Reconciling Shareholder Limited Liability with Vicarious Copyright Liability: Holding Parent Corporations Liable for the Copyright Infringement of Subsidiaries

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INTRODUCTION

A deeply rooted principle of corporate law is that shareholders of a corporation are insulated from liability for the acts of the corporation. However, there are exceptions to this rule. Under the corporate law doctrine of "piercing the corporate veil," plaintiffs can seek to hold shareholders liable for the debts and acts of a corporation when the corporate form is misused as a mere instrumentality or alter ego of its owner. Furthermore, corporate law principles recognize the direct liability of shareholders when they actually commit the transgressions on behalf of the corporation. Both of these doctrines require a thorough analysis of the relationship between the shareholders and corporation, as well as the relationship between the shareholders and the acts that create liability.

1. See, e.g., RESTATEMENT (SECOND) OF JUDGMENTS § 59 (1982).


3. See United States v. Bestfoods, 524 U.S. 51, 64–65 (1998) (stating direct liability under corporate law recognizes that those who commit the infringement will not be insulated from liability merely because they committed the wrongdoing through a corporation or subsidiary); see also infra Part II.B. Copyright law also holds one who commits the infringement directly liable. See 17 U.S.C. § 501(a) (2000) ("Anyone who violates the exclusive rights of the copyright owner ... is an infringer of the copyright or right of the author.").
Yet, in the copyright context, shareholders are not as well shielded from liability. While courts generally recognize that shareholders may be vicariously liable for the copyright infringing acts of a corporation, the test for determining shareholder liability is imprecise and unsettled. Under traditional vicarious copyright liability, a parent corporation may be held liable when it has the right and ability to supervise its subsidiary, and has a financial interest in the infringement. Some courts hold that a parent corporation will always meet this standard by virtue of its "legal control" of the subsidiary, and thus will always be liable for the copyright infringement of its subsidiary. However, other courts look to evidence that the parent exercised "actual control" over its subsidiary and require a "substantial and continuing connection" between the parent and subsidiary with respect to the infringing acts. This test is better suited to assessing the liability of a parent corporation in such situations, but it erroneously considers certain elements of the corporate relationship, such as the percentage of stock ownership by the parent, which creates incorrect presumptions as to parental "control" over the subsidiary.

Neither theory of vicarious liability works adequately when applied to a parent-subsidiary relationship. Instead, copyright law should incorporate elements of corporate law when determining whether a parent corporation is liable for its subsidiary's infringement. Rather than applying traditional vicarious liability theories in these instances, courts should employ a standard based on the extent of parental participation in the infringement, the purpose of the infringing activity, and whether the parent explicitly or implicitly endorsed the activity that resulted in the infringement.


5. See infra Part II.B.2. Another type of secondary liability, contributory infringement, generally holds that one who, with knowledge of copyright infringing activity, induces, causes or materially contributes to infringing conduct of another may be held liable as a "contributory" infringer. Gershwin Pub'lg Corp. v. Columbia Artiste Mgmt., Inc., 443 F.2d 1159, 1162 (2d Cir. 1971). However, that form of liability is beyond the scope of this paper.


7. See id.
Part I of this article discusses the liability of parent corporations for the acts of their subsidiaries under different theories of corporate law. Part II discusses the policy behind copyright law, the theory of vicarious liability under copyright law, and the policy behind that doctrine. Part III compares and contrasts the various ways courts have applied vicarious copyright liability or corporate law to either hold liable or absolve shareholders, investors, and parent corporations. Finally, Part IV argues the rules of vicarious liability under copyright law should consider corporate law doctrines when a plaintiff seeks to hold a parent liable for the acts of a subsidiary, and proposes a different standard for such a purpose.

I. CORPORATE LAW & POLICY

A. Limited Liability

An overriding doctrine of corporate law is that shareholders are traditionally shielded from the liability of a corporation whose shares they own. As a corollary, "[i]t is a general principle deeply ingrained in our economic and legal systems' that a parent corporation . . . is not liable for the acts of its subsidiaries." Thus, "it is hornbook law that 'the exercise of the "control" which stock ownership gives to stockholders . . . will not create liability beyond the assets of the subsidiary.'"

Section 6.22 of the Model Business Corporation Act codifies the limited liability of shareholders by specifying that a shareholder's obligation to the corporation is solely "to pay the consideration for which the shares were authorized to be issued." Moreover, the

8. See, e.g., Hambleton Bros. Lumber Co. v. Balkin Enters., Inc., 397 F.3d 1217, 1227 (9th Cir. 2005) (refusing to pierce the corporate veil of defendant corporation).
11. MODEL BUS. CORP. ACT § 6.22(a) (2005). The Model Business Corporation Act ("the Act") is designed as a general corporation statute to be enacted in whole or in part by state legislatures. Id. at Introduction. It was approved by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association ("ABA") and many states'
Act mandates that "a shareholder of a corporation is not personally liable for the acts or debts of the corporation." In addition, the vast majority of state incorporation statutes expressly insulate shareholders from liability for the debts or acts of a corporation. Some commentators have suggested this grant of limited liability is "the greatest advantage of incorporation" and "perhaps the distinguishing feature" of corporate law.

The purpose of granting limited liability to shareholders is to encourage investment in private entities. Two separate principles promote private investment. First, limited liability reduces risk aversion among shareholders. Without limited liability, an investor might avoid valuable investments because he is averse to the risk of losing his assets, no matter how small the risk. Even if an investor accepts the risk, the high monitoring costs unlimited liability requires might force him to forego the investment. By limiting the shareholder's risks, limited liability increases the availability of funds for financially riskier, but more valuable, corporate endeavors which, "[b]y hypothesis . . . are socially desirable projects." Second, limited liability encourages efficient investment strategies by separating "capital" from "skill." It allows individuals with capital, but no business management skills, "to invest in the enterprises of others."
Previously, some commentators suggested the fact that a corporation has a legal status "independent" of its shareholders justifies limited liability.\(^{20}\) They reasoned that corporate activities are distinct from shareholder activities, and a change in shareholder ownership should not affect the corporate entity.\(^{21}\) However, this justification has been "largely abandoned."\(^{22}\) The current view is that limited shareholder liability is "an attribute of the investment rather than of 'the corporation.'"\(^{23}\)

