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Business Law Newsletter

LESSONS FROM MORGAN STANLEY

By James V. Irving

The fall out from *Enron* and other corporate greed cases continues to resound in our judicial system. The development of court policies requiring strict compliance with pretrial scheduling orders and discovery requests predates *Enron*, but penalties for non-compliance have dramatically increased. While local courts in particular are increasingly less sympathetic to claims that legitimate business demands should excuse strict adherence with court orders, the case of *Perelman v. Morgan, Stanley* reminds us that courts are holding corporate litigants to new and higher standards, and are willing to impose drastic penalties for compliance failure. In May, a Florida judge lost patience with Morgan Stanley's failure to produce thorough electronic discovery in a timely manner and entered a partial default judgment directing the jury to assume that Morgan Stanley had acted fraudulently, setting the stage for a potentially crippling award against the investment giant.

Morgan Stanley had advised Sunbeam in its 1998 acquisition of Perelman's camping gear company, Coleman Co. Sunbeam filed for bankruptcy in 2001, and Perelman claimed that he lost millions when the value of his Sunbeam shares plummeted. In his suit, Perelman claimed that Morgan Stanley, motivated by a conflict of interest that made its own financial welfare paramount, had conspired with Sunbeam to defraud investors by misstating the value of Sunbeam's assets and stock.

As part of the discovery process, Perelman had demanded that Morgan Stanley produce voluminous information stored on PCs, PDAs, laptops, backup tapes and other electronic media. Morgan Stanley claimed that their repeated failures to comply with Perelman's discovery requests were inadvertent: there was no centralized repository of records or retrieval system and the requested documents were stored all over the company. However, Judge Elizabeth Maass was not persuaded. By directing the jury to conclude that Morgan Stanley had acted fraudulently, the jury had only to find that Perelman had relied upon the fraudulent statements when deciding whether to sell his controlling interest in Coleman and whether he suffered damages as a result. The jury returned a 1.45 billion dollar verdict. Post-verdict rulings have raised this number to 1.58 billion dollars.

Local businesses of all sizes should take two lessons from Morgan Stanley. The first is that courts are increasingly less deferential toward corporate explanations for failures to make full and timely discovery or to adhere to other elements of a Scheduling Order; and that every company must have an electronic media management policy that allows them to retrieve and produce discoverable emails when ordered to do so by a court.

These trends require that all parties enter litigation fully prepared to undertake and manage the burdens imposed by the court system. This means, among other things, halting all automatic email destruction practices *immediately* when litigation ensues; promptly considering the means of producing, as well as demanding, technology-based discovery at an early stage in the suit (if not before its is filed); and developing an intra-office program for maintaining, accessing, and organizing electronic media.

Because the absence of relevant emails can lead a judge to conclude that they were prejudicial, the party most prepared for the burdens of pre-trial practice is likely to have a significant advantage at the outset of litigation.

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"Getting It Done"

2000 14th Street North, Suite 100 Arlington, Virginia 22201
(703) 525-4000 fax (703) 525-2207
www.beankinney.com

The Battle Over Internet File Swapping, Part II – TKO
By Scott J. Spooner

The Supreme Court dealt yet another blow to the electronic transmission and downloading of copyrighted music and video files with its decision in Metro-Goldwyn-Mayer Studios, Inc. v. Grokster. In Grokster, the Supreme Court held that the defendant software developers had committed contributory copyright infringement by facilitating and encouraging the widespread transmission of copyrighted music and video files. In so ruling, the Supreme Court rejected the Ninth Circuit Court of Appeals' rationale that the software developers could escape liability by invoking the Sony non-infringing uses defense.

Before the 9th Circuit Court of Appeals, the software developers argued that they could not be held liable for contributory infringement because the peer-to-peer networking software is capable of "substantial non-infringing uses." The 9th Circuit Court of Appeals held that the software developers' defense prevailed under Sony Corp. of America v. Universal City Studios, Inc. In Sony, the Supreme Court held that the distribution of a commercial product capable of "substantial noninfringing uses" cannot give rise contributory liability for infringement without actual knowledge of specific instances of infringement. The 9th Circuit in Grokster reasoned that the Sony rule applied to bar a finding of infringement because the indexing models used by the defendants precluded knowledge of actual occurrences of copyright infringement by network users. Additionally, the software developers did not materially contribute to the users' copyright infringement since it was the users themselves who created the network and provided the access to the copyrighted material.

However, the Supreme Court did not agree with the 9th Circuit Court's reasoning. Rather, the Court held that "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." According to the Supreme Court in Grokster, Sony stands only for the proposition that third-party liability for contributory infringement attaches when a party intentionally induces or encourages infringement through use of the commercial product.

The Supreme Court explicitly recognized that the defendants' software was a product capable of noninfringing uses. The Court even observed that the defendants' peer-to-peer networking software facilitated the transmission and sharing of many non-copyrighted files, such as the works of Shakespeare and even briefs in the very case being decided. The Court also reasoned that, due to the nature of the peer-to-peer networks, the defendants did not have actual knowledge of discrete instances of infringement.

Nevertheless, the Court ruled that the absence of actual knowledge was not enough to insulate the defendants from liability as Sony was not intended to displace all theories of secondary liability. Instead, the defendants' direct encouragement of users to utilize the peer-to-peer networking software for infringing purposes was sufficient to find liability based on a theory of contributory infringement.

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TRAFFIC STOPS
By Martin J. Yeager

You are being stopped by the police. The blue lights and headlights are flashing behind you. Your palms are sweating and your heart is racing. You pull over, and look in the rear view mirror to see the officer speaking on his radio before coming to "greet" you. What do you do?

