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COMMENTARY

## Grokster's Loss Is America's Gain

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Monday was the Fourth of July for property rights in the high-tech economy. The U.S. Supreme Court issued two verdicts that will ripple through the information sector for years to come. In *MGM Studios v. Grokster*, the Court found that tacitly assisting the appropriation of intellectual property is not legal just because it is passive. In *National Cable and Telecommunications Assn. v. Brand X*, regulations mandating that cable operators share their networks with potential rivals were effectively struck down.

These victories for the "property rights" position will strike some as hostile to innovation. Not to worry. Rules that allow those who invest in creative content or valuable networks to reap at least a slice of the rewards are rules that tend to advance consumer interests.

*Grokster* was the closer call. At issue was the file-sharing software distributed by Grokster and StreamCast Networks, programs that allow users to swap digital content, including copyrighted songs or movies, without compensating the owners or informing the software companies. That the resulting decentralized theft was illegal was not at issue. The question was whether the software makers were liable. The Ninth Circuit Court of Appeals ruled that the firms were not "contributory infringers" because they did not possess "knowledge of direct infringement."

The Supreme Court saw this as a dodge, and overturned. The firms collected advertising revenues on the Internet traffic they generated; the eyeball count was overwhelmingly driven by the free sales of other peoples' property. While Grokster and StreamCast didn't copy material directly, there was "no evidence that either company made an effort to filter copyrighted material from users' downloads or otherwise impede the sharing of copyrighted files." With the dominant use of their product to pilfer, the suppliers were found at fault.

The bigger property-rights mark may well be left by *Brand X*. Today, two rivals vie for broadband household subscribers: Cable systems provide cable-modem access, telephone operators supply digital-subscriber lines (DSL). For years, cable operators have enjoyed the more favorable regulatory treatment. While

phone carriers must share their lines with competitors at regulated rates, cable systems are not subject to such rules. *Brand X* was about rules to impose sharing obligations on cable providers.

The idea of "open access" is that, while network operators provide transport (Internet connections for customers), additional competition may blossom if numerous service providers are able to use these links. This could be mandated by regulations forcing the incumbent carrier to rent its facilities to potential rivals. This would exploit economies of scale in the physical network, even as brisk rivalry flourishes for retail services.

But let's go to the videotape. Cable operators, subject to no such sharing obligations, have invested vigorously in upgrading their systems for high-speed data. Instead of DSL services being more attractive, given their "open platform" courtesy of government regulation, consumers have strongly preferred "closed" cable systems, which maintained virtually a two-to-one advantage in market share for several years.

Marketplace evidence strongly rejects the hypothesis that broadband network sharing rules are pro-consumer, a conclusion bolstered by an interesting experiment. In February 2003, the Federal Communications Commission elected to substantially pare back the network-access obligations shouldered by phone companies. The terms on which independent Internet Service Providers could use telephone networks to provide DSL, were made much less favorable. Newspaper headlines announced that this would increase the price of broadband service and slow its deployment across the U.S.

The reverse occurred. With expanded property rights, and reduced regulatory overhang, phone carriers became much more ambitious in deploying and marketing broadband. DSL price cuts and build-out led to cable-modem price cuts and upward-spiking subscribership. DSL is now running even with cable-modem providers in terms of new subscribers, closing a huge market-share gap. Consumers, expressing their own choices in the marketplace, prefer the less regulated alternative.

Property rights provide incentives for creativity and investment in the information goods of the New Economy similar to those witnessed in economies past. Courts that understand the central importance of ownership to economic growth should be celebrated for doing their part for entrepreneurship and consumer welfare.

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