B. Exceptions to Limited Liability

However, there are exceptions to limited liability; shareholders may, in particular circumstances, be held liable for the acts of the corporation. First, the "alter ego" theory permits a court to "pierce the corporate veil" by reaching beyond the assets of a corporation in order to access its shareholder's assets. This doctrine allows piercing, and thus, indirect shareholder liability, "when, _inter alia_, the corporate form would otherwise be misused to accomplish certain wrongful purposes . . . on the shareholder's behalf."\(^{24}\)

In order to pierce the corporate veil in the parent-subsidiary context under the alter ego theory, generally a plaintiff must show: (1) there is such unity of interest and ownership that the subsidiary is a "mere instrumentality" of the parent; and (2) an overall element of injustice is present.\(^{25}\) When evaluating whether a corporation is a "mere instrumentality" of its shareholder/parent, courts must determine whether the shareholder has abused the corporate form by exercising "undue domination or control."\(^{26}\) Although the law varies between jurisdictions, under this analysis courts generally find relevant: (1) whether the corporation was insolvent; (2) whether dividends were paid; (3) whether there was a co-mingling of funds between the corpora-

\(^{20}\) Id. at 1212.
\(^{21}\) Id.
\(^{22}\) Id. at 1213.
\(^{23}\) Id. (quoting FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 11 (1991)).
\(^{25}\) Harris Rutsky & Co. Ins. Servs. v. Bell & Clements Ltd., 328 F.3d 1122, 1134–35 (9th Cir. 2003) (quoting Doe v. Unocal Corp., 248 F.3d 915, 926 (9th Cir. 2001) (per curiam) (reversing and remanding district court's determination that piercing the corporate veil was appropriate)).
\(^{26}\) See Fletcher v. Atex, Inc., 68 F.3d 1451, 1459 (2d Cir. 1995).
tion and the shareholder; (4) whether the shareholders represented themselves as being personally liable for the corporation; (5) whether the corporation functioned as a facade for the parent/shareholder; (6) whether corporate formalities were observed; and (7) whether the dominant shareholder siphoned funds away from the corporation. 27

Under a second corporate law doctrine, a parent may be found directly liable for the acts of its subsidiary. The Supreme Court of the United States held in United States v. Bestfoods, 28 where "the parent is directly a participant in the wrong complained of," and not simply a source of personnel and management who perpetuate the wrong, "the parent is directly liable for its own actions." 29 This form of liability, unlike piercing the corporate veil, focuses not on the corporate form, but on the parent's actual involvement in the acts that created liability. In Bestfoods, the Supreme Court stated that "[c]ontrol of the subsidiary, if extensive enough, gives rise to indirect liability under piercing doctrine, not direct liability." 30 Thus, in regards to direct liability, the existence of the parent-subsidiary relationship alone is irrelevant. 31 The inquiry is instead whether a parent "actually operated the business of its subsidiary." 32 It is immaterial if the acts com-

27. See Taylor Steel, Inc. v. Keeton, 417 F.3d 598, 605 (6th Cir. 2005); Patin v. Thoroughbred Power Boats Inc., 294 F.3d 640, 648–49 (5th Cir. 2002); Fletcher, 68 F.3d at 1458; Bolivar v. Pocklington, 975 F.2d 28, 33 (1st Cir. 1992); NLRB v. O'Neill, 965 F.2d 1522, 1529–30 (9th Cir. 1992); Phoenix Canada Oil Co. v. Texaco, Inc., 842 F.2d 1466, 1476 (3d Cir. 1988); LeRoux's Billyle Supper Club v. Ma, 602 N.E.2d 685, 689 (Ohio Ct. App. 1991) (holding that in deciding whether the company is an alter ego of the individual, Ohio courts consider such factors as: "(1) grossly inadequate capitalization, (2) failure to observe corporate formalities, (3) insolvency of the debtor corporation at the time the debt is incurred, (4) shareholders holding themselves out as personally liable for certain corporate obligations, (5) diversion of funds or other property of the company property for personal use, (6) absence of corporate records, and (7) the fact that the corporation was a mere facade for the operations of the dominant shareholder(s)").


29. Id. at 64–65 (quoting Douglas & Shanks, supra note 9, at 208); see also HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES 347 (3d ed. 1983) ("Apart from corporation law principles, a shareholder, whether a natural person or a corporation, may be liable on the ground that such shareholder's activity resulted in the liability.").


31. See Jacksonville Elec. Auth. v. Bernuth Corp., 996 F.2d 1107, 1110 (11th Cir. 1993) (holding a parent is liable if it actually exercised control over or was otherwise intimately involved in the operations of the subsidiary corporation).

32. See United States v. Kayser-Roth Corp., 910 F.2d 24, 27 (1st Cir. 1990) (stating
plained of occurred superficially through the subsidiary, so long as the parent can be said to have committed them.  

II. COPYRIGHT LAW AND VICARIOUS LIABILITY FOR COPYRIGHT INFRINGEMENT

A. Copyright Law and Policy

The Copyright Clause of the U.S. Constitution provides that Congress shall have the power "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." The federal power to enact copyright legislation is derived from this clause. The Copyright Act affords copyright protection to "original works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device."

The predominant philosophical framework underlying the Copyright Act is utilitarian. The purpose of copyright protection is not purely to reward the author, but rather to balance copyright protection, "which seeks to ensure a fair return to authors" and establish incentives for creation, with dissemination of the work, which promotes progress and advancement. Copyright law motivates the creative activity of authors and inventors by granting economic incentives, in the form of a limited monopoly, which permits authors to maintain exclusive control over their

that operator liability "requires active involvement in the affairs of the subsidiary").

33. See Bestfoods, 524 U.S. at 72-73 (holding parent corporation liable for CERCLA violations that occurred at the facility of its subsidiary). "The question is not whether the parent operates the subsidiary, but rather whether it operates the facility, and that operation is evidenced by participation in the activities of the facility, not the subsidiary." Id. at 68 (quoting Lynda J. Oswald, Bifurcation of the Owner and Operator Analysis Under CERCLA: Finding Order in the Chaos of Pervasive Control, 72 WASH. U. L.Q. 223, 269 (1994)).