1. Calm Yourself. Now is the time for clear thinking, or thinking as clearly as you can if certain ingested substances make clear thinking more difficult. If the officer has not yet left his cruiser, obtain your driver's license, registration and insurance information. These documents should be at your immediate reach at all times, not buried in a mess of receipts, paperwork and other things generally found in the glove compartment. Once you have found them, wait with the documents in your hand, ready to give them to the officer.

If the officer has left his cruiser, you should wait with your hands on the steering wheel for him or her to come to your window. Your driver's window should be down and your hands should remain visible at all times. This is very important because a police officer is at his or her most vulnerable during a traffic stop. Sudden movements can lead to unfortunate consequences.

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2. Remain Polite and Cooperative. This is by far the most important instruction as it can mean the difference between receiving a summons and receiving a warning. This is your best opportunity to avoid receiving a ticket, or to receive leniency from the officer, not later in court.

You must remember that while in these circumstances the officer is not your friend, he or she is also not your enemy. If you are difficult with the officer, he or she will be much more difficult with you, because he can be. On the other hand, he will usually remember that you were polite and courteous and report the same to the Court, which does matter. Several judges in both Maryland and Virginia ask the officer whether the defendant was polite and courteous before imposing a sentence. Aside from proper etiquette, acting the way that Miss Manners taught you to can make a difference in the outcome of your confrontation.

3. Follow the Officer's Instructions, but Don't Volunteer Anything. Everyone has seen the "Miranda Warnings" given on television and in the movies. ("You have the right to remain silent . . ."), but very few people actually listen to or follow them. These simple warnings give specific instructions on how you can best protect yourself in your current situation.

The first warning is that you have the right to remain silent, but that if you give up the right to remain silent, anything that you say or do can be used against you. The police officer is a trained professional. When he stops you for a traffic infraction or worse, his job is to gather evidence that can be used to convict you of that traffic infraction or crime. While you need to remain polite and courteous, you do not need to help him with that process. If he asks you how fast you were going, you should not give him a number that is higher than the speed limit. If you do, he will place that "admission" in his notes, and you will convicted of doing at least that speed. If he asks you if you were racing with the car next to him, you should not say that you were, and never say that "at least I won" (four words that cost a young driver 3 days in jail).

The second Miranda warning is that you have the right to an attorney and that if you cannot afford one, the court will appoint one for you at no charge to you. In any interrogation setting, the magic words, "I want to speak with a lawyer" require the police to stop questioning you. You must ask for the assistance of a lawyer in very definite terms. It is not good enough to ask the officer if he or she thinks that you should see a lawyer, or that you think that you should speak with a lawyer. You must specifically ask for the assistance of a lawyer.

When making a traffic stop, the officer's job is to investigate to see if you are doing or carrying anything else that is against the law. One of the ways that an officer will carry out this duty is to search you and your automobile, but he can only do this with a court issued warrant or under very limited circumstances. The easiest way for the officer to search anything is if you give your permission, or consent to do so. You do not need to do this. It does not earn you any points, and could (if you have something in the car or your house that you do not want found) prove very costly. When the officer asks for your consent to search something, you should always say no, politely and courteously, but firmly. If the officer then chooses to search without your permission, you have at least not waived your constitutional rights.

4. Virginia's New Driving While Intoxicated Statute: In July 2004, Virginia enacted what is by far the toughest drunk driving statute in the country. For years, Virginia's blood alcohol limit was .08, and it still is. The newer statute, the first of its kind in the country, provides that if a person is found guilty of driving with a blood alcohol level of .15 or higher, the court must impose the mandatory minimum sentence of 5 days in jail. This means that in addition to a whole host of other lingering probation terms, you serve 5 full days in jail if you have more than a .15 percent alcohol in your bloodstream. There is only one way to establish this level; by testing either your breath or blood to determine if the level meets the statutory threshold. If you find yourself with the blue lights flashing behind you and you know that you have been drinking, you have the option to refuse to provide your blood or breath for analysis. This option does not come without a cost, namely that for a first offense you may lose your privilege to hold a Virginia driver's license for one year, however, that might be a small price to pay for staying out of jail for 5 days.

Good luck, drive safely and remember these tips if you ever have an encounter with law enforcement for something more than retrieving a cat in a tree.

Contact Us

2000 14th Street North, Suite 100 Arlington, Virginia 22201
(703) 525-4000 fax (703) 525-2207
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The Court also found significant the fact that the defendants both sought to satisfy "a known source of demand for copyright infringement, the market comprising former Napster users." Neither defendant made an attempt to utilize filtering tools to diminish the infringing uses of their software. Both defendants were absolutely aware that users of their software were illegally downloading copyrighted material and the defendants even provided technical support to aid the network users in locating and playing copyrighted materials. Both defendants engaged in advertising "designed to stimulate others to commit violations." Based on these facts, the Supreme Court held that the defendants' intent to induce widespread copyright infringement was unmistakable.

The Supreme Court's decision in Grokster struck a decisive blow in favor of the record and movie industries and other industries predicated on the creation of mass-distributed copyrighted works. It remains to be seen whether the decision in Grokster will spawn even greater variations and mutations of peer-to-peer networking software, or whether the decision will deter others from attempting to enter the market to service the vast appetite for free copyrighted music and video files.

BEAN KINNEY & KORMAN PC
ATTORNEYS
2000 14TH STREET NORTH, SUITE 100
ARLINGTON, VIRGINIA 22201
"GETTING IT DONE"