as newsworthy/public interest, there can be considerable value in having participants sign appearance releases containing a merger clause, to make it undeniably clear that the entire agreement between the parties is fully memorialized in the release. Otherwise, there is nothing to stop participants who later develop cold feet from claiming they agreed to appear only in exchange for the producer's promise to do something for them, such as pay an appearance fee, restrict the area in which the show may be aired, or show the participant only in a favorable light. Where appropriate, releases should also contain an acknowledgment that the person's appearance was not compelled by any third party, lest he ever claim that he felt pressured to give his consent.

Location releases. It is an act of trespass in every state to enter upon real



property without the consent of the owner or lawful tenant. Although the penalties for simple civil trespass are normally quite low, the "price" of violating the property rights of others can escalate quite quickly. In most jurisdictions, for example, ignoring an owner's request to leave the property or breaching a perimeter fence is a sufficient basis for a charge of criminal trespass. Moreover, unauthorized entry into a home or place of business is not only a criminal act but also a civil violation compensable in quite sizable amounts, depending upon the level of disruption and/or emotional distress caused thereby. *See, e.g., Ayeni v. CBS, Inc.*, 848 F. Supp. 362, 22 Med.L.Rptr. 1466 (E.D.N.Y. 1994) ("CBS had no greater right than that of a thief to be in the home, to take pictures and to remove the photographic record.")

It is thus imperative that producers obtain location releases for all filming and recording conducted on private property. Crews must be trained to capture as much footage as possible from public property such as streets and sidewalks, or if possible the property of other consenting individuals, if a location release cannot be secured from the owner or tenant of the subject property. Yet even when the purpose of the shoot is to record unhappy events, such as an arrest, or the circumstances surrounding a family member's injury or death, it should never simply be assumed that property owners will not sign a location release. Criminal suspects have often been known to sign releases as they sit in police vehicles, perhaps because they are keen to know that somebody is making a filmed record of what the police are doing inside their homes, perhaps because they want to tell their side of the story, and sometimes because they just like the idea of having their faces and homes on television, despite their predicament at that particular moment.

As in the case of personal appearances, reality TV participants often welcome production crews to their homes with open arms because they expect some sort of benefit, such as the opportunity for a home renovation or personal makeover. The more substantial the expected benefit, the more likely that the owner or tenant will release the producers from liability for negligent damage to their property and even for injury to themselves, including even death and dismemberment.

Ongoing guidance. When working in close collaboration with the production staff, the skilled media lawyer can shape a program's initial development, offering preproduction advice about what will work legally and what won't, assisting the producer in obtaining errors and omissions insurance, helping to draft the show "bible" that is provided to the network and the insurer, providing advice regarding acceptable rules for competition-style programming, offering instantaneous advice to producers in the field, and vetting rough cuts of the show during post-production. At the option of the client, the attorney may provide various types of training for staffers inexperienced in the legal issues that come with the territory in reality programs.

In deciding the appropriate level of involvement for their media counsel, clients typically weigh a number of factors, including the level of experience of the production staff, the extent to which the subject matter of the show is inherently contentious or controversial, the operating budget for the program, and the risk of exposure in the event that claims arise. Even when the operating margin of a particular program or series is small, however, producers are well advised to provide for realistic legal expenditures in the budgets they negotiate with the networks, which along with the insurer typically insist that the producer be represented by counsel. (Despite the fact that the usual network agreement requires indemnification from the production company, networks are by nature anxious to avoid being named as a defendant in any lawsuit, whether or not they would ultimately be liable.)

Clearly, even producers with highly skilled and proactive media counsel can never be completely certain that they will never be a litigation target. They can be certain, however, that like the news organizations of old, they cannot regard the media lawyer as a mere luxury. Today's reality is that for reality show producers, the effective media attorney is a necessity. ◆

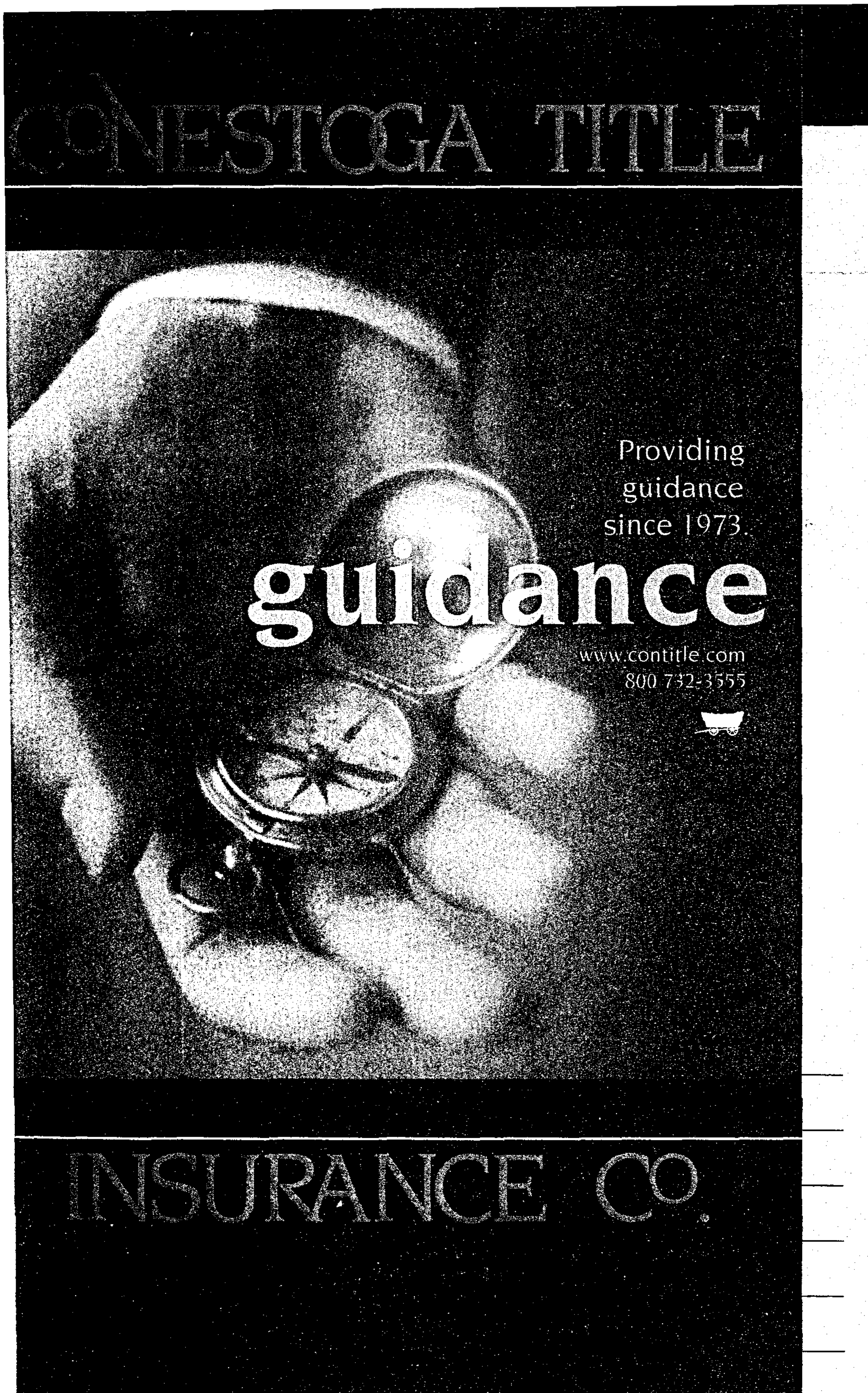
Edward Copeland

Grokster and the Future of Digital File Sharing

The issue of digital file sharing of copyrighted material is prominent today as it continues to revolutionize how people receive and enjoy music, video, and other forms of entertainment.

Owners of copyrights in music, films, and other media content struggle every day to protect their interests in a world where copying of digital files and materials has been made easier and easier by technological innovations. Adding to the problem is the fact that many people believe they have a moral right to download creative content without paying for it.

A recent *Wall Street Journal* article cited a study that reported that 67 percent of undergraduates are either in favor of downloading pirated music or movies, or find it acceptable because everyone does it.[1] The article goes on to say that this belief is held by many adults as well, referring to an unnamed music label executive who told the *Journal* that his father copies rented DVD movies so "he doesn't have to pay late charges."[2] With the content owners trying to enforce their rights against a pirating public, such as the Record Industry Association of America's (RIAA) filing of thousands of suits (according to its Web site), coupled with the huge success of the iPod music player and expected success of the iPod video player, the subject of copyright law has recently taken a prominent role in public dialogue. The controversy spans international borders with a recent decision from the Australian courts against the file-sharing service Kazaa and even reports of a criminal conviction for operating an Internet file-sharing service in Taiwan. The issue of digital file sharing of copyrighted material is as prominent today as any other issue surrounding computers and the Internet as it continues to revolutionize how people receive and enjoy music, video, and other forms of entertainment. At the same time, related issues of copyright law seem to emerge constantly. For example, just recently a coalition of authors and a group of



copyright, as shown by clear expression or other affirmative steps taken to foster infringement."[3]

This inducement standard set by *Grokster* carries with it a clear message: If one sets out to devise or distribute a system designed to facilitate copyright infringement and takes actions or steps to promote the use of the system to infringe copyrighted material, then the

tralized server and to allow each user of the software to broadcast a search request to other users of the software seeking a match between the file sought and the files the second user was willing to make available.

The system was designed to avoid the legal issues that had faced earlier file-sharing systems in lawsuits brought by a similar coalition of copyright own-

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extent of any noninfringing uses was significant because of the Supreme Court's earlier decision in *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417 (1984), addressing the Sony Betamax videotape recorder. In what now seems almost a relatively simple dispute, the owners of less than 10 percent of the content available on television sued Sony, the maker of the Betamax videotape recorder, along with

FEATURE

Edward Copeland

Grokster Future o

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Edward Copeland

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his father copies rented DVD movies so "he doesn't have to pay late charges."[2] With the content owners trying to enforce their rights against a pirating public, such as the Record Industry Association of America's (RIAA) filing of thousands of suits (according to its Web site), coupled with the huge success of the iPod music player and expected success of

ing of copyrighted material is as prominent today as any other issue surrounding computers and the Internet as it continues to revolutionize how people receive and enjoy music, video, and other forms of entertainment. At the same time, related issues of copyright law seem to emerge constantly. For example, just recently a coalition of authors and a group of publishers filed separate lawsuits claiming that Google's plan to scan the collections of libraries and make them available for searching through its search engine violates the copyright laws. These and other issues that have yet to emerge will need to be resolved as the courts, the entertainment industries, other content owners, and the technology industries resolve the application and limits of copyright law in a digital era.

The *Grokster* Decision

When the Supreme Court agreed to review the decision of the United States Court of Appeals for the Ninth Circuit in *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.* to address the liability of distributors of file-sharing software for the copyright infringements of the users of their software, the Court stepped into an arena where two sets of interests clash: the interests of the copyright owners (represented by the music labels, studios, television networks, and associations of the creative artists) versus the interests of the technology industry promoting advances in computer innovation. The economic magnitude of this dispute is vast: The music industry alone has estimated that illegal file swapping has contributed to a 20 percent decline in music sales since 1999. The figures cited to the Court included estimates that lost sales of music ranged from $700 million to several billion dollars yearly.

In June 2005, the Supreme Court unanimously ruled in *Grokster* that the distributors of file-sharing software programs may be liable for inducement of copyright infringement by the users of the software where the plaintiff could prove that the file-sharing software was distributed "with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement."[3]

This inducement standard set by *Grokster* carries with it a clear message: If one sets out to devise or distribute a system designed to facilitate copyright infringement and takes actions or steps to promote the use of the system to infringe copyrighted material, then the courts will find liability with that distributor.

In *Grokster*, the owners of copyrighted materials brought lawsuits against two distributors of peer-to-peer (P2P) file-sharing software, Grokster and StreamCast, which distributed software known as Morpheus. The plaintiffs in the lawsuits included most of the major motion picture and recording companies as well as a class of over 27,000 music publishers and songwriters who collectively control the rights to the vast majority of copyrighted motion picture and sound recordings in the United States.

When the Supreme Court agreed to review *Grokster*, it stepped into an arena where two sets of business interests clash: those of the copyright owners and those of the technology industry.

Grokster and Morpheus software enabled users to exchange digitalized music, video, software, and motion picture files over the Internet. The system was designed to avoid the use of a centralized server and to allow each user of the software to broadcast a search request to other users of the software seeking a match between the file sought and the files the second user was willing to make available.

The system was designed to avoid the legal issues that had faced earlier file-sharing systems in lawsuits brought by a similar coalition of copyright owners. The earlier systems utilized a centralized server that matched requests for a particular — usually copyrighted — recording or file with a list of available files and then transmitted the results back to the requester who could then connect with the computer that offered to share the recording or file. In litigation over these earlier file-sharing systems, Napster and Aimster, the operators of the systems met legal difficulties for the unauthorized copying taking place through their systems because, among other reasons, they had sufficient knowledge of the users' infringement or deliberately avoided such knowledge, and had the ability to control the infringement. Under well-established principles of secondary liability traditionally applied in copyright cases, the courts in those cases granted preliminary injunctive relief based on the likelihood of success on the claim that the operators were responsible for the infringement by the users.[4]

Faced with the new P2P software of Grokster and Morpheus that did not operate by means of a centralized server, a coalition of copyright owners sought to hold the distributors of these software programs liable for the unlawful copying and distribution of the copyrighted works by the users of the software. There was little dispute that the software was used in large part to unlawfully copy material protected by copyright, although the distributors of the software pointed to instances in which it was used to distribute public domain works and authorized copies of certain copyrighted works. There was, however, substantial dispute over the relative degree of infringing versus noninfringing uses and whether noninfringing uses would increase over time.

The extent of any noninfringing uses was significant because of the Supreme Court's earlier decision in *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417 (1984), addressing the Sony Betamax videotape recorder. In what now seems almost a relatively simple dispute, the owners of less than 10 percent of the content available on television sued Sony, the maker of the Betamax videotape recorder, along with four retailers who sold the Betamax. The plaintiffs asserted that home users had illegally taped copyrighted television shows that had been broadcast commercially and, in doing so, had infringed upon their copyrights, making Sony and the retailers liable for selling and marketing the Betamax recorders.

The Court, however, found that Sony was not liable by adopting a rule that sought to balance the rights of the copyright owners with the competing values of companies developing a new technology. In *Sony*, the Court saw the issue in broad terms as the question of when is it "just to hold one individual accountable for the actions of another."[5] Turning to the traditional doctrines applied in copyright cases to hold one party liable for acts of another (generally referred to as "vicarious" and "contributory" liability and collectively referred to as "secondary liability"), the Court found that none of the principal theories applied in the circumstances.[6]

Nonetheless, the Court looked outside the traditional areas of liability by drawing upon doctrines of patent law in holding that the "sale of copying equipment, like the sale of other articles of commerce, does not constitute contributory infringement if the product is widely used for legitimate, unobjectionable purposes. Indeed, it need merely be capable of substantial noninfringing uses."[7] The Court found in the record evidence that a substantial use of the video recorder was for time-shifting (i.e., recording a program for viewing at a later time). The Court concluded that much of the time-shifting of copyrighted television programs was authorized by the owner of the content and to the extent that the time-shifting was not authorized, it was a fair use.[8]

But how much of the noninfringing use of a device is "substantial" and what other factors may come into play? Significantly, the Court in *Sony* did not answer these questions. Consequently, much of the debate in *Grokster* was framed by the dispute over whether there were sufficient "substantial noninfringing uses" of the file-sharing software to satisfy the *Sony* doctrine. In both the District Court and the Ninth Circuit Court of Appeals, Grokster and Morpheus had prevailed, mainly based on their ability to convince the courts of three propositions:

1) the software was capable of substantial noninfringing uses within the meaning of the *Sony* decision;

2) the distributors of the software did not have knowledge of any particular infringement because they only distributed the software that operated the file-sharing activities without a centralized server or index; and

3) the distributors did not have the ability to control what material was being traded using the software.

When the Supreme Court faced the issues presented in the case, it looked outside the *Sony* framework. Its view seems focused by the perception that the file-sharing software was part of the distributors' effort to deliberately design a system that would allow them to profit from the infringement of copyrights by others and to market the system in a manner that encouraged the users to use it to infringe. The fact that the software was used to infringe copyrights on a large scale was highly significant, as was the fact that the Court saw in the record evidence that the distributors encouraged the use of the software to distribute unauthorized copies of copyrighted works.

The Court did little to explain the application of the *Sony* rule, for it found a different basis on which to dispose of the *Grokster* case.

The Court avoided much of the debate concerning the intricacies of how to apply the *Sony* decision. The Court saw *Sony* as addressing circumstances where the claim that the product at issue — whether it be software or a device such as a video recorder — performs no real function other than infringing copyrights. In that circumstance, the *Sony* rule allows one to impute an intent to infringe to the maker or distributor of the software or device. But even where a product may be capable of substantial lawful uses, that does not establish that a maker or distributor was never liable for the infringing use by others. The Court expressly found that the Ninth Circuit had erred in its view that *Sony* created such a safe harbor.[9] Beyond explaining the limits of *Sony's* ambit, the Court did little to explain the application of the *Sony* rule, for it found a different basis on which to dispose of the *Grokster* case.

The Court turned to other theories of vicarious liability for the infringing acts of the users of the software and viewed the case as one in which the liability, if any, was to be predicated upon the statements or actions of the makers or distributors directed to promoting infringement. This standard turns on their intent, actions and statements with respect to the particular software or product rather than the capabilities of the software or product.

The Court fashioned a new "inducement" standard for copyright infringement liability drawing upon principles of common law as well as patent law. Under the inducement rule "one who distributes a device with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties."[9] In order to prevail on this inducement theory, one must show that the defendant communicated an inducing message to the users of the device and "evidence of actual infringement by recipients of the device."[11]

The Court found unmistakable evidence on the issue of intent, focusing primarily on evidence that the defendants sought to fulfill a market demand for the ability and means to receive copyrighted materials (i.e., to infringe copyrights). It also pointed, with caution, to the failure by the software makers to include any filtering technology or other means to restrict infringing activity, coupled with a business model that linked the distributors' revenues to the volume of infringing use.[12]

Although the Court's opinion did not delve into the meaning of the *Sony* decision beyond explaining that the Ninth Circuit's view was incorrect, the two concurring opinions engaged in a lively debate over the meaning and application of the *Sony* test. With each of these opinions gathering three votes, the disparity of views on the Court reflects some of the problems that lie ahead for the players in the field.

To all six justices expressing a view, the critical question under *Sony* revolved around the meaning of the phrase "capable of substantial noninfringing uses." In Justice Ginsburg's view (joined by Chief Justice Rehnquist and Justice Kennedy), the Ninth Circuit misapplied the *Sony* decision in ruling for the distributors because the evidence reflected that the software was "overwhelmingly used to infringe" and was insufficient to demonstrate beyond genuine debate, "a reasonable prospect that substantial or commercially significant noninfringing uses were likely to develop over time."[13] To Justice Ginsburg, the evidence that the overwhelming use of the software was for infringing purposes and that the infringing uses were in a real sense the "source of revenue from the products" should have been enough to prevent summary judgment in the district court.[14] Justice Ginsburg found little support for any "substantial noninfringing uses" of the software in the record in the evidence concerning actual uses and did not address in any detail potential future capabilities.

Justice Breyer (joined by Justices Stevens and O'Connor) expressed a very different view of the application of the *Sony* test, seeing in the evidence a substantial noninfringing use. Justice Breyer referred to a survey that the files available for sharing through Grokster were 75 percent infringing, 15 percent likely infringing, and 10 percent apparently noninfringing. Justice Breyer drew from the evidence an inference that the quantity of lawful uses was roughly equivalent to that present in *Sony*.[15] He also pointed to the possible future capabilities of the technology as weighing in the application of the *Sony* standard.[16]

Faced with the unanimous opinion on the concept of liability through inducement (but with divergent views on the meaning and application of *Sony*) the content providers on one side and the technologists on the other have reacted differently to the decision. For the content owners, *Grokster* is a clear victory. The Motion Picture Association of America calls it "an historic victory for intellectual property in the digital age."[17] But consumer groups, technology advocates, and software and device makers have expressed grave concern over the ruling's potential to create more litigation aimed at technology innovators while providing little to no guidance as to how to avoid lawsuits.[18]

Consumer groups have expressed grave concern over the ruling's potential to create more litigation while providing little guidance as to how to avoid lawsuits.

Content owners are rightly encouraged by the clear message from the Court: Attempts to profit by enabling and encouraging others to violate copyright laws are likely to meet a bad end in the courts. To those devising new digital systems, the *Grokster* decision provides a clear guidepost of the kinds of activity that may lead to liability for infringing acts by users of the system.

In tying liability to intent in such a direct way, *Grokster* harks back to the principle articulated in *Sony* for imposing vicarious liability for infringements by others when it is "just." However, discerning intent is not always easy to do and it may be difficult in some instances to predict in advance which future digital systems will run afoul of the inducement standard.

One result of the inducement test is that it becomes possible for the same software system or product to withstand challenge under the *Grokster* test when distributed for one purpose but fail the test when distributed for another purpose. It seems possible, for example, under *Grokster*, that a distributor of file-sharing software system used by individuals with a particular common interest that does not involve trading copyrighted material would have no liability under *Grokster* while a commercial distributor of the same software system who promoted and marketed it to facilitate downloads of copyrighted music might have liability under *Grokster.*

The *Grokster* decision does not settle the questions of the meaning and proper application of the *Sony* decision, although it may make the questions potentially less important as the world unfolds. The focus on intent in *Grokster* makes it somewhat less likely that going forward a commercial entity can frame and market a system that facilitates illegal file sharing without running awry of the inducement test. Certainly, to the extent that the "intent" standard now comes to the forefront, it will become somewhat more difficult to construct a system — or market a system — that seeks to attract users by promoting illegal file sharing. Equally, given the weight the Court gave to the evidence that the distributors sought to fulfill a market for the ability to copy and distribute copyrighted material illegally coupled with a business model to do so, it will be very difficult to construct a viable commercial system that depends on the ability of the system to enable illegal file sharing to generate revenue.

Success in litigation, nonetheless, does not put an end to the practice of illegal digital file sharing. The weekend edition of *The Wall Street Journal* recently featured a front page story of a 21-year-old computer programmer from Norway who was indicted in his native country for gaining unauthorized access to a DVD and posting his DVD copying program on the Internet and twice was acquitted. He is currently at work on making a program that cracks security of Apple's iTunes software programs.[19]

Whether, and to what extent, the *Grokster* decision changes actual consumer behavior remains to be seen.[20] With an estimated tens of millions of people still using file-sharing networks,[21] the likelihood of completely shutting down these activities for good seems remote, particularly given the past history of file sharing. When one file-sharing system is shut down (such as Napster), another (such as Grokster) appears in its place.

Ultimately, the *Grokster* decision may and should make companies and individuals wary of software systems or products that are designed to share and download copyrighted materials without the permission of the copyright owner. The real question, from a market perspective, still remains: How will the content industry, now armed with *Grokster*, adapt to the changing technological landscape by creating business models that co-opt and capitalize on their content in a digital form?[22] ◆

FOOTNOTES

1. Steve Stecklow, *Repro Man: Meet the 21-year-old Norwegian who defied Hollywood to help the world copy DVDs – and beat the studios in court. Now, he's liberating your iPod.*, WALL ST. J., Oct. 15, 2005 at A8.

2. *Id.*

3. *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 2005 U.S. LEXIS 5212 at ***10, 125 S. Ct. 2764, 2770 (2005).

4. *See In re Aimster Copyright Litig.*, 334 F.3d 643 (7th Cir. 2003) and *A & M Records, Inc., v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001).

5. 464 U.S. at 435.

6. *Id.* at 435-39.

7. *Id.* at 442.

8. *Id.* at 442-55.

9. 125 S. Ct. at 2778-79.

10. *Id.* at 2770.

11. *Id.* at 2782.

12. *Id.* at 2781-82.

13. *Id.* at 2786.

14. *Id.*

15. *Id.* at 2789.

16. *Id.* at 2789-90.

17. MPAA Press Release (June 27, 2005), *available at* http://www.mpaa.org/MPAA Press/index.htm.

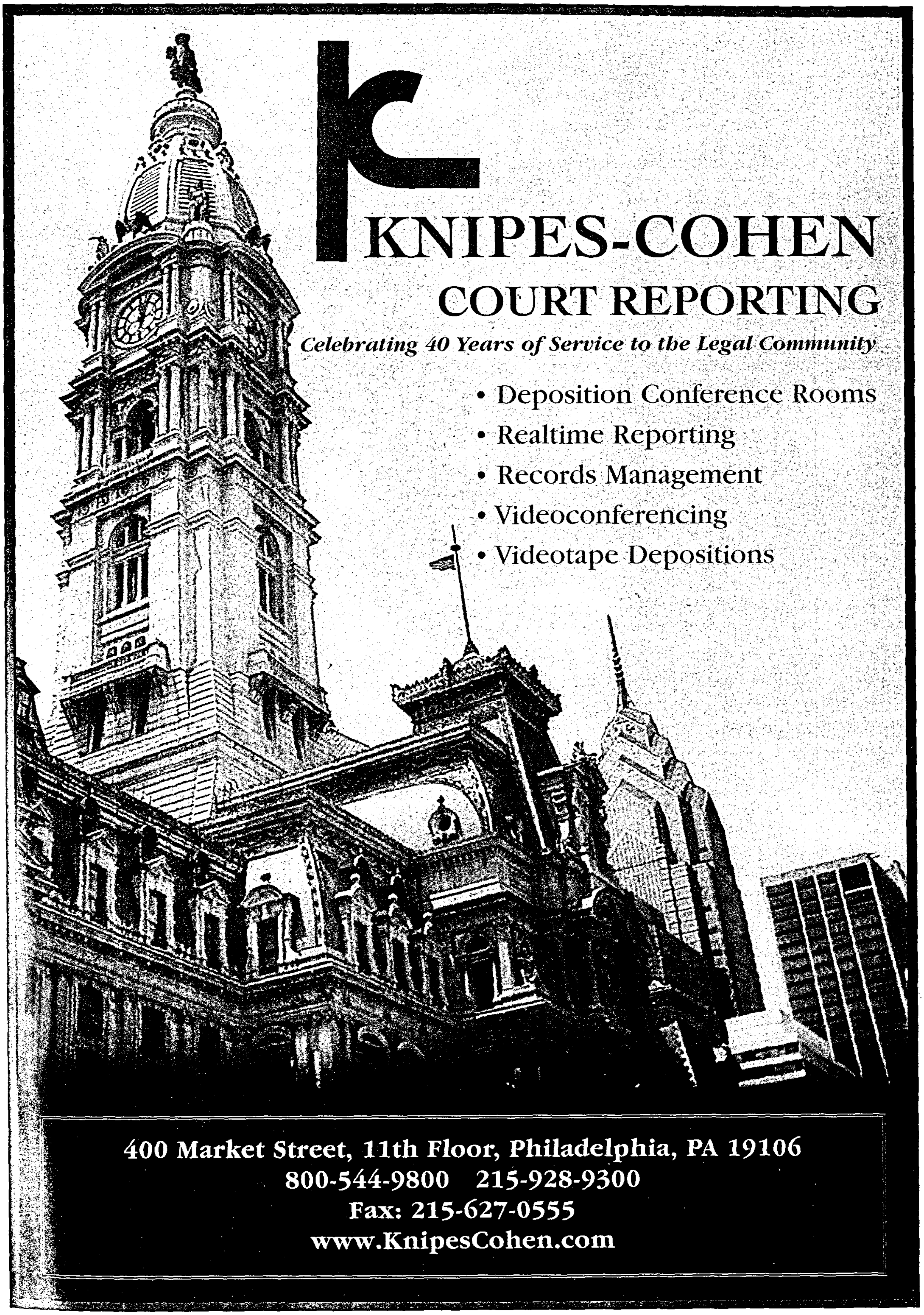
18. Consumer Electronics Association Press Release (June 27, 2005), *available at* http://www.ce.org/Press/CurrentNews/default.asp.

19. *See* fn. 1, *supra*.

20. Tom Zeller, Jr., *The Imps of File Sharing May Lose in Court, But They Are Winning in the Marketplace*, N.Y. TIMES, July 4, 2005, at C3; Jeff Leeds and Steve Lohr, *No Pot of Gold in Court Ruling for the Studios*, N.Y. TIMES, June 28, 2005, at C1.

21. *Id.*

22. WIRED NEWS, *The Real Lesson of Grokster* (June 29, 2005), *available at* http://www.wired.com/news/technology/0,1282,68033,00.html.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FEATURE

John W. Anderson
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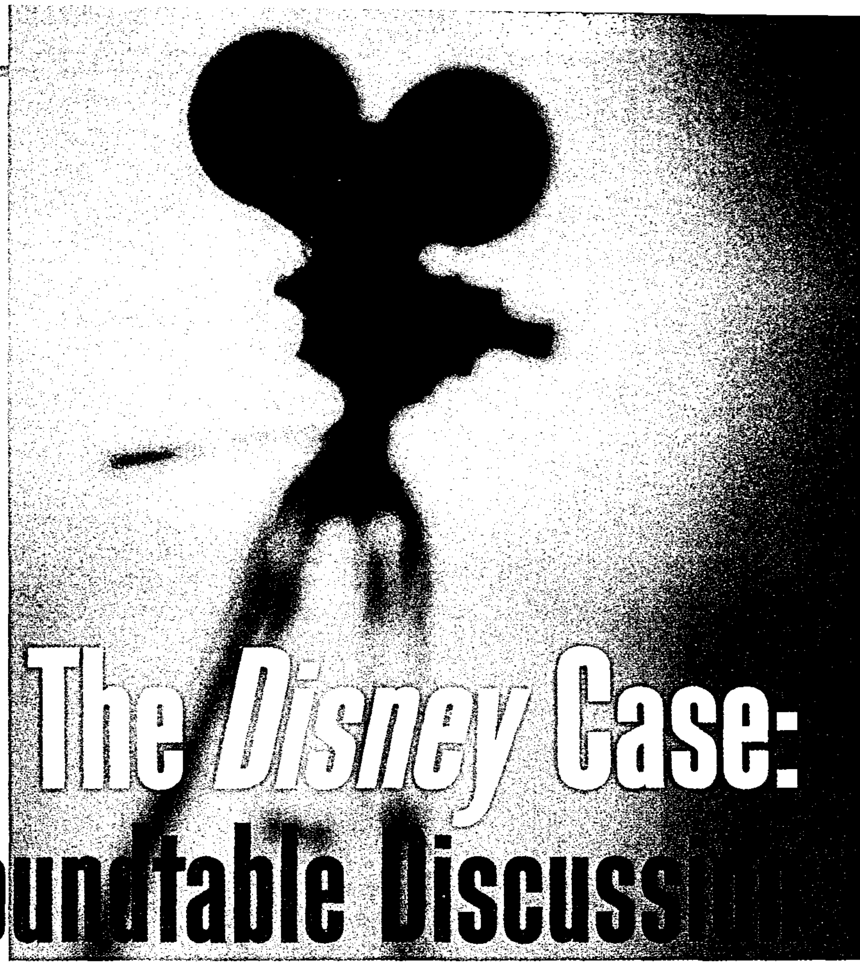

The *Disney* Case: A Virtual Roundtable Discussion

Chancellor Chandler hopes that the opinion will serve as guidance for future officers and directors — not only of the Walt Disney Company, but other Delaware corporations.

The national spotlight fell on Delaware in 2004-05, as the Disney shareholder lawsuit stemming from the hiring and quick termination of Hollywood superagent Michael Ovitz as president of *Disney* was tried in the Court of Chancery in Georgetown before Chancellor William B. Chandler, III. In the wake of the Chancellor's post-trial opinion, we "gathered" (via several telephone conferences) some noted commentators to discuss the decision and its ramifications: best-selling author James B. Stewart, whose recent book *Disney War* dissects the corporate intrigue at Disney during Michael Eisner's reign as CEO; Professor Lawrence A. Hamermesh of the Widener University School of Law; Columbia University law professor John C. Coffee, Jr.; and William T. Allen, former chancellor of the Delaware Court of Chancery.

DELAWARE LAWYER: You've heard the phrase "WWJD — What would Jesus do?" Our first question is: WWWD? What would Walt Disney do with this case?

JAMES B. STEWART: I think Walt would be rolling in his grave to be reading this opinion and the conduct that led to it. The interesting thing about Walt is, he purported to be completely uninterested in anything having to do with corporate governance. He was not on the board himself. He never had a corporate title. And he didn't want it. He was not interested in corporate maneuvering.

JOHN C. COFFEE: I can't imagine Walt ever having gotten into this situation. I can't imagine him going outside of the firm for executive help. And if he did go outside, he wouldn't have gone to the largest talent agency in Hollywood and hired a professional agent. I think he was a craftsman who wanted you to come from the world of either cartooning or movies where you knew something about real production values.

Background and Overview

DL: Chancellor Chandler describes this case as "a dispute over an executive compensation and severance package." Can you set the stage for us regarding the players in this whole case and why this suit came about in the first place?

JBS: The contract that he is describing was between Michael Ovitz, who under this contract became the president of Disney, and the Walt Disney Company. And it was, for all intents and purposes, negotiated by Michael Eisner, the chief executive and chairman of Disney.

At the time of the contract, Ovitz was widely described as the, quote-unquote, most powerful man in Hollywood, and he was a co-owner of the Creative Artists Agency, which far and away was at the time the most powerful, influential and successful talent agency in Hollywood. He also — and this plays a great role in what ultimately happened — was at the time, as far as I could tell, Eisner's best friend.

But very important characters in the story are the board members of Disney who approved the Ovitz contract in the first place and then also [supported] the decision to fire Ovitz without cause, which meant that he was entitled to all the severance benefits of the contract, which amounted to approximately $140 million.

DL: How did this story transform into a lawsuit?

LAWRENCE A. HAMMERMESH: The short answer is in the 140-million-dollar figure. That was an attention-getting number, not just because of the size, but because of the apparent lack of return on that investment. It didn't take a genius to figure out that there was at least something facially questionable, to put it as gently as possible, about the size of the payment to someone who was only in the position for a bit over a year.

How did that payment come to be? What obligation gave rise to it? Did it come about in a way that comported with even the fairly relaxed legal standards applicable to those who act on behalf of public companies? How that comes into court is at the instance of one or more stockholders of Disney, who claim that, first of all, the payment was excessive and in breach of the fiduciary duties of the company's directors, and second, that the resulting corporate claim for waste and mismanagement is not one that the directors themselves can properly determine how to proceed with and that it's one the stockholders are themselves are entitled to prosecute on behalf of the company.

> "If anybody really blew it here, it was the outside expert who didn't figure out that, under certain circumstances, the best of all possible worlds was for Mr. Ovitz to get fired very nearly at the outset."

JBS: The payout owed is so startling because it basically amounts to roughly $10 million a month for failed performance in the job. Now, I go around talking to ordinary people on the street, and they are speechless at that. That on its face is nonsensical as far as they are concerned.

DL: In light of that view, would anyone want to explain the legal reasoning of the case in terms that perhaps a layperson could understand?

WILLIAM T. ALLEN: This case is about whether or not the board exercised the care that it should have in supervising the succession planning of the company. And whether it supervised the termination [of Michael Ovitz] appropriately.

If you read Chancellor Chandler's opinion, it reports that the Disney Company had no number two. The board in pursuing its obligation really pressured Eisner to get a succession plan in place. So Disney was a buyer on a market for human talent. They locate Ovitz. Ovitz was this powerful, informed insider in the entertainment business. He controls a company that generates for him between $20 and $25 million a year. He is being asked to forego that to take a position in a company that could — heaven forbid — not work out.

So they come up with this contract with this huge payment if things don't work out. He negotiated for some protection. And in what might have seemed the unlikely event, that he needed the protection, he got paid. This is a very big company, with a board that was pushing on an issue that is one of the most important issues for a board to push on, succession planning. The board made a decision that turned out to be a wrong decision, but it doesn't seem crazy to me.

JCC: The board was faced with difficult decisions at both junctures. At the first point of hiring Michael Ovitz, I realize he was an unusual choice, but it's interesting to note that when his appointment was announced the market went up and Disney's stock market capitalization increased by over $1 billion.

So at that moment, the market, as well as the Disney board, thought that bringing in Michael Ovitz was a sound business move. And because Mr. Ovitz owned a controlling share of Creative Artists, he had to be given something called downside protection. If anybody really blew it here, it was the outside expert who didn't figure out that, under certain circumstances, the best of all possible worlds was for Mr. Ovitz to get fired very nearly at the outset. No one saw that. I don't think even Mr. Ovitz saw that, but that was the strange pathological part of this formula.

At the termination side, I think you had a dysfunctional family, and the question was only: On what basis were you going to dismiss Mr. Ovitz? And I don't know how a board of lay directors can resist the advice of a very good lawyer, ultimately backed up at trial by very good experts, all of whom convinced Chancellor Chandler that a no-fault termination was the only appropriate course. There was no way you could have fired him for cause without triggering a major litigation that would embarrass the company at least as much.

I think your perspective on this case depends on what prism you are looking through. If you are looking through the prism of the American public or someone professionally interested in corporate governance, you could say, "This is pathological corporate governance." But if you are looking at this case through the prism of a common-law judge, a common-law judge is being asked to decide whether or not someone is liable for participating in this decision-making process. And I think it would have been very, very troubling if you held the outside directors liable for relying upon counsel and a compensation expert, in the original decision, or later, when the directors were faced with, I think, no acceptable alternative, if you had held them liable because they agreed to the no-fault termination. Indeed, I think it would have produced some paranoia in the world of corporate directors.

But both perspectives could be right. You could say this is pathological corporate governance, and you could say faced with the choice between liability and no liability, there was not a principled basis based on established precedents for holding these directors liable.

LAH: [The $140 million] is an almost incomprehensible number to me certainly, and to most people, I think. But in that industry, it's hard to say that it's unrealistic, given what people's perceptions were of Michael Ovitz at the time he was hired. Those perceptions may have been vastly inflated and without thoughtful foundation. But that they were widely held views, I think, is hard to argue with.

Fiduciary Duties

DL: Could you review for us the fiduciary duties that a director has?

LAH: In broad outline form, they are, first of all, the duty that didn't get a lot of attention in the case, but that exists to prevent directors from using their authority and their office to benefit themselves, one thing — shorthand for that is a duty of loyalty — and a duty of care, which is generally understood as a responsibility, broadly speaking, to conduct the business and manage it in a way that comports with the level of attention a reasonably prudent person would give to his or her own affairs.

There is also a duty that lawyers and judges and academics like to debate a lot that has been described as a duty of good faith. You are forced to talk in terms of good faith because of our history in Delaware with dealing with claims of breach of the fiduciary duty of care. Our history includes the adoption in 1986 of a statute [8 *Del. C.* § 102(b)(7)] that allows companies to include in their certificate of incorporation a provision that exonerates directors from any claim of monetary liability to the company or its stockholders for claims other than certain identifiable types of claims, breach of the duty of loyalty being one of them, but also liability for conduct not in good faith. Because of that exclusion, focusing on conduct not in good faith, because Disney, like 99.9 percent of other Delaware public companies, has one of these exclusions in their charter, it necessarily forced the parties to examine whether or not what the directors did in reference to the Ovitz situation was conduct not in good faith.

> "It would have been very troubling if you held the outside directors liable for relying upon counsel and a compensation expert in the original decision."

WTA: The duty of care is simply the duty to act as a reasonable person would act in same or similar circumstances. It's designed to encourage directors to be seriously engaged, take seriously the obligation of the directorship.

The problem that it creates in large-scale public corporations is that the financial size of questions that come up to the board are so huge in some of the big companies that if the directors feel that if, in the event of a loss from this decision, a shareholder's lawyers will get a chance to present to a jury someplace the question whether a "reasonable person" would have made this horrendous decision, directors may decide not to authorize the assumption of risk. That would very much not be in the best interests of shareholders, who can cheaply diversify away the risk of poor decisions. To avoid the problem of risk avoidance by corporations, the law creates the business judgment rule and several other techniques for protecting directors from the risk of this possibility of liability.

The duty of loyalty is, in my opinion, really the core of the fiduciary obligation. And you can phrase it in two ways: You can phrase it narrowly, which a lot of people tend to think in this way, which is it's a duty not to get into financially conflicted transactions, or if you get in them to make sure they are on entirely fair terms. Or you could phrase it more broadly, as I do, and say it's the duty to only exercise power over the corporation or the processes in a good-faith effort to advance the corporate purposes and not for selfish purposes.

DL: What's your thought on the duty of good faith?

WTA: Well, I think it's a tempest in a teapot. Good faith is the core obligation of a director — this is the way I think of it: A director must in good faith attempt to be engaged. So good faith underscores or is the foundation of the duty of care. And good faith is the obligation to take action only in connection with advancing the corporate purposes. Though in some ways I think good faith is the foundational obligation and that care and loyalty, as long as loyalty is understood as going beyond financial conflict, are really expressions of the good-faith obligation.

The legislation, section 102(b)(7), was written in a way that made good faith seem like an independent, third element. It is, I think, conceptually not a great statute, but I don't think it's going to be a problem. The simple fact is that no corporate system of regulation, including the Delaware corporation law, will really work effectively if courts and juries are going to second-guess board decisions where there is not a financial conflict of interest. So any system that's going to function is going to have something like a strong version of the business judgment rule, which will attach whenever people are seen as trying to do the right thing. That's the ultimate rule in Delaware, I think. When directors are seen as trying to do the right thing, they are not going to be held liable.

JCC: Let me try a slightly different twist on this line between the duty of care and the duty of good faith. If you can imagine a breach of the duty of care, which is based simply on negligence, simply on stupidity, that is the first case. You miss something that you should have seen. It could be ordinary negligence or it could be gross negligence. You were either stupid or you were very stupid, but the duty of good faith is something quite distinct.

Chancellor Chandler defined it in this decision as "deliberate indifference and inaction in the face of the duty to act." That is, you have to have an element of deliberate disloyalty or intentional dereliction of duty. This requires some level of consciousness. And I think once you allege that directors have consciously breached their duties, consciously failed to protect the corporation in a moment of peril, it is appropriate to say this is something that cannot be exculpated. This is something that 102(b)(7) does not protect against. It's easy to plead that, but it's hard to prove that.

There is going to be any number of Law Review articles, written mainly by students, dealing with what the duty of good faith means. And I think it's still a very open issue that only the Delaware Supreme Court can resolve: whether the duty of good faith is a separate, independent duty, like the duty of care or the duty of loyalty, or whether it just refers to a nonexculpable breach of fiduciary duty, which is what I think it really is — a special kind of subset of fiduciary breaches from which you cannot be protected, either in the form of indemnification or an exculpatory provision.

"This case was notably more egregious in terms of reasonable inferences that could be drawn from the facts than most others I can recall."

Denial of Motion to Dismiss

DL: Directors get a pretty wide berth when it comes to the business judgment rule and a presumption that they make reasonable business decisions based on an informed basis. A lot of people were initially surprised this case even got to trial. Could you talk a little bit about why the Chancellor let it go to trial versus just dismissing it?

LAH: It's easy to say that he let it go forward to trial in 2003 because he was in an environment in which we were still recovering from or dealing with the after-effects of Enron and WorldCom and just a grave shake-up in public concern about public company corporate governance. But the more legally oriented, legally analytical explanation is that life is just different when you are talking about dismissing a case without having had discovery, without having had a trial, as opposed to making a judgment on the basis of live testimony and full documentary explanation and so forth.

The Chancellor's explanation was, I look at $140 million, I look at the way in which this was negotiated or not negotiated, I see facts from which all I can conclude is that it's at least reasonable to infer that what happened here was a complete orchestration by Eisner with not only no board input, but behavior by directors that amounted to deliberate indifference to their responsibilities. And as long as he was prepared to, on the facts presented to him, draw that inference, arguably, he had no choice but to let the matter go to trial.

Clearly, that concerned a lot of people, because, gee, if this goes to trial, doesn't every due-care botch-up case go to trial? I think the answer to that is very clearly no. This case was notably more egregious in terms of reasonable inferences that could be drawn from the facts than most others I can recall.

JCC: In his decision [to allow the case to proceed trial], Chancellor Chandler construed the complaint to allege that the board had acted in a manner that fell outside of section 102(b)(7) of the Delaware General Corporation Law. That is, he said that even though you have an exculpatory provision that protects you against violation of the duty of care, I find that the complaint has alleged that you recklessly and intentionally disregarded your duties, and that could violate something called the duty of good faith. That was widely approved by reformers. And then they were disappointed when at trial plaintiffs found that you often cannot prove what you plead, which is essentially what happened in this case.

Conflicts of Interest

JBS: Could I just chime in about the facts? There are a number of facts that I think are very startling about this particular situation. The fact that this was basically all negotiated by Eisner and his own personal lawyer, Irwin Russell, who happened also to be on the board and was the chairman of the compensation committee, was an egregious conflict of interest. Is it any wonder that Eisner was the highest paid chief executive in America for several years? I am flabbergasted by that.

LAH: It is a weird choice and not one that I think would be even permissible today under existing standards. I think the simple answer is that it depends on which case you are looking at. Clearly, Russell, as Eisner's counsel, how he manages or managed to act on Eisner compensation decisions is an interesting question, but was not the question posed in the case.

The question posed in the case is how is he supposed to behave vis-à-vis the Ovitz compensation contract. On that score, he may have, and clearly did have, loyalties to Eisner. But the question is, were those loyalties ones that were, vis-à-vis Ovitz, inconsistent with obligations to Disney? That is not as clear.

WTA: I don't think that Russell's relationship with Eisner throws a coloration over the contract. Eisner had no conflict of interest with Ovitz.

JBS: The Chancellor did excoriate Eisner for stacking the board with directors who were conflicted. And I think he specifically did criticize Russell as well a number of other directors, but nonetheless, ruled as he did.

JCC: I'd say the involvement of [Disney general counsel] Sandy Litvack, who I know and respect, and Russell, would suggest that lawyers with relationships to management may not be the best directors. That I think has been a view of many boards. To the extent the lawyers have a role, they should be brought into the room. They should present their legal conclusions, but they may not be the best directors, where they are in some respect serving two masters, the corporation and its senior management.

Board Decision-Making

DL: Mr. Stewart, in your book, *Disney War*, you talk about how the board's approval of Ovitz's hiring seemed to be so after the fact. It seemed like Eisner worked the deal out and then told the board piecemeal, "Here. This is what we are doing. Is this okay?" after it was done, rather than putting it before them.

JBS: The press release that Ovitz was being hired had already gone out [on August 14, 1995]. Ovitz was at work around Labor Day. The board did not get around to actually voting on Ovitz's contract until sometime after he had shown up [on September 26, 1995].

There is testimony that there was minimal discussion of this. I believe the summary of the deal terms that was given to the board members, it either didn't mention the severance payments at all or it barely mentioned them. It certainly gave the board no way of seeing how enormous this was going to be.

"Lawyers with relationships to management may not be the best directors, where they are in some respect serving two masters."

LAH: In terms of Ovitz's hiring, there was no question, as Chancellor Chandler pointed out, that Michael Eisner exercised a pretty heavy hand in setting up the matter so that it would have taken something like a palace coup for the board to have rejected it at that point. I mean, the press release did go out before the board acted, and the Chancellor was critical of that.

I don't think anybody is going to argue it was something where Eisner or the other directors sort of covered themselves with glory. It was a flawed process, unquestionably.

JBS: The idea that they called Sidney Poitier, the distinguished actor, in the middle of the night, who was on board his yacht off the coast of Sardinia or something, and told him they were going to hire Michael Ovitz or allegedly told him the terms of the contract, and he said, "Yeah, okay, fine," I mean, that is just preposterous in terms of any kind of due diligence or reasonable care in looking at the contract.

DL: That raises the issue of whether these particular individual directors acted on a sufficiently informed basis in connection with the hiring of Ovitz. Is that level of knowledge and understanding enough, assuming that you remain pure of heart and hopeful that this person will be the right thing for the organization?

WTA: We know the answer to that question is yes. We have an opinion by Chancellor Chandler. But assuming that we don't want to require directors to be able to foresee the future, what other rule could we have?

JCC: We talk about legal rules. There are different kinds of legal rules. The legal rules of common law adjudication are essentially binary, someone is liable or not liable. And that's a really cruel choice and you don't want to put directors too often into that kind of peril. Particularly where this wasn't the choice of the chief executive officer, this was the choice of a chief operating officer who may or may not have been the successor [to Eisner].

Chancellor Chandler points out in a footnote at the end of this case that there were several executive officers of Disney who had individual contract authority of over $500 million to commit to movies. That's a lot more money than the $140 million that turned out on a contingency to have been paid here. If you held the directors liable because they didn't personally become more involved, because they didn't question [executive compensation consultant] Graef Crystal more, or they didn't ask general counsel [Sanford Litvack] who is highly respected in the bar to justify his comments and his conclusions about no-fault termination ... you would be asking the directors to spend an extraordinary portion of their time on what I still think is a second-level decision for this board of directors.

Are there rules relating to disclosure, shareholder voting, rules that would enable shareholders to have a little bit more oversight? Probably, but I don't think that you should respond to any sense that there was a deficiency here by saying "let's impose more liability on outside directors," where we fundamentally think that, although they were sloppy, they were trying to advance the best interests of Disney.

Insurrection and Sabotage?

WTA: What strikes me as the most remarkable thing in the case is the fact that Michael Eisner picked Ovitz. And then almost immediately upon Ovitz coming on board, [Disney's general counsel Sanford] Litvack and [CFO Stephen] Bollenbach say, "We are not reporting to you." And Eisner doesn't correct that. He hired him as [president] and he allows those two people to simply say no. Now, Ovitz was dead in the water when that happened. And so Eisner almost immediately torpedoed the effectiveness of what he had done.

DL: Mr. Stewart, you also talk in *Disney War* about that meeting at Eisner's home in Bel Air [on August 13, 1995], shortly before the public announcement of Ovitz's hiring, where Litvack and Bollenbach told Ovitz that they would refuse to report to him.

JBS: Yes. And that was a key point that I made in describing the board meeting where they approved [the Ovitz employment contract]. Neither [Litvack nor Bollenbach] said a word about having any reservations about Ovitz at that meeting, even though they had blown up and had this big scene.

Even in that Bel Air house meeting, Eisner takes Ovitz upstairs and is all but asking him to abandon this and walk out. He says, you know, you can leave if you want, having had this insurrection just happen right under his nose. And yet Ovitz didn't do it. Again, Eisner went ahead. It's so obvious to me, at this point, that Eisner doesn't want this to happen. Eisner had concluded, before any contract was ever signed or Ovitz ever showed up to work, that this was a disastrous mistake. He told both his wife and his then-biographer, Tony Schwartz, that it was the worst mistake of his life. Yet he went right ahead and did it anyway.

Then, by the way — I'm not sure whether this is relevant in this case, it has nothing to do with the other directors — but Eisner, having decided he didn't want Ovitz in there, he was obviously jealous of Ovitz for various reasons, he was angry that Ovitz had been called the most powerful man in Hollywood. He sabotaged Ovitz day in and day out for that entire 14 months.

> **"The most remarkable thing in the case is that Eisner picked Ovitz and almost immediately torpedoed the effectiveness of what he had done."**

He made it all but a certainty that Ovitz was going to fail.

DL: Does that raise another question about the plaintiffs' strategy? Would they perhaps have gone further, rather than attempting to say that, well, you could have terminated Ovitz for cause, taking a different tack, by painting Ovitz ultimately as another victim and trying to place more of the blame on Eisner and his machinations?

JBS: I totally agree with that. If I was trying that case, that is exactly what I would have done, because, first of all, the facts are much stronger on that.

DL: That ties back sort of neatly to some of the language that the Chancellor uses in the opinion, in attempting to articulate Delaware law in terms of lack of good faith. He says, I think he is quoting from an opinion of Chancellor Allen's, that bad faith can be the result of any emotion that may cause a director to intentionally place his own interests, preferences or appetites before the welfare of the corporation, including greed, hatred, lust, envy, revenge, and so on.

Do you think that if these facts had been found by the Chancellor, the sorts of facts that Mr. Stewart is outlining, then that could be a breach of the duty of good faith?

LAH: Well, in terms of motivation, absolutely. But I think you have got to be precise in your analysis of when those motivations come into play.

Once Ovitz is on board and is hired, the question is did Eisner sabotage him out of considerations of his own ego or otherwise, for other improper motivations. If the answer is yes, that is a very different case than saying too much was spent on Ovitz and he ought to give it back, the directors should be held liable. That wasn't the case that was brought.

The focus was much more on trying to demonstrate why Ovitz should have been fired for cause. That's a very interesting case in terms of its legal theory. But, you know, if the facts don't support it, you can't take it anywhere. And it didn't go anywhere.

JBS: I am curious, too, within the context of the shareholder derivative suit, could the plaintiffs have argued that Eisner and only Eisner was liable in the sense that, one, knowing that it was a mistake to hire Ovitz, particularly with such a generous severance provision, he recklessly went ahead and did it anyway and, then, secondly, having done it, and again knowing the cost to the company of failure on Ovitz's part, sabotaged him for reasons that we just heard, for envy and resentment and personal reasons like that? Would that sustain a cause of action?

LAH: The legal problem with that is once the plaintiffs turn all their guns on Eisner and don't turn them on the rest of the board — the rule that I referred to earlier on about who gets to bring these suits yields a very different result.

If the question is should Disney sue Eisner for that kind of conduct or misconduct, and none of the other directors is implicated in the wrongdoing, I think the law is pretty clear that that decision ought to be left up to the board of directors as the ultimate repository of authority over when, where and how and whether to bring that claim against Eisner on behalf of the company.

So I think from the plaintiffs' standpoint, and from the plaintiffs' lawyers' standpoint, their suit doesn't get anywhere unless you can fairly implicate a majority of the board.

JBS: Do they get anywhere if they could argue that, well, we can't rely on the board to sue Eisner because they are all his handpicked stooges?

LAH: And they argued that. In the law of allocating responsibility for pursuing litigation, there are a lot of opinions about whose interests and whose conflicts and whose proclivities ought to be weighed and counted against in giving the board authority.

But it is a very generous standard in terms of leaving the board in charge of the disposition of corporate claims. And it's only rarely that cases survive motions to dismiss for failure — the formal terminology is for failure to make a presuit demand on the board of directors. What it is really about is whether the courts are going to defer to a board and not allow individual plaintiff shareholders to pursue corporate causes of action. When will they cease to do that when they don't trust the majority of the board?

There were allegations in the early stages of this case just of the sort Mr. Stewart is talking about — specifically, that it was a hand-picked board, and Eisner exerted effective control, and therefore the claim ought to be allowed to go forward without giving the board authority over it. But that was rejected at an early stage of the case. What you see in the later stages is just the echo of that, where the plaintiffs are almost of necessity making charges against the full board, which is hard to do, as this case demonstrates.

The very interesting question, which doesn't get litigated or at least doesn't get litigated very often except maybe in bankruptcy cases, is: What is the quality of the company's claim against Eisner? What standards ought to govern that? It doesn't get litigated much because it is in the hands of the board of directors, and the board very often will find some way outside of litigation to resolve the claims against an executive or a former executive.

The Termination of Ovitz

JBS: As I understand it, there were really two prongs to the plaintiffs' attack. The first was the abdication of fiduciary duty by the directors [in Ovitz's hiring]. The second was the somewhat narrower but easier to understand idea that they could have terminated Ovitz for cause and therefore didn't owe him the 140 million, because even under the generous contract, if he was terminated for cause they didn't have to pay. And there was pretty shocking testimony, to me, anyway, that there was minimal scrutiny given to the issue of whether he could have been terminated for cause. It was so scanty, I believe — again, there was kind of conflicting testimony about this — but the general counsel, Litvack, he didn't really ever even seek an outside opinion on it. There was certainly no research done, there was no research memo ever produced in which Disney looked, even did a law-student, rudimentary scan of the applicable statutes and case law to see if it would have been for cause.

> "It really wasn't fair to Ovitz the things that Eisner said about him. Every single one of the allegations against him evaporated in testimony."

By the way, I can see why plaintiffs would have thought they had a good case there when Eisner had been going around publicly referring to Ovitz as a psychopath and saying he was dishonest and he cheated and he did all this. It was very striking to me that the facts really did not support that contention. Every single one of these allegations against Ovitz evaporated in testimony. That was my experience in the reporting as well, that Eisner would make these allegations, and I would go out and try to confirm them. And when I would get to the bottom of these things after, I must say, laborious efforts on my part, they went up in smoke. It really wasn't fair to Ovitz the things that Eisner said about him. Actually, I tend to agree that had they done the research, they couldn't have terminated him for cause.

JCC: The interesting area where [Eisner] most pushed the envelope was on the firing. Because it was an open question that Chancellor Chandler discusses (and cites disagreeing commentators) as to whether the board should instead have made the decision to remove. But [general counsel] Sandy Litvack gave an opinion, that Chandler decided was correct, that the CEO alone could fire the president, even though the Chancellor could line up commentators on both sides of that question.

If there was one area where I think the litigators felt a little sensitive and vulnerable on the defense's side of this case, it was whether or not there had been enough consultation of outside counsel on this issue of whether or not a no-fault termination was necessary or whether there was some possibility of no-fault terminating for cause. I would expect that if [Litvack] had to do this over again, he would line up two or three opinions of outside counsel because that might have forestalled any litigation whatsoever.

No-Fault Termination Clauses

DL: Are these no-fault termination clauses fairly normal in high-level executive positions and are they getting more scrutiny now after this decision?

JCC: They are even worse than this typically. You look at the Tyco one. Even an indictment and conviction of a felony didn't automatically terminate the contract. You had to show that it was a certain kind of felony involving moral turpitude. So they typically get written quietly by the CEO and his lawyer with no one else really wanting to negotiate at arm's length very adversely with the new incoming CEO.

WTA: I agree. What you see when people are hired typically — I'm not talking about Disney — is that the board works on the theory of "one great man." That is that there is one great man who is going to be right for this job, and once we identify him we pretty much have done what we are supposed to do.

And then it turns to the general counsel or the head of HR to negotiate the terms of the agreement. And the candidate brings in his specialist lawyer, and there is really no incentive for the head of HR and the general counsel to be so awfully tough with the person who is going to be CEO of the company.

In the detail of these contracts you do sometimes see things that are kind of ridiculous. Now, typically what constitutes cause for termination is one of the things where you get very extreme things. Only a crime of moral turpitude, not just any old standard felony, for example, in some contracts. So I think there is something that, as a general practice of boards, has not been attentive to the details, thinking that they as directors only have to address the big picture: Who is the right person? And the general pieces of his compensation. So I do think that the board should have some specialized advice in this setting.

DL: Do you think they will take more action now after seeing a case like this or will they just continue on the way it always has been?

WTA: I think this case is one piece of evolution. Compensation is obviously a major concern of the public, of the institutional investors, of politicians, and therefore, boards are paying more attention to it. The number of option grants is down. They substitute more restricted stock. And so these changes are kind of organic. I think they are running in the right direction.

But a person such as Mr. Ovitz is always going to insist upon a no-fault termination clause because he is giving up $20 or $25 million a year in order to take this risky position. If he could be fired without fault, no one would take the job. So having a no-fault termination is not really the issue, the issue is what constitutes fault for termination or not.

JCC: I agree that the balance of the advantage will always be in the hands of the CEO and his personal lawyer, nor do I think that the common-law process could solve this problem.

> **"The overwhelming sense is that having a substantial majority of nonofficer directors and people who are truly independent of the CEO, is healthy."**

I do think this is the kind of area where [Securities and Exchange Commission (SEC)] attention to what is disclosed about employment compensation and employment contracts could have the impact of embarrassing some CEOs and some boards from engaging in quite this much of a grant of absolute right to go out and plunder without being fired. So I think disclosure is the one weapon that's most likely to work here. I don't think you can expect that there is going to be arm's-length bargaining between the general counsel and his new boss.

DL: Do you think the SEC will move in that direction?

JCC: This is not what I would call a moment of high activism at the SEC. But I do think, and I recently heard this from its director of corporation finance, that they do want to look at the compensation area because they are responsive to a public mood and the public mood is that maybe there are inadequate controls. I think what the SEC has recognized is that the disclosure in this area has become boilerplate. There aren't really meaningful details given, and I do think that sunlight is the best disinfectant.

Looking to the Future

DL: Chancellor Chandler says he hopes that the opinion may serve as guidance for future officers and directors — not only of the Walt Disney Company, but other Delaware corporations.

What new guidance, if any, has occurred here? What do you think is the upshot of this whole opinion and the case in general?

LAH: I don't think it is new guidance. I really don't. The result that you get when you surround yourself by people who are not inclined to question, criticize you constructively, is suboptimal, to put it in an awfully formal way.

There is no doubt that the Chancellor's message is one of an expectation that real independent directors can make a contribution and that a CEO who behaves as the imperial magister, is not going to last for long, not in today's corporate governance environment.

JBS: Is that due to WorldCom/Enron?

LAH: I think that is just a part of it. I think we were heading in that direction well before that. This case is a good illustration. I am not one who is convinced by rote formulas for defining who should be on a board or how many outside directors you should have. But the overwhelming sense is that having a majority of people, a substantial majority of nonofficer directors and people who are truly independent of the CEO, is healthy. And that obviously wasn't the case with Disney. I just don't think boards are being or will be as tolerant of that kind of unilateralism by CEOs than they might have been in the past.

But there is this more troubling question lurking here. That is, who is going to bring this kind of lawsuit in the future if there is no percentage in it? And that is a concern.

There is another interesting Disney case that has been kicking around in the last year, brought by Roy Disney, involving an effort to inspect and publicize documents relating to the work of the compensation committee. This is an opinion by Vice Chancellor Lamb that was remanded to him by the Delaware Supreme Court for further determination of whether or not some of these documents could or should be allowed to be made public by Roy Disney. And the decision was not to allow it.

It strikes me that is a hugely important question, almost as important as what the liability standards are for breach of the duty of care or an obligation of good faith, because if this kind of conduct cannot be explored, or the results of exploration are inexorably private, we might lose something in the system that does operate as a check on corporate misbehavior.

I am not a big fan of civil liability for lack of care. I am not a fan at all of that. But I think we do have to think about ways in which our system does work to get out the message about how directors should behave.

WTA: I think that this decision in the ebb and flow of centuries will be unimportant. The earlier opinion of the Court of Chancery was an opinion on the law and may have ongoing significance. But this was a decision that simply looked at the evidence and, applying the evidence to the legal standards, found that the board had acted appropriately. The court did what the Delaware courts do from time to time, in that it expressed itself freely on the sort of general tenor of the board. The Chancellor no doubt intended his broader language as an encouragement to other boards to be even more engaged in the governance process in the future.

[The decision] shows that the fundamental rules of Delaware corporation law, with respect to corporate directors, have not radically changed. The business judgment rule is still going to be respected. We weren't going to fundamentally change the last 50 years of Delaware corporation law on that point.

JCC: What we do know is that Chancellor Chandler did feel that there is a major difference between best practices and breach of fiduciary duty. It could be that some of the public thinks that best practices over time do constitute what your fiduciary duty is. I think that's the most debatable area of this decision because Chancellor Chandler did say that fiduciary duties are fixed and static. And I think tort law scholars know that over time, changes in technology or changes in practices can make a particular practice unreasonable today even though it was quite acceptable 20 years ago. It may be [the case] that fiduciary duties do have to evolve and expand as practices improve, but I think the bar is quite comforted with Chan-dler's decision that there is a major difference between a breach of best practices and a breach of fiduciary duty.

Chandler did engage in a certain amount of moralizing. I think that's become a characteristic, a unique characteristic of Delaware decisions, but basically I would applaud it. I think it does tell the public that Delaware courts will tell you what they think of the behavior even though they will ultimately come down on the question of liability versus no liability based on very traditional bedrock rules.

"If this kind of conduct cannot be explored, we might lose something in the system that does operate as a check on corporate misbehavior."

DL: Will this case have any impact on the advice that corporate attorneys give to CEOs? Is there any value to them in this case?

JCC: Well, I think that this goes back to Holmes's good man and bad man distinction. The bad man always listens to what the penalties are. The bad man will know that Eisner got away with this; he escaped. "I, therefore, learned nothing from the case." The good man may say, "I want to comply with my full fiduciary obligations." And the court thought the following things were inappropriate. I do think this was a fairly weak board that Eisner dominated.

Now that could only be changed, not by common law judges imposing liability, but by institutional investors exercising their voting rights. Possibly also by the SEC giving shareholders greater access to the proxy statement. Those are separate issues.

But I think if there is a problem that's in this case, it is the domination of the board, a fairly weak board, by the so-called proverbial imperial CEO. All of that, however, is exactly the kind of issue that is better addressed by the SEC or an administrative agency than it is by common law adjudication. So one message I take away from this is although I think Chandler got it right on all of the issues he faced, probably sensible reform of executive compensation is going to have to be handled more by the SEC than by the common-law process.

WTA: I would just add that this process shows both the appropriate limits of the law and the alternatives to court-driven change.

If you look at the Disney board today, it's a completely different board filled with strong outside business people, that has chosen a new CEO, who although he came from within the company, only came into the company a couple of years ago. The market has — the company has performed well. Ironically, the company was performing well during much of the problem period for Eisner. So reform happens without court orders or SEC change because institutional investors have a great deal of influence, and corporate American is listening to them. ◆

FEATURE

John W. Anderson

The Virtual Law Firm

The idea of a world flattened by technology isn't new. However, it is new for lawyers, so it's time for all of us to embrace the change, or suffer the consequences.

Paul Young, a 1980s British pop star, said it best: "Wherever I lay my hat — that's my home."[1] Or was that "my office"?

The law firm of Smith Dornan & Dehn PC (SSD), "located" in New York, has taken this slogan to heart — literally.

I live and work for SDD in Roanoke, Virginia, "The Star City of the South," nestled in the heart of the Blue Ridge Mountains. Russell Smith, our managing partner, lives atop another mountain range in rural North Carolina, except during the winter months when he works out of his house in Mysore, India. Frank Dehn, meanwhile, lives in Rochester, New York, and works out of an office there two days or more per week. Yes, SDD does have offices at its headquarters in Midtown Manhattan, but our attorneys don't have to be there, so most of us, on any given day, aren't.

The virtual law office has arrived.

The latest buzzword in the workplace is ROWE, which stands for Results Oriented Workplace Environment. The basic premise of ROWE is this: Executives, managers, and employees can work whenever and wherever they want — so long as they get their jobs done. We've been practicing the concepts of ROWE for years, but have taken it one step further — employees can live wherever they want as well. By going virtual, Smith Dornan & Dehn drastically lowers its overhead, while at the same time making its attorneys and staff much more efficient and productive. We believe the virtual firm structure is critical for law firms to adopt in order to succeed in the years ahead.

Technology has finally caught up to the business of law, forever changing how we do our work. The first seismic change on the horizon is the outsourcing of legal work to India. That's right — law is on the list. In less than 10 years, legal services performed in India are expected to become a nearly $1 billion business, according to *The Washington Times*. Corporations like United Technologies, Oracle, and Bayer are already outsourcing legal work to India, with many more multinational corporations expected to follow. "Law firms send case work overseas to boost efficiency."[2]

"We did a survey of corporate houses in the United States in which 86 percent identified the high cost of legal services as their No. 1 cost worry," according to Sanjay Kamlani, cofounder of the New York-based legal outsourcing firm Pangea 3 LLC (with more than 25 lawyers on staff in India). "There are 1 million lawyers in India and 70,000 graduating from law schools every year. We realized that we had an enormous, enormous business opportunity," he said.[3] Kamlani, in an article about law outsourcing done by *The Wall Street Journal* not three weeks before, said, "Short of anything where you have to physically be there or sign on the dotted line, we can do it."[4] DuPont Co. admitted to the *Journal* that it regularly uses Indian attorneys to draft patent applications.

Good Indian lawyers, on average, make about $12,000 a year.[5] They don't have, or even ask for, corner offices and personal assistants, in large part because the practice of law is not a high-income, prestigious profession there. "The pecking order is engineering, medicine, MBA, CPA, and then law," according to Alok Aggarwal, chairman of Evalueserve, a New Delhi corporate-research outsourcing company.[6]

How do these outsourcing companies get around the licensing requirements of various states? "We are not a law firm," according to IndiaLegal.net, "though our team comprises of lawyers. We do not provide any legal advice or render any legal opinion. Our purpose is to aid and supplement your work." [7] The "your" to whom IndiaLegal refers are their clients; licensed attorneys in the United States. As long as a barred attorney supervises their work, IndiaLegal effectively functions as legal assistants. The outsourcing companies make sure that's clearly understood. Under the terms and conditions page of IndiaLegal.net, for example, a disclaimer reads: "Client represents and agrees that: Client is a licensed attorney in the state(s) in which he/she practices and has and will continue to direct and supervise any research conducted by IndiaLegal, its members, contractors, and/or employees on Client's behalf as may be necessary or appropriate to discharge Client's professional responsibility."[8]

Protected by this disclaimer, the scope of legal work done in India appears to be endless. Another outsourcing company, Lexadigm, was interviewed by National Public Radio reporter Jennifer Lunden of *Weekend Edition* about their offered services. Puneet Mohey, president of the company, had this to say about their work:

MOHEY: We, for example, do research in different states or under federal law. Then a lot of times we would draft briefs. We will draft responsive briefs. We've done some contract drafting. Then we've done some document review. And then we do — on the patent side, we draft patent applications and provisional patents.

LUNDEN: I understand you actually prepared your first brief for the U.S. Supreme Court a few months ago?

MOHEY: It was fun, though I didn't really find it such a big deal, honestly, because we've been preparing a lot of U.S. Circuit Court of Appeals briefs.[9]

The full impact of this is still unknown, but *The Economic Times* of India in September 2005 cited a Forrester, Inc. study that estimates that more than 35,000 jobs will be lost in the next four years.[10]

So what can lawyers here in the United States do? Go virtual, for one, which will have a huge impact on lowering overhead costs. We at SDD don't have all those unnecessary costs to pass along to our clients — the hard-copy law library, the swank reception area, secretaries, to mention a few pricey areas. An even bigger cost savings is derived from the fact that by virtualizing most of our lawyers, we don't need much space in Manhattan, where we're based as New York attorneys. Thanks to our embrace of the "www" world, we live and work in places where the cost of living is much lower than in New York. Everything is less — our offices (which are often in our homes), houses, taxes, electricity, and even doggie spas.

Does all this mean that we make less money for our legal services? Nope. Thanks to our virtual office, we work much more efficiently than we would traveling back and forth to a central office. We get more work done in less time. We work when we want, where we want. I work late at night, often in my study beside a fire. Russell, on the other hand, is an early riser, greeting the sun from his office with a 270-degree view of the Great Smoky and Blue Ridge Mountains. Frank, meanwhile, spends odd hours with clients in Britain and Singapore in exchange for the freedom to help out at his children's schools while other dads are desk-bound.

Thanks to our cost savings, and complete flextime approach to work, our attorneys spend more time socializing with family and friends, fishing, golfing, reading, etc. We are additionally blessed with the ability to hire great new associates to the firm who see the lifestyle the other attorneys at our firm enjoy. I did say "enjoy." That's because we love what we do. The proof is in our turnover rate. To date, it's near zero.

So now let's address the big question — what do our clients think? They love it. That's because our rates are more competitive than most firms (thanks to our cost savings and efficiency), while our work product, we believe, is on par with the best. Our clients are Fortune 500 companies, large entertainment companies, television and film stars, directors, producers, film and television production companies. Thanks to the way we run our office, we often bill on a flat-rate, per-project basis rather than hourly, which clients appreciate because it allows them to budget their legal costs to the penny, without any surprises later. Being virtual, with its inherent flexibility, also allows us to be more responsive to our clients' needs.

When Russell is in India, for example, clients who need to reach him in emergencies during production at odd hours of the night were surprised to find that he is more easily reached there than in the United States. That's because the thirteen-hour time difference means that at 1 a.m. Eastern time, Russell's wide-awake. One client, HBO, readily appreciated this when Russell served as production counsel for them on *Da Ali G Show*. The HBO folks were so impressed that they volunteered to tell other prospective clients about their experience with us.

From India, Russell has worked on film and television projects all over the United States, reviewed content for television networks and others, negotiated contracts, filed court briefs, and handled just about every kind of legal work except court appearances. Our clients are assured that on those rare occasions when other attorneys at the firm cannot handle his court appearances, he is prepared to get on a plane back to the States at a moment's notice.

What about client contact? We still think that's important. We're committed to seeing our clients — by going to them, rather than having them come to us. When we hit the road, the office comes with us, conveniently located in our briefcase in the form of a laptop computer — Mac for John, Alienware for Russell — to London, New York, Dublin, Los Angeles, India, wherever. Our e-mail runs on the Web-based IMAP system, so all inboxes, outboxes and attachments are accessible in the same form anywhere on the planet.

Where will our firm go from here? We are now in the development stage of creating our own BPO (Business Process Outsourcing) center in Mysore, India. There, we will establish our entire back-office operation of accounting, IT, and paralegal work. Once established, it is our goal to expand these services to be offered to our clients and other law firms as well.

We selected Mysore over better well-known Indian locales like Banglore, Mumbai (Bombay) and Delhi because of the large pool of college talent there, coupled with the fact that wages are half the amounts paid in more developed areas of India. Having been in Mysore for over two years, we learned that there are thousands of educated and talented young people who would jump at the chance to work in a company that would allow them stay in their home town with their families, rather than uproot themselves by moving to Mumbai, New Delhi, or Bangalore, places where traditional Indian culture is being lost. We intend to be the highest-paying employer in Mysore, and to be a positive force in the local economy and culture. Additionally, we will use our office in Mysore to represent U.S. companies for their corporate, litigation, and intellectual property needs in dealings with India.

The idea of a world flattened by technology isn't new. However, it is new for lawyers, so it's time for all of us to embrace the change, or suffer the consequences. ◆

FOOTNOTES

1. Paul Young, *Wherever I Lay My Hat (That's My Home)*, NO PARLEZ (Columbia Records, 1985).

2. Tom Ramstack, *Law firms send case work overseas to boost efficiency*, THE WASHINGTON TIMES, Sept. 26, 2005.

3. Biman Mukherji, *India rides outsourcing boom to capture legal work from abroad*, Agence France Presse, Oct. 16, 2005 *available at* http://www.channelnewsasia.com/stories/afp_asiapacific_business/view/173723/1/.html.

4. Eric Bellman; Nathan Koppel, *More U.S. Legal Work Moves to India's Low-Cost Lawyers*, WALL ST. J. Sept. 28, 2005, at B1.

5. *Id.*

6. *Id.*

7. http://www.Indialegal.net/faqs.htm.

8. http://www.Indialegal.net/terms&con.htm.

9. *Weekend Edition* (National Public Radio broadcast, May 1, 2005).

10. Navneet Anand, *India to Grab 35k US Law Jobs By 2010*, THE ECONOMIC TIMES (New Delhi, India), September 2, 2005 *available at* http://economictimes.indiatimes.com/articleshow/1217525.cms.

OPINION/*Continued from Page 40*

Because what Medea did is reasonable — for someone ruled by passion, that is. The illegal downloaders are driven by the same emotions. (It may surprise you that greed, something the music industry often points to as the underlying motivation for illegal downloads, is not really a factor at all.)

So, is the music industry living a Greek tragedy? Sounds like one to me. The balance between copyright interests and consumers can only be achieved if the copyright owners first get a better understanding of their customers — the consumers (yes, the very ones the RIAA is suing). As long as they do not understand them, however, the copyright community is vulnerable not only to the wholesale theft of its assets, but to the rejection by the public as well.

Unless we understand human nature, we will not have a clue as to how to fix this mess we're in. In the myth of Gyges, the protagonist finds a ring that allows him to make himself invisible. What did he do when he could get away with murder and not be caught? He killed the king, raped the queen, and took over the kingdom. No punishment? No problem. Some will say that this is exactly what we are seeing among the peer-to-peer sharers. But there's a reason they are called peers. They are of a similar mind that has neither been taught correctly or effectively; and they act as if they can do whatever they want because they won't be caught. Like Gyges, they only think of what they can do — not what they should be doing or not doing.

There are those who say that good conscience cannot be taught. Even if that is true, making available what people want, when they want it, at a reasonable price, is the best policing the music industry can achieve in the marketplace. Wise business decisions will neutralize those who would take advantage of the vacuum and provide alternatives to hungry consumers.

In the digital rights area, the battle is between those who use passion to define their strategies (while hiding behind the cover of reason) and those who use reason to justify their behavior (while hiding behind the cover of passion). Who's right? Let's look again to the Greeks to help us out. In *The Republic*, Plato defined law as reason unaffected by desire. Not long afterwards, Aristotle defined law as reason without passion, and wrote that reason applied to the law must benefit all, not just the few. Has the music industry got it backwards?

When all is said and done, the survival of copyright will depend on two things. First, does the citizenry understand the purpose of copyright? And if they do, are those who enjoy the benefits of copyright willing to recognize a balance between their interests and those of the rest of the population? Hopefully, the public will recognize that copyright is as much, if not more, in their interest, than if there were no copyright at all — a proposition that is not as much out of the question as it sounds.

As Medea says:

Things have worked out badly in every way.
Who can deny the fact? Nonetheless,
You should not assume that's how things will stay.

Let's just hope that the chorus is singing in tune and getting it right. ◆

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Best wishes from all of us for
a healthy and happy New Year!

Peter M. Thall

Illegal Downloading and the Music Industry: A Modern-Day Greek Tragedy

One of the legendary music lawyers in the field (and my mentor), Harold Orenstein, would regularly compare copyrights to children. "Nurture them," he would say. "Feed them. Protect them." I had no clue as to what he was talking about.

Over the years, I learned. A copyright that lies fallow is like a child starved. Paul Simon once offered millions of dollars to purchase an entire publishing company where he once worked as a low-level employee before his success with Art Garfunkel. During his brief employment, the company had acquired six of his copyrights (the only significant ones being *59th Street Bridge Song (Feelin' Groovy)* and *Red Rubber Ball*, a hit with the 1960s group The Cyrkle). After Simon's success, he tried to buy the music publishing company for the sole reason of getting back his six songs at any cost. He was distressed that his six copyrights were not being exploited, nurtured. I began to understand what Orenstein meant.

While likening copyrights to children is a fine sentiment, warranting such noble efforts as that of Mr. Simon in the early 1970s, it appears these "children" today are in far more jeopardy than mere lack of attention. Indeed, songwriters are watching helplessly as their "children" are being killed off, first by peer-to-peer "sharing," and second (most surprisingly, and disappointingly) by the copyright proprietors themselves — most often music publishing companies in whom the songwriters entrusted their copyrights.

What does this have to do with Greek tragedy? Remember Euripides' Medea? She was the sorceress who was betrayed by Jason (of Argonaut fame) and who decided to pay him back by killing their children. I can't help but consider Medea as a perfect metaphor for the music industry.

As I describe in my book *What They'll Never Tell You About the Music Business: The Myths, the Secrets, the Lies (and a Few Truths)* [Billboard Books: 2002], Napster was the well-publicized software created by a then 19-year-old which permits multiple Internet users to access each others' collections of MP3 files for free. It was the mechanism for the deluge of illegal downloads which has been nothing short of catastrophic for the music industry. For years, the music industry allowed illegal downloading to become totally out of control. It gave birth to mass infringements by neglect, by standing on the sidelines while technology advanced well beyond its ability to keep up with legal protections, and by seeking to remedy the situation by a bumbling array of solutions that really are mind boggling, given the perceived sophistication of the industry.

Just as Medea was driven by the passion of a betrayed suitor, so the music industry seems to be driven more by passion than by reason. And in so doing, it has become the victim. It just rolls right along, suing college kids, teenagers, and unsuspecting grandmothers. Nearly 15,000 lawsuits so far. How many more must it initiate before it realizes that this remedy is not achieving what it is seeking? The industry did not understand then, and still does not understand, that much of the record-buying public today has been brought up using music, but not owning it, and that that's okay with the youth of the world today.

Kids perceive that morality is on their side. Why? Partly out of youthful naiveté, partly out of ignorance, and partly because of the well-documented perception that songwriters and artists have never been paid a fair share of the money they generate. The public perception of the music industry is more likely to be that it is avaricious, manipulative, and oppressive than fair and sympathetic. Yet the music industry feels betrayed as well. After all, did not the music industry invest heart, soul, artistic talent, and oodles of money to produce and distribute the very art that the consumers now feel entitled to take for free?

As was inevitable in international commerce, copyright owners and those who depend on copyright sanctity looked to the courts to enforce what they considered to be their divinely given rights. In cases like *A&M Records, Inc. v. Napster, Inc.*, 114 F. Supp. 2d 896 (N.D. Cal. 2000), *aff'd in part, rev'd in part*, 239 F.3d 1004 (9th Cir, 2001), and the recent U.S. Supreme Court decision in *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. ___ (2005), the courts have ruled for the music industry and against the Napsters and the Groksters of the world as infringers of copyrights. So finally we saw that "reason," according at least to those who value the federal courts' decisions, thwarted the "passion" of the file sharers.

Of course, there is a certain logic to what the copyright interests are trying to do, just as there is a certain logic to what Medea did. According to the RIAA, the lawsuits themselves constitute a form of education of the public and the RIAA is actually quite encouraged by the willingness of their numerous defendants' acknowledgements of *mea culpa*. Unfortunately, the numbers of the converted are miniscule when compared to the actual damage being done on a worldwide basis. Every time a well-founded action is commenced, the public is reminded of other lawsuits whose rationales and results are, in a word, absurd. Take, for example, the 41-year-old disabled single mother living in Oregon who is counter-suing the RIAA for fraud, invasion of privacy, abuse of process, electronic trespass, violation of the Computer Fraud and Abuse Act, negligent misrepresentation, and the Oregon RICO Act alleging racketeering by the music industry. Her personal home computer had been secretly entered by the record companies' agents, MediaSentry.

Right or wrong, moral or immoral, supported by the court system or not, I believe there is still something wrong about putting your most passionate, avid customers in the dock. I have always felt that suing college students is a losing proposition — not because it is the wrong thing to do, but because it is self-defeating. Suing four college students who are transferring a million files each is not effective if they are replaced by four million college students transferring one file apiece. And believe me, none of these kids are transferring only one file apiece. In my opinion, these lawsuits are like parents saying no to their teenage children. We all know what the response is likely to be. Add a layer of moral justification because their musical heroes are also being taken advantage of and you have an almost insurmountable scenario.

We must ask again: "Is the desire for free music dictated by passion or by reason?" I would suggest the latter.

Continued on Page 38

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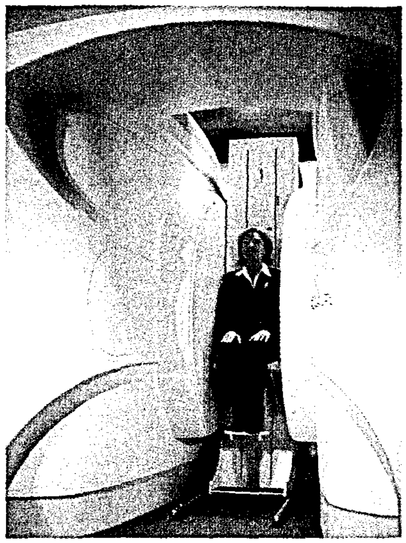

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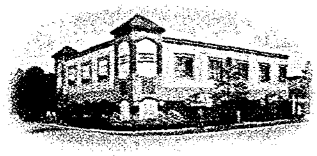

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