34. U.S. CONST. art. I, § 8, cl. 8.
35. See U.S. CONST. art. I, § 8, cl. 18 (stating that Congress can make "[a]ll Laws which shall be necessary and proper for carrying into Execution the foregoing Powers.").
37. While this rationale is predominate in the United States, an alternative "natural law" justification is prevalent in Europe. See MARSHALL A. LEAFFER, UNDERSTANDING COPYRIGHT LAW § 1.7, at 18 (3d ed. 1999).
work. This limited monopoly "reflects a balance of competing
claims upon the public interest: Creative work is to be encouraged
and rewarded, but private motivation must ultimately serve the
cause of promoting broad public availability to literature, music,
and the other arts." Dissemination is achieved by allowing the
public to access the creation or invention after the limited period
of exclusive control has expired. The rationale is that the public
benefits from the creative activities of authors, and a copyright
monopoly is a necessary condition to the full realization of such
activities.

B. The Doctrine of Vicarious Copyright Liability

1. Statutory Support

While the Copyright Act provides liability for acts of copyright
infringement, it does not contain any provision explicitly provid-
ing for one party's liability based on infringing acts committed by
another party. However, while not expressly stated, the Act
does provide some support for indirect liability. Among the rights
granted to a copyright owner is the "exclusive right . . . to author-
ize" others to exercise the various rights under the copyright. One
can conclude that Congress's use of the term "exclusive right . . .
to authorize" creates liability for one who, without the au-
 thor's permission, authorizes another to engage in acts exclu-
sively granted to the author. Furthermore, the Act defines an
infringer as "[a]nyone who violates any of the exclusive rights of

39. See Universal City Studios, Inc. v. Sony Corp. of Am., 659 F.2d 963, 965 (9th Cir. 1981), rev'd on other grounds, 464 U.S. 417 (1984); see also Am. Geophysical Union v. Tex-
aco Inc., 802 F. Supp. 1, 27 (S.D.N.Y. 1992), aff'd, 60 F.3d 913 (2d Cir. 1994) ("C)opyright law celebrates the profit motive, recognizing that the incentive to profit from the exploita-
tion of copyrights will redound to the public benefit by resulting in the proliferation of
knowledge. . . . The profit motive is the engine that ensures the progress of science.").
40. Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975); see also Mazer v. Stein, 347 U.S. 201, 219 (1954) ("The economic philosophy behind the [Copyright
Clause] . . . is the conviction that encouragement of individual effort by personal gain is
the best way to advance public welfare through the talents of authors and inventors. . . .").
41. Sony, 464 U.S. at 429.
42. Id. at 434 ("The Copyright Act does not expressly render anyone liable for in-
fraction committed by another."); see also Demetriades v. Kaufman, 690 F. Supp. 289, 291–92 (S.D.N.Y. 1988) ("Federal copyright law, unlike patent law, does not expressly cre-
ate any form of derivative, third-party liability.").
44. Id. (emphasis added); see also Columbia Pictures Indus. v. Aveco, Inc., 800 F.2d 59, 62 (3d Cir. 1986); Peter Starr Prod. Co. v. Twin Cont'l Films, Inc., 783 F.2d 1440, 1443 (9th Cir. 1986).
the copyright owner."45 The term "anyone" can be read to include those who control, contribute to, or benefit from the infringement.46 A House Report in the legislative history of the Copyright Act also indicates that the Act intended to codify case law which allows vicarious copyright liability.47 The House Report notes that in order to be a vicarious infringer, "a defendant must either actively operate or supervise the [infringing activities], or control the content of the infringing [material], and expect commercial gain from the operation and either direct or indirect benefit from the infringement."48

Congress also endorsed secondary liability by enacting two statutes that shield some entities from such liability. First, under certain conditions, section 111(a) of the Copyright Act exempts passive carriers from liability arising out of secondary television transmissions of copyrighted material.49 Second, the Digital Millennium Copyright Act ("DMCA")50 includes a safe harbor provision for online service providers that shields them from monetary liability for infringing material posted or transmitted by their subscribers.51 As the Supreme Court stated:

The absence of such express language in the copyright statute does not preclude the imposition of liability for copyright infringements on certain parties who have not themselves engaged in the infringing activity. For vicarious liability is imposed in virtually all areas of the law, and the concept of contributory infringement is merely a species of the broader problem of identifying the circumstances in which it is just to hold one individual accountable for the actions of another.52

As a result, a long series of cases under the Act impose liability for acts of infringement committed by others.

2. The Shapiro Test

The United States Court of Appeals for the Second Circuit in Shapiro, Bernstein & Co. v. H.L. Green Co., Inc. was the first to establish the modern test for vicarious copyright liability. In Shapiro, Jalen Amusement Company directly infringed copyrights on sound recordings by manufacturing "bootleg" records. Jalen operated its business as concessionaire in various stores of H.L. Green Co. ("Green"). The copyright owners sued Green, claiming it contributed to and actively participated in the sale of the "bootleg" records. Several licensing agreements between Jalen and Green provided that Jalen and its employees were to "abide by, observe and obey all rules and regulations promulgated from time to time by H.L. Green Company, Inc." In addition, Green had the authority to discharge any of Jalen's employees believed to be conducting themselves improperly. The licenses also provided that Green was to receive a percentage of Jalen's gross receipts from the sale of records. The trial court found, based on these facts, that Green did not actively participate in the sale of the records and had no knowledge of the unauthorized manufacture of the records.

On appeal, the Court of Appeals for the Second Circuit reversed. The court evaluated two lines of cases involving vicarious infringers who exhibited varying degrees of involvement in the direct infringement. The first line of cases involved landlord-tenant relationships, which held that a landlord was not responsible for the infringing acts of a tenant if the landlord had no notice of the infringement. In contrast, the second line of cases, involving dance halls, held dance-hall proprietors liable for in-

53. 316 F.2d 304 (2d Cir. 1963).
54. Id. at 305-06.
55. Id. at 306.
56. Id.
57. Id.
58. Id.
59. Id.
60. Id.
61. See id. at 307-08; see also Charles S. Wright, Actual Versus Legal Control: Reading Vicarious Liability for Copyright Infringement into the Digital Millennium Copyright Act of 1998, 75 WASH. L. REV. 1005, 1011 (2000) (arguing that courts should use an "actual" control standard when evaluating vicarious liability of internet service providers).
62. See Deutsch v. Arnold, 98 F.2d 686, 688 (2d Cir. 1938); cf. Fromont v. Aeolian Co., 254 F. 592, 594 (S.D.N.Y. 1918) (holding that the landlord was not responsible for infringement when he had no notice of the infringement when he entered into the contract with the defendant).
fringing performances by bands and orchestras, regardless of whether the proprietor had knowledge of the works to be performed or the ability to control their selection.\textsuperscript{63} Because \textit{Shapiro} involved a relationship with a high degree of actual control and direct benefit, the court viewed the facts in that case as similar to the "dance hall" cases rather than the "landlord-tenant" cases and held Green liable for Jalen's infringement.\textsuperscript{64} The court found "[w]hen the right and ability to supervise coalesce with an obvious and direct financial interest in the exploitation of copyrighted materials . . . the purposes of copyright law may be best effectuated by the imposition of liability upon the beneficiary of that exploitation."\textsuperscript{65} Thus, the Second Circuit developed a two-prong test for determining vicarious liability; a plaintiff must prove the defendant had a right and ability to supervise the infringing activity and had an obvious and direct financial interest in it.\textsuperscript{66} This is widely accepted as the modern test for vicarious copyright liability and is applied by the vast majority of courts.\textsuperscript{67}

The first prong of the \textit{Shapiro} test focuses on a party's power to police the primary infringer. As the court in \textit{Shapiro} stated:

\begin{quote}
[T]he imposition of vicarious liability in the case before us cannot be deemed unduly harsh or unfair. Green has the power to police carefully the conduct of its concessionaire Jalen; our judgment will simply encourage it to do so, thus placing responsibility where it can and should be effectively exercised. Green's burden will not be unlike that quite commonly imposed on publishers, printers, and vendors of copyrighted material.
\end{quote}

\begin{itemize}
\item \textsuperscript{64} \textit{Shapiro, Bernstein & Co. v. H.L. Green Co.}, 316 F.2d 304, 308–9 (2d Cir. 1963).
\item \textsuperscript{65} \textit{Id.} at 307.
\item \textsuperscript{66} \textit{Id.}
\item \textsuperscript{67} See, e.g., \textit{Gordon v. Nextel Commc'ns, Inc.}, 345 F.3d 922, 925 (6th Cir. 2003); \textit{Nelson-Salabes, Inc. v. Morningside Dev., LLC}, 284 F.3d 505, 513 (4th Cir. 2002); \textit{A&M Records, Inc. v. Napster, Inc.}, 239 F.3d 1004, 1022–24 (9th Cir. 2001); \textit{Matthew Bender & Co. v. West Publ'g Co.}, 158 F.3d 693, 707 n.22 (2d Cir. 1998); \textit{Fonovisa, Inc. v. Cherry Auction, Inc.}, 76 F.3d 259, 262 (9th Cir. 1996); \textit{Hard Rock Café Licensing Corp. v. Concession Servs., Inc.}, 955 F.2d 1143, 1150 (7th Cir. 1992); \textit{Columbia Pictures Indus. v. Redd Horne, Inc.}, 749 F.2d 154, 160–61 (3d Cir. 1984). The Supreme Court has arguably endorsed this test as well. \textit{See Sony Corp. of Am. v. Universal City Studios, Inc.}, 464 U.S. 417, 435 (1984) ("The absence of such express language in the copyright statute does not preclude the imposition of liability for copyright infringements on certain parties who have not themselves engaged in the infringing activity.").
\item \textsuperscript{68} \textit{Shapiro}, 316 F.2d at 308.
\end{itemize}
However, subsequent court decisions interpret the "power to police" in different ways. Some courts hold that mere legal authority to control, not an actual exercise of control, is sufficient to show liability. These courts assign liability so long as the party has the potential ability to prevent infringement, even if the "ability" is founded only in a legal or contractual right. Under this view, it is relatively easy to satisfy the control requirement.

For example, in *Gershwin Publishing Corp. v. Columbia Artists Management, Inc.*, the plaintiffs sued Columbia Artists Management, Inc. ("CAMI"), claiming it was vicariously liable for its role in promoting concerts. At these concerts, which were sponsored by local concert associations, performers infringed copyrights in musical compositions. The court noted that while CAMI had no actual power to control the local associations or the artists, because the local associations depended on CAMI for direction in such matters, "CAMI was in a position to police the infringing conduct of its artists." Thus, the court relied on CAMI's "pervasive participation" in the associations to conclude that CAMI had the requisite ability to control, despite its lack of formal power to supervise the infringers.

In contrast, other courts employ a higher standard and require evidence of an actual exercise of control. These courts also assess the defendant's ability to prevent the infringement. However, unlike the legal control standard, this standard rejects control predicated upon a legal relationship. "Actual control requires more than the potential right to cease all activities undifferentiated from the infringement, the right to terminate other

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69. See, e.g., Fonovisa, 76 F.3d at 262–63; Gershwin Publ'g Corp. v. Columbia Artists Mgmt. Inc., 443 F.2d 1159, 1163 (2d Cir. 1971).
72. 443 F.2d 1159 (2d Cir. 1971).
73. Id. at 1160.
74. Id.
75. Id. at 1163.
76. Id.
79. See Banff, 869 F. Supp. at 1107–08.
activities, or the effective ability to terminate only after infringement is evident."\(^80\)

The Southern District of New York applied the actual control standard in *Demetriades v. Kaufmann*.\(^81\) In that case, the court evaluated the vicarious liability of a real estate broker who was involved in negotiations between a developer and landowner; the developer and landowner infringed a copyright in architectural plans.\(^82\) In its analysis, the court required "meaningful evidence . . . of control over the direct infringers."\(^83\) Although the broker was aware of the infringement and in a position to prevent it, the court held that potential ability to control the infringement was insufficient to impose liability.\(^84\)

The second prong of the *Shapiro* test is also subject to varying interpretations. Some courts require evidence of direct financial benefit.\(^85\) In *Softel, Inc. v. Dragon Medical & Scientific Communications, Inc.*,\(^86\) the Second Circuit held that Hodge, the president and shareholder of an infringing corporation, was not vicariously liable because the mere fact he owned shares of the corporation was "too attenuated to establish a sufficiently 'direct' financial interest in the exploitation of copyrighted materials."\(^87\) Conversely, other courts hold that a defendant can, as a matter of law, have a direct financial interest as a result of the legal relationship between it and the direct infringer.\(^88\)

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80. Wright, *supra* note 61, at 1013. Also note that the legislative history of the Copyright Act states, "a defendant must either *actively* operate or supervise the [infringing activities], or control the content of the infringing [material], and expect commercial gain from the operation and either direct or indirect benefit from the infringe[ment]." H.R. REP. No. 94-1476, at 159–60 (1976), as reprinted in 1976 U.S.C.C.A.N. 5659, 5775–76 (emphasis added).


82. *See id.* at 290–91.

83. *Id.* at 292–93.

84. *See id.* at 293–94.


86. 118 F.3d 955 (2d Cir. 1997).

87. *Id.* at 971–72 (citing *Shapiro*, 316 F.2d at 307–08).

The court in *Shapiro* deliberately excluded actual knowledge as a requirement for vicarious copyright infringement. The court noted that a dance-hall proprietor "is liable whether the bandleader is considered, as a technical matter, an employee or an independent contractor, and whether or not the proprietor has knowledge of the compositions to be played or any control over their selection." Since *Shapiro*, courts have consistently held that lack of knowledge is no defense.

C. Vicarious Copyright Liability Policy

The doctrine of vicarious liability "developed from the law of agency, specifically employer-employee relationships, in which the 'master' was held strictly liable for the torts of a 'servant.'" In this respect, "[v]icarious copyright liability is an 'outgrowth' of respondeat superior," imposing liability on those with a sufficiently supervisory relationship to the direct infringer. However, in the copyright context, vicarious liability exceeds the tra-
ditional scope of the master-servant theory. As noted above, the proprietor of a dance hall is liable for infringing performances of the orchestra, even if the orchestra is hired as an independent contractor and exclusively selects the music to be played. This broad net of liability is founded primarily on a policy of risk allocation:

When an individual seeks to profit from an enterprise in which identifiable types of losses are expected to occur, it is ordinarily fair and reasonable to place responsibility for those losses on the person who profits, even if that person makes arrangements for others to perform the acts that foreseeably cause the losses. The law of vicarious liability treats the expected losses as simply another cost of doing business. The enterprise and the person profiting from it are better able than either the innocent injured plaintiff or the person whose act caused the loss to distribute the costs and to shift them to others who have profited from the enterprise. In addition, placing responsibility for the loss on the enterprise has the added benefit of creating a greater incentive for the enterprise to police its operations carefully to avoid unnecessary losses.

As one commentator observed, "It is the innocent infringer who must suffer, since he, unlike the copyright owner, either has an opportunity to guard against the infringement (by diligent inquiry), or at least the ability to guard against the infringement (by an indemnity agreement . . . and/or by insurance)." Similarly, as the court noted in Shapiro, "Green ha[d] the power to police carefully the conduct of its concessionaire . . . our judgment will simply encourage it to do so, thus placing responsibility where it can and should be effectively exercised."

III. APPLICATIONS OF VICARIOUS COPYRIGHT LIABILITY TO SHAREHOLDERS, INVESTORS, AND PARENT-SUBSIDIARY ENTITIES

A. Individual Shareholders and Investors

Generally, copyright lawsuits against individual shareholders seek to hold them jointly and severally liable for the infringing


96. Shapiro, Bernstein & Co. v. H.L. Green Co., 316 F.2d 304, 308 (2d Cir. 1963) (citations omitted).

97. Id.
acts of the corporation. The resulting court decisions indicate that shareholder status alone is insufficient to impose vicarious liability. In *United States v. Washington Mint, L.L.C.*, the United States government sued a private mint for copyright infringement arising from its production of a gold coin replica. After finding the mint directly liable, the court found the mint’s sole shareholder, Suvon, and one of Suvon’s principals, Henry Cousineau, not vicariously liable. The court stated that “although Suvon is the controlling shareholder in the Washington Mint’s stock, status as an investor, without more, is insufficient . . . to impose liability for [copyright infringement].” Similarly, the court held “[although [Cousineau] has significant ownership interests in [Suvon], these interests are not alone sufficient to impose liability upon him for any of the violations alleged.” The court found that “although the government has shown that Cousineau is on the Washington Mint’s board of directors, it has not demonstrated that he had any direct participation in or control over its activities.” In *Softel, Inc. v. Dragon Medical & Scientific Communications, Inc.*, the court determined that Dragon’s President, Hodge, was not vicariously liable for Dragon’s copyright infringement. The court stated that “[the only evidence that Softel adduced . . . relating to the issue of Hodge’s supervisory capacities and financial interests was that Hodge was the president of Dragon and a shareholder.” Thus, at least in the individual shareholder context, courts do not find shareholder status determinative of supervisory ability.

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100. See id. at 1091–92.
101. See id. at 1106.
102. Id.
103. Id. The court also held that Suvon’s status as a shareholder would not cause him to be liable for trademark infringement. Id.
104. Id.
105. 118 F.3d 955 (2d Cir. 1997).
106. Id. at 971–72.
107. Id. at 971.
108. See also United States v. Washington Mint, L.L.C., 115 F. Supp. 2d 1089, 1106 (D.
Those cases that have found shareholders vicariously liable for the infringing acts of a corporation usually involved a shareholder who was also an officer or director of the corporation.\textsuperscript{109} While courts have not directly addressed the issue, cases tend to support the idea that an individual's position as a shareholder is only determinative of financial interest, while his position as a director or officer of a corporation is determinative of supervisory capacity.\textsuperscript{110} In \textit{RCA/Ariola International, Inc. v. Thomas & Grayston Co.},\textsuperscript{111} a record company brought suit against retailers and manufacturers who allowed customers to use a cassette tape recording machine for copyright infringement.\textsuperscript{112} The plaintiff also sued the manufacturer's president, James McCann.\textsuperscript{113} In finding McCann vicariously liable, the United States Court of Appeals for the Eleventh Circuit noted that as president, McCann instructed the direct infringers on what uses of the copiers to permit and that he had a direct financial interest in the manufacturer because he was a fifty percent shareholder.\textsuperscript{114} Also, in \textit{Pinkham v. Sara Lee Corp.},\textsuperscript{115} the United States Court of Appeals for the Eighth Circuit found the president and sole shareholder of the direct infringer vicariously liable for copyright infringement.\textsuperscript{116} The court noted that, as president, he approved the sale of the infringing materials, and as sole shareholder, he had a financial interest.
in the sale of the infringing material. By examining a defendant's position in corporate management to determine supervisory ability, these decisions suggest that a defendant's status as shareholder does not indicate the requisite "ability to control" infringing activity. The holdings of Softel and Washington Mint lend support to this view.

B. Parent-Subsidiary Entities

In the parent-subsidiary context, courts take a different approach to determining vicarious copyright liability by employing one of three closely-related tests. Some courts use the traditional Shapiro test. Other courts recognize that "the mere potential to influence inherent in the parent-subsidiary relationship is inadequate to ground vicarious liability for infringement." These courts employ either a modified Shapiro test, or a "substantial and continuing connection" standard, to determine vicarious copyright liability of parent corporations for the acts of their subsidiaries.

1. Traditional Shapiro Analysis

In the few decisions that use the traditional Shapiro test, the courts rarely undertake a separate analysis under the two prongs of the test and do not explicitly state which facts are relevant to each prong. For example, in Data General Corp. v. Grumman Data Systems Corp., the court applied the Shapiro test to find Grumman Data liable for the infringing acts of its subsidiary, GSSC. In reaching this holding, the court simply stated that: (1) GSSC was a wholly owned subsidiary of Grumman Data; (2) two of GSSC's three directors were Grumman Data employees; (3) the President of GSSC was employed by and received his compensation from Grumman Data, not GSSC; (4) the President of GSSC reported directly to Grumman Data's President, who was also a GSSC director; (5) the entire first tier of GSSC's executives was employed by Grumman Data, not GSSC, and was responsible for conducting and supervising the everyday activities of GSSC; (6)

117. Id.
120. See id. at 930.
Grumman Data employees knew about and approved the alleged infringing conduct of GSSC; and (7) Grumman Data, as the sole owner of GSSC, benefited financially from GSSC's alleged infringing activity. By simply listing these factors, the court failed to specify which were applicable to the first prong and which were applicable to the second prong.

2. The “Substantial and Continuing Connection” Standard

The “substantial and continuing connection” standard was first set forth by the United States Court of Appeals for the Ninth Circuit. In *Frank Music Corp. v. Metro-Goldwyn-Mayer, Inc.* (“Frank Music I”), the Ninth Circuit affirmed the district court's holding that a subsidiary infringed the copyright in a dramatico-musical play, but remanded for reconsideration of the issue of whether the parent should also be liable. The court held that “[a] parent corporation cannot be held liable for the infringing actions of its subsidiary unless there is a substantial and continuing connection between the two with respect to the infringing acts,” and instructed the lower court to use this test in its determination.

On remand, the district court found the parent not liable, and the plaintiff again appealed to the Ninth Circuit. In *Frank Music II*, the Ninth Circuit once more reversed, finding the parent corporation had a sufficiently “substantial and continuing connection” to its subsidiary with respect to the infringing acts to be vicariously liable.

While the *Frank Music* test is somewhat vague as to what constitutes a “substantial and continuing connection,” the *Frank Music II* decision, as well as other decisions in courts that have adopted the test, are instructive. In finding the parent corporation vicariously liable in *Frank Music II*, the Ninth Circuit fo-

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121. *Id.* at 930–31; *see also* Brode v. Tax Mgmt, Inc., No. 88C 10698, 1990 WL 25691 (N.D. Ill. Feb. 1, 1990) (denying defendant's motion for summary judgment where plaintiff showed that there was an issue as to the company vice president's role in the company's copyrights infringement).
122. 772 F.2d 505 (9th Cir. 1985).
123. *Id.* at 519.
124. *Id.* at 519–20.
125. *Frank Music Corp. v. MGM*, Inc., 886 F.2d 1545, 1547 (9th Cir. 1989).
126. 886 F.2d 1545 (9th Cir. 1989).
127. *Id.* at 1553.
cused on the fact that: (1) the subsidiary was wholly owned by the parent; (2) the subsidiary used the parent's facilities for preparing the infringing performances; (3) the parent's legal counsel responded to the plaintiff's allegations of infringement; (4) the parent hired the subsidiary employee who created the infringing performances; (5) the subsidiary employee who created the infringing performances maintained an office at the parent; (6) the purpose of the infringing performances was to promote the parent; and (7) the employee who created the infringing performances actively consulted with personnel from the parent.\textsuperscript{128}

Other courts have endorsed the \textit{Frank Music} factors or incorporated them into the traditional vicarious liability test.\textsuperscript{129} These courts note that under the \textit{Frank Music} test, "there must be indicia beyond the mere legal relationship showing that the parent is actually involved with the decisions, processes, or personnel directly responsible for the infringing activity."\textsuperscript{130}

3. A Hybrid Approach Under \textit{Banff, Ltd. v. Limited, Inc.}

In \textit{Banff Ltd. v. Limited, Inc.},\textsuperscript{131} the court adopted a hybrid test, incorporating the \textit{Frank Music} standard into the traditional \textit{Shapiro} test.\textsuperscript{132} The court began its discussion with an analysis of \textit{Shapiro}, which noted the doctrine of \textit{respondeat superior} clearly placed vicarious liability for an employee's infringement upon the employer.\textsuperscript{133} The court stated that "[i]n the typical employer-employee relationship, it is reasonable to presume that the employer is intimately linked with and responsible for an employee's acts of infringement. Indeed, when acting within the scope of employment, an employee is presumed to be the employer's agent."\textsuperscript{134}

\begin{itemize}
\item \textsuperscript{128} \textit{Id.}
\item \textsuperscript{129} For cases endorsing the "substantial and continuing connection" standard, see \textit{Goes Lithography Co. v. Banta Corp.}, 26 F. Supp. 2d 1042, 1045 (N.D. Ill. 1998). \textit{See also} Howard Johnson Co. v. Khimani, 892 F.2d 1512, 1518 (11th Cir. 1990) (applying the \textit{Frank Music} test in the trademark context); \textit{Banff Ltd. v. Limited, Inc.}, 869 F. Supp. 1103, 1108–09 (S.D.N.Y. 1994).
\item \textsuperscript{130} \textit{Banff}, 869 F. Supp. at 1109.
\item \textsuperscript{131} 869 F. Supp. 1103 (S.D.N.Y. 1994).
\item \textsuperscript{132} \textit{Id.} at 1109–10.
\item \textsuperscript{133} \textit{See id.} at 1107 (citing \textit{Shapiro, Beinstein & Co. v. H.L. Green Co.}, 316 F.2d 304, 307 (2d Cir. 1963)).
\item \textsuperscript{134} \textit{Id.} at 1109.
\end{itemize}
However, the Banff court analogized the parent-subsidiary relationship as closer to a landlord-tenant relationship than an employer-employee relationship.135 "[T]he Shapiro court cited with approval a line of cases finding no vicarious liability for landlords leasing property . . . to tenants engaged in infringing activities."136 Although the Banff court recognized that an employer-employee relationship carries with it a presumption that one party’s acts are attributable to the other, this is not so in a landlord-tenant relationship, and "[l]ike the landlord-tenant relationship, the parent-subsidiary relationship is not marked by [this] presumption."137 Discussing the issue of the exercise of control a parent may exert over its subsidiary, the Banff court focused on the independent nature of subsidiary corporations, stating:

A subsidiary possesses an independent legal existence; it may organize its affairs and make its decisions completely independently of its parent. Of course, it may also do the opposite and organize its affairs and make its decisions according to the direction of its parent. That parent’s influence, however, is characteristic only of that particular parent-subsidiary relationship, and is not inherent in the nature of the relationship in either legal or practical terms. Given that the actual exercise of control cannot be presumed from the mere power to control, it is logical to require evidence of actual control and supervision before holding the parent liable.138

Thus, the Banff court rejected a presumption that a parent always, as a matter of law, controls its subsidiary.139 It found such a presumption unworkable.140 As the court stated, "The case is easiest when the parent wholly owns the subsidiary, but what of a parent that owns 51% of its subsidiary? Or perhaps 40% of the subsidiary, making it the largest shareholder? The need to determine whether actual control is exercised is inevitable."141

The Banff court established that, in order

to prevail against a parent corporation on the theory of vicarious copyright infringement, . . . the plaintiff must show that the parent has a direct financial interest in the infringing activity, and that the

135. See id.
136. Id. (citing Shapiro, 316 F.2d at 307).
137. Id.
138. Id. at 1109–10.
139. See id.
140. See id. at 1110 n.6.
141. Id.
parent has the right and ability to supervise the subsidiary, which is evidenced by some continuing connection between the two in regard to the infringing activity.\textsuperscript{142}

Following \textit{Banff}, other courts have adopted this rule as well.\textsuperscript{143}

4. Per Se Liability

At least one court has held that, as a matter of law, a parent corporation is always liable for the infringing acts of its subsidiary. The United States District Court for the Northern District of Illinois, in \textit{Broadcast Music, Inc. v. Hartmarx Corp.},\textsuperscript{144} held that the defendant, Hartmarx, a holding company, was vicariously liable for infringing public performances of copyrighted musical compositions at two stores owned by the defendant's subsidiaries.\textsuperscript{145} The court stated:

\begin{quote}
We also find as a matter of law that Hartmarx has the right and ability to supervise its subsidiaries—that is, to guard against or police the allegedly infringing activity. Our conclusion rests in part on the legal relationship between Hartmarx and its subsidiaries. Because Hartmarx owns a controlling interest in the subsidiaries, it elects the Board of Directors, who in turn select each subsidiary's officers. Control over the Board, then, in effect equals control over the subsidiaries' officers. Since the officers run the day-to-day affairs of the subsidiary, control of those officers in turn equals the right to control even the day-to-day matters of the subsidiary. Though Hartmarx makes much of the fact that it merely makes "recommendations" to the subsidiaries' CEOs and that the CEOs do not always comply, it cannot be disputed that if a CEO refuses to "cooperate," Hartmarx can simply, through its power over the Board, have her removed. Thus, it is clear to us that Hartmarx has the right to supervise its subsidiaries' activities—down to a subsidiary's unlicensed use of copyrighted music—through its power to remove recalcitrant officers. It is the existence of the right to supervise, not whether Hartmarx in fact chose to exercise that right, that is at issue.\textsuperscript{146}
\end{quote}

\textsuperscript{142} Id. at 1110.


\textsuperscript{144} No. 88 C 2856, 1988 WL 128691 at *3 (N.D. Ill. Nov. 17, 1988).

\textsuperscript{145} Id. at *1, *4.

\textsuperscript{146} Id. at *3.
However, in *Goes Lithography Co. v. Banta Corp.*, the holding was later criticized by a different judge sitting in the same district court. There, the court declined to adopt the holding that a parent company's power to supervise and control the conduct of a subsidiary may be inferred solely from the parent-subsidiary relationship. In fact, the court used the test set forth in *Banff*.

No case since *Broadcast Music* has taken such a strict view of vicarious copyright liability.

IV. INCORPORATING VICARIOUS LIABILITY AND CORPORATE LAW PRINCIPLES WITH THE ACTUAL CONTROL STANDARD

A. Courts Should Use the Actual Control Standard When Evaluating Parental Liability for the Acts of a Subsidiary

1. Incentives to Supervise

Any test for vicarious copyright liability must create incentives for limited supervision in order to increase copyright protection but maintain the separate nature of corporate ownership and management. Requiring mere legal control would create greater incentives for heavy supervision. If a parent could be found vicariously liable based solely on ownership of the subsidiary, it would be forced to monitor all the subsidiary's operations in order to ensure no infringement occurs, thus shielding itself from liability. This intense level of supervision would be in direct conflict with corporate law principles that encourage a separation between shareholders and management, and the limited liability of shareholders. In addition, if a parent or other majority shareholder was too controlling of its subsidiary, the rights of the other shareholders would be diminished. As the court noted in *Banff*,

147. 26 F. Supp. 2d 1042 (N.D. Ill. 1998).

148. *See id.* at 1045 (citing *Broadcast. Music*, 1988 WL 128691, at *3); *see also* Seals v. Compendia Media Group, 290 F. Supp. 2d 947, 953 n.5 (N.D. Ill. 2003) (explaining that *Goes Lithography* declined to adopt the holding that a parent company's power to supervise and control infringing conduct of a subsidiary may be inferred solely from the parent-subsidiary relationship, but did not reject the *Hartmarx* analysis of the direct financial benefit prong).


150. In the case of a wholly owned subsidiary, the rights of minority shareholders
“the formal relationship between parties is not the driving force behind liability.”

Furthermore, the heavy supervision required by a legal control rule would expose the parent to liability under other causes of action. If copyright law insists on forcing a parent to dominate its subsidiary and treat it merely as a division of the parent rather than as a separate corporation, the veil would be pierced for all purposes. Thus, the parent’s assets would be exposed not only to infringement claims, but to all the subsidiary’s creditors. This illogical result reveals that traditional corporate law doctrines are better suited for determining liability than copyright law.

In addition, courts recognize the considerable cost of requiring parties to institute extraordinary measures to supervise may outweigh the benefit of monitoring the direct infringer. In *Artists Music, Inc. v. Reed Publishing (USA), Inc.*, the plaintiffs—copyright owners sued Reed, a trade show organizer, when Reed rented out booths at a trade show to direct infringers. The plaintiffs argued Reed could have policed the exhibitors to prevent infringement of plaintiffs’ copyrights in songs played at the exhibitioners’ booths. However, Reed pointed out that in order to police the infringers, “[it] would have had to hire several investigators with the expertise to identify music, to determine whether it was copyrighted, to determine whether the use was licensed, and finally to determine whether the use was a ‘fair use.’” The court held that “[t]he mere fact that [Reed] could have policed the exhibitors at great expense is insufficient to impose vicarious liability.”

Likewise, in the corporate context, the cost, in terms of the effect on the corporate entity, of forcing a parent corporation to overly monitor and become involved in the activities of its subsidiary outweighs the benefit of enforcing infringement against the parent. The financial burden that results from maintaining
such a high level of supervision would greatly hinder the overall economic success of a corporation. This effect is critical to consider, particularly for the corporate world, because corporations function almost exclusively on cost-benefit principles in every aspect of their operation. Thus, such a legal principle would bring business to a grinding halt when costs begin to outweigh benefits.

However, requiring evidence of actual control would create incentives for limited supervision. First, a parent corporation which does not supervise the acts of a subsidiary risks damaging its investment. If the subsidiary is found liable for infringement, it will be forced to pay damages and submit to other remedies. In addition, the business reputation of both the subsidiary and parent would be tarnished, thereby negatively affecting future business. Furthermore, if a subsidiary does infringe a copyright, a potential plaintiff would not necessarily be without a cause of action. Assuming a plaintiff could in fact prove infringement, the subsidiary, as the direct infringer, will always be liable. Then, if the assets of the parent corporation need to be reached, the remedies under the doctrines of piercing the corporate veil and direct liability would be available. Finally, although vicarious liability traditionally seeks to encourage those who have the means to prevent infringement to do so, corporate law doctrines seek to encourage investment without excessive interference with corporate management. Because the ultimate aim in granting copyrights is to "serve the cause of promoting broad public availability of literature, music, and the other arts," and limited shareholder liability is an "attribute of the investment rather than of the corporation," the law should encourage investment and accept the risk of some copyright losses, rather than discourage investment and provide wide-ranging enforcement of copyright violations.

An actual control standard would also encourage limited parental supervision without exposing the parent to liability. Absent a "substantial and continuing connection" related to the infringing activity, a parent could take steps to ensure a subsidiary is not engaged in copyright infringement. This would encourage limited supervision without the parent incurring liability, and a lack of complete interference with the subsidiary's operations

158. Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975).
159. EASTERBROOK & FISCHEL, supra note 23, at 11.
would shield the parent from liability under corporate law doctrines. 160

2. Factors Showing a “Substantial and Continuing Connection” Between the Parent and Subsidiary With Respect to the Infringing Acts

When evaluating a parent corporation’s degree of supervision and control over a subsidiary, courts should look for a “substantial and continuing connection” between them with respect to the infringing acts, similar to the analysis in Banff 161 and Frank Music II. 162 However, several factors are imperative to this determination that courts do not currently consider.

First, courts should look for evidence establishing the extent of parental participation in the infringement. This includes whether the subsidiary’s employees consulted with the parent’s employees in committing the infringement, and whether the subsidiary used the parent’s resources (e.g., facilities or distribution channels) in furtherance of the activity. If a parent’s resources were used to assist the infringement, then the parent had an opportunity to prevent the infringement by withholding its resources from the subsidiary. Evidence that the parent’s resources were used in furtherance of the infringing activity shows the parent has control over the activity, even if the parent was unaware of its infringing nature. 163

Second, courts should determine the purpose of the infringing activity. If the goal of the infringement was to directly benefit the parent, for example by promoting its trademark or its products, this would demonstrate the parent had both a direct interest in the activity and control over it. In contrast, if the purpose was to benefit only the subsidiary, parental interest and control would

160. For a discussion of the application of these policies in the case of wholly owned subsidiaries, see supra text at note 150.

161. See supra Part III.B.3.

162. See supra Part III.B.2.

163. Under this factor, a parent’s knowledge of the infringement is not a consideration. However, if the parent has knowledge of the infringing activity and allows its resources to be used in furtherance of the activity, it may be held liable under the doctrine of contributory infringement. As the Second Circuit stated, “One who, with knowledge of the infringing activity, induces, causes or materially contributes to the infringing conduct of another, may be held liable as a ‘contributory’ infringer.” Gershwin Publ’n Corp. v. Columbia Artists Mgmt., Inc., 443 F.2d 1159, 1162 (2d Cir. 1971).
necessarily be excluded. While one could argue any benefit to the subsidiary is also an indirect benefit to the parent by virtue of the parent's ownership of the subsidiary, this factor must look only to direct benefit. Indirect benefits to the parent, predicated solely on the legal relationship between the parent and subsidiary, do not indicate parental supervision, control, or involvement.

Finally, courts should evaluate whether the parent explicitly or implicitly endorsed the activity that resulted in infringement. This includes whether the parent proposed or initiated the infringing activity by directing the subsidiary to take such action, or whether it was solely the subsidiary's plan to commit the infringing act. This factor ensures that a parent will be liable if it formed the subsidiary for the sole purpose of engaging in the infringing activity, or if the parent directed an already existing subsidiary to undertake the infringing activity in order to shield itself from liability. Courts should also evaluate whether the parent endorsed the activity, or whether the parent disapproved or explicitly instructed the subsidiary not to undertake it. Parental direction and endorsement would establish substantial connection and control in the infringing activity. Conversely, parental disapproval or explicit instructions not to engage in the infringing activity would tend to establish little or no control. Whether counsel for the parent or counsel for the subsidiary responded to the plaintiff's allegations of infringement would also be relevant. Because the law should encourage limited supervision and dissuade claims of ignorance, under this factor, a complete lack of knowledge by the parent would neither help nor hurt its position. A parent seeking to avoid liability could not argue it simply did not approve the infringing activity; it must show it tried to prevent it. Evaluation of these elements of control ensures that a parent's "right to police" the subsidiary could in fact be exercised if the parent/shareholder chose to do so.164

164. See, e.g., A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1025 (9th Cir. 2001) ("To escape imposition of vicarious liability, the reserved right to police must be exercised to its fullest extent. Turning a blind eye to detectable acts of infringement for the sake of profit gives rise to liability."); Fonovisa, Inc. v. Cherry Auction, Inc., 76 F.3d 259, 261 (9th Cir. 1996) ("There is also no dispute for purposes of this appeal that Cherry Auