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Internet Challenges to Business Innovation

By Nancy Kim

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I. Introduction.

Several months ago, I received a copy of a casebook with the words “PROFESSOR REVIEW COPY NOT FOR SALE” emblazoned on the cover. I was not the only law professor to receive this text, and the legal significance of those six words was the topic of much heated debate on the AALS Contracts law professor listserv. Much of the discussion, perhaps predictably, revolved around whether the prohibition against subsequent sale of the textbook was enforceable as a “contract.”¹

This particular publisher’s action of placing the “PROFESSOR REVIEW COPY NOT FOR SALE” language upon the book cover was likely sparked by two recent developments made possible by the Internet. The first is email solicitations by entities seeking new, complimentary copies of casebooks from professors for cash. The solicitors then resell the books to students for less than the retail price. This proposition benefits the entities, the professors who make a little cash for giving away books that might otherwise end up in the recycle bin, and students who spend a bit less for already costly textbooks. These textbook reseller businesses were not feasible in the pre-Internet era. A business model based on individuals traveling door-to-door, soliciting textbooks from cranky professors would be impracticable, if not downright laughable. The distance between universities, the erratic hours kept by professors, and the base salaries that would need to be paid to the solicitors would have resulted in costs that would hardly be offset by the profit made on the sales of any textbooks (profits that would need to be shared with the aforementioned cranky professor). Email substantially reduces the cost of these solicitations by enabling a solicitor to contact many more professors at no increased cost. The fixed costs—computers and an email account—are minimal. The only parties that don’t benefit from these new reseller businesses are the publishers that distribute these complimentary copies as part of a marketing effort to woo professors into adopting them for their courses.

The second Internet-related change giving rise to these businesses is the creation of the electronic marketplace itself. The Web opens up a world-wide secondary marketplace where buyers can become sellers with minimal start-up costs. Unauthorized resales of textbooks are facilitated by a plethora of companies, such as Amazon and eBay, as well as scores of lesser known Web sites, where both new and used books can be purchased quickly and efficiently at a discount to the publisher’s retail price.

Book publishers are hardly the only companies to face business challenges spawned by the Internet. Old media and entertainment companies have viewed the changes created by the Internet with apprehension. Book publishers fear rampant and uncontrollable copyright infringement in the form of unauthorized digital distribution of printed works even as they struggle with diminished sales attributable to a marketplace made much more efficient by the Internet. Publishers are not alone. The decline in CD sales is due, at least in part, to the unauthorized online distribution and sharing of music.²

In response, some companies, like the textbook publisher mentioned in the first paragraph, have tried to stem the tide of change by resorting to contracts or contractual language to restrict the use (or reuse) of goods. In a recent case, however, the federal court for the central district of California ruled that the distribution of a promotional CD was a gift or a sale, and not a license.³ The promotional CD at issue was labeled with language that stated the following:

“This CD is the property of the record company and is licensed to the intended recipient for personal use only. Acceptance of this CD shall constitute an agreement to comply with the terms of the license. Resale or transfer of possession is not allowed and may be punishable under federal and state laws.”⁴

The court held that the music company’s distribution of the promotional CDs provided the recipient with many of the critical rights of ownership, including the right to perpetual possession and the freedom from obligations to the music company.⁵ The distribution of the promotional CDs, therefore, was not a license, but a gift or sale and subject to the first sale doctrine.⁶

II. The Contracting of Everything.

In attempting to attach conditions to the transfer of tangible goods, whether that transfer is labeled a gift or a sale, these companies are marching down the path paved by the software industry. During the fledgling days of the Information Age, it was uncertain whether copyright law protected digital information.⁷ Software producers attempted to protect their intangible ownership rights through contracts, that is, software licenses, which enabled them to transfer tangible media and relinquish some, but not all, of the exclusive rights granted to them under copyright law.⁸ The courts, while at first skeptical of this approach, increasingly stamped approval upon this licensing model in order to nurture the growth of the software industry.⁹ Now, shrinkwrap, clickwrap, and browsewrap agreements are ubiquitous and their use is no longer limited to the software industry.¹⁰ In fact, many businesses with an Internet presence incorporate some sort of ‘wrap agreement that governs a user’s interaction with the Web site.

Now it looks as though other industries are adopting not only the software industry’s contracting forms but also its licensing model. While the adoption of the licensing model in the hard goods arena is problematic from a legal standpoint, it is misguided from a purely policy-oriented one as well. The embrace of ‘wrap agreements and the licensing model (as opposed to the old-fashioned idea of a sale) by courts was motivated by a desire to encourage business innovation and deter bad faith business conduct on the part of licensees such as the defendants in the high-profile cases *ProCD v. Zeidenberg*¹¹ and *Register.com v. Verio*.¹² In *Zeidenberg*, the defendant bought a package of ProCD’s database software and formed a company to resell the information contained in the database on the Internet. The court held that the defendant’s conduct was prohibited by the agreement that accompanied the software, even though the agreement was not accessible to the defendant until after the software had been purchased.¹³ In *Verio*, the defendant sold Web site development services that competed with the plaintiff’s business. Verio received domain name registration information from Register.com and repeatedly solicited business from those names in violation of Register.com’s policies. Verio claimed that, because the restriction on solicitation did not

appear until after the registration information was received, it was not contractually bound to the restriction.¹⁴ The court disagreed because Verio had submitted multiple queries. In other words, even if Verio did not know of Register.com's policy when it submitted the first query, it knew about the policy when it submitted subsequent queries.

Unfortunately, many of the technology innovators of yesterday are the innovation stiflers of today, attempting to control what consumers can do with software through overreaching contractual clauses and overzealous legal departments. To make matters worse, companies in established industries, such as book publishing, are following the lead of the software giants by relying upon innovative contracting models rather than by developing innovative business models.

III. Old Industry Giants React to Internet Challenges.

While one may disapprove of the type of business that resells complimentary products, the courts should be wary of letting their distaste for this particular type of business cloud legal analysis, which may result in case precedents that ultimately hinder business innovation. When cornered, savvy companies, even those in old media industries such as book publishing, will eventually respond. Random House Publishing Group, for example, recently announced that it will offer individual chapters of books in digital form, adopting the strategy followed by the music industry.¹⁵ NewsCorp's HarperCollins Publishers also announced its "Full Access" program that will make select titles free online for a limited time.¹⁶ Paulo Coelho, a bestselling author who will be taking part in HarperCollins' "Full Access" program, expressed his belief that "online reading helps increase book sales."¹⁷ HarperCollins also recently announced that it is forming a new publishing unit that will offer authors a much larger share of profits in lieu of cash advances and try to eliminate the publishing industry's practice of allowing booksellers to return unsold copies of books.¹⁸ In addition, the new unit plans to release electronic books and digital audio editions of all of its titles, thus accommodating readers' growing penchant for reading online.¹⁹ Jane Friedman, the chief executive of HarperCollins, acknowledged that the new imprint was a response to industry changes brought about by technology.²⁰ In the ailing music industry, three major record companies have struck a deal with MySpace, a social networking Web site, to start a music Web site.²¹

Often, the efforts of old media industries to embrace the Internet are hindered by their fear of letting go of what worked in the non-virtual world. HarperCollins' Full Access Program has been criticized for being slow and difficult to use.²² At a recent panel discussion at the South by Southwest music conference, representatives of traditional music companies clashed with those who proposed an advertising-based model whereby music would be given away free.²³ Skeptics debate whether these old industry giants are nimble enough to succeed online, and certainly many of their initiatives will fail. Yet, these companies should be encouraged and applauded for adapting their business to emerging technologies and to a changing marketplace rather than adopting agreements to stifle emerging businesses.

IV. Sharing the Wealth as a Business Strategy.

Ironically, and unfortunately, many Internet businesses have not done the same. Social networking sites and other online enterprises have capitalized on the digitization of books and music to enhance their sites and attract members. They encouraged unknown musicians and other artists to post their content and then gave themselves, via non-negotiable clickwrap and browsewrap agreements, royalty-free licenses to use that content in perpetuity. Facebook's terms of use, for example, state that :

By posting User Content to any part of the Site, you automatically grant, and you represent and warrant that you have the right to grant, to the Company an irrevocable, perpetual, non-exclusive, transferable, fully paid, worldwide license (with the right to sublicense) to use, copy, publicly perform, publicly display, reformat, translate, excerpt (in whole or in part) and distribute such User Content for any purpose, commercial, advertising, or otherwise, on or in connection with the Site or the promotion thereof, to prepare derivative works of, or incorporate into other works, such User Content, and to grant and authorize sublicenses of the foregoing.²⁴

While shaming the greed and inflexibility of old media dinosaurs, social networking sites have with willful blindness ignored the way that technology has impacted the content providers who have made their own sites successful. The founders and employees of these companies reap pecuniary reward, but the true value of these sites lies in their content. In an op-ed to the *New York Times*, songwriter and author Billy Bragg wrote, "Technology is advancing far too quickly for the old safeguards of intellectual property rights to keep up . . . the first legal agreement that (fledgling songwriters and musicians) enter into as artists will occur when they click to accept the terms and conditions of the site that will host their music. Worryingly, no one is looking out for them."²⁵

Consequently, those companies should not be surprised when those musicians, realizing their market power, start to look out for themselves. An analogy may be found in the music industry where, realizing that the decline in CD sales is not temporary, some musicians have already scoped out alternative revenue sources. The rapper Jay-Z announced that he was leaving his longtime record label to join concert giant, Live Nation, which would in effect bundle his entertainment offerings and related merchandise.

The changes in the music industry may also benefit lesser known musicians. Patterson Hood, the guitarist and lead singer of the band Drive-By Truckers, remarked that the shake-up in the music industry has "leveled the playing field" for his band.²⁶ Bands like his, talented but not camera-ready, can earn revenue from selling merchandise at shows. These bands no longer need to sign with a major record label in order to reach an audience. They tour and set up websites; their fans establish virtual communities. Some bands may even decide to sell digital downloads exclusively, thus avoiding the costs associated with producing CDs. The survival of the existing music industry giants may very well depend upon their ability to prove their value to independent musicians whom they may have formerly snubbed.

Online content providers, too, may decide to join or form alternatives to the existing social networking sites. Several high profile musicians, unhappy with the terms of service of sites such as MySpace or Facebook, have already started their own social networking sites. 50 Cent, for example, has started a social networking site which enables

him to own the content and data, and generates revenue from advertisements and merchandise offered on the site.²⁷

V. Conclusion.

The distributive power of the Internet and the relatively low cost of setting up a virtual community and online shop open up possibilities for musicians and other artists that were unavailable just a few years ago. Consequently, the next wave of online business innovation may be driven by content providers who recognize their value and demand some sort of compensation, whether it be in the form of cash, royalties, or equity. While such a thought might be distasteful for companies that are currently operating without such incentives, in order for these companies to remain relevant, they must revisit and rethink the way that they have done business. Otherwise, these promising young Internet companies of today will be the dinosaurs of tomorrow.

NOTES

¹ While there was no definitive resolution about the enforceability of the caption, the consensus was that the publisher would likely not attempt to enforce the prohibition for fear of harming its reputation among its book-buying constituency.

² Jon Pareles, "1,700 Bands, Rocking as the CD Industry Reels," *NY Times*, A-1 (Mar. 15, 2008).

³ *UMG Recordings, Inc. v. Troy Augusto*, 2008 U.S. Dist. LEXIS 48689.

⁴ *Id.* at 2. The court noted that some promotional CDs may simply state "Promotional Use Only-Not for Sale," but that the meaning was the same as the cited language. *Id.* at f.n. 1.

⁵ *Id.* at 8.

⁶ *Id.*

⁷ See Maureen O'Rourke, "Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms," 45 *Duke L.J.* 479, 488 (1995), Robert L. Oakley, "Fairness in Electronic Contracting: Minimum Standards for Non-Negotiated Contracts," 42 *Hous. L. Rev.* 1041, 1048 (2005).

⁸ David A. Rice, "Copyright as Talisman: Expanding 'Property' in Digital Works," 16 *International Review of Law Computers & Technology* 113, 117-118 (2002).

⁹ See generally, Nancy Kim, "Clicking and Cringing," 86 *Oregon L. Rev.* 101 (2007) (forthcoming).

¹⁰ See Nancy S. Kim, "The Software Licensing Dilemma," 2008 *B.Y.U. L. Rev.* (forthcoming, Oct. 2008).

¹¹ *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

¹² *Register.com v. Verio*, 356 F.3d 393 (2d Cir. 2004).

¹³ *Id.*

¹⁴ *Id.* at 401.

¹⁵ Jeffrey A. Trachtenberg, "Publisher Tests Selling by the Chapter," *Wall St. J.*, B7 (Feb. 11, 2008).

¹⁶ *Id.*

¹⁷ Press Release by HarperCollins Publishers, Feb. 11, 2008.

¹⁸ Motoko Rich, "New HarperCollins Unit to Try to Cut Writer Advances and End Unsold Book Returns," *N.Y. Times*, C3 (Apr. 4, 2008).

¹⁹ *Id.*

²⁰ Friedman stated, "This is the right time to experiment with a new business model. We have to look at a changing marketplace." Jeffrey A. Tachtenberg, "HarperCollins Turns Page in Publishing," *Wall St. J.*, B7 (Apr. 4 2008).

²¹ Jeff Leeds and Brad Stone, "Three Record Companies Team Up with MySpace for Music Website," *N.Y. Times*, C1 (Apr. 4, 2008).

²² Cory Doctorow, "Free download of Neil Gaiman's American Gods," www.boingboing.net/2008/03/01/free-download-of-nei.html and accompanying posts (Mar. 1, 2008).

²³ Dan Mitchell, "Free Music? Only With a Fight," *N.Y. Times*, B5 (Mar. 15, 2008).

²⁴ <http://www.facebook.com/terms.php> (last visited Apr. 17, 2008).

²⁵ Billy Bragg, "The Royalty Scam," *N.Y. Times*, A25 (Mar. 22, 2008).

²⁶ David Carr, "Live Music Thrives as CDs Fade," *N.Y. Times*, (June 23, 2008)

²⁷ Jennifer Netherby, "Musicians Take Social Networking into Their Own Hands," Reuters, (March 28, 2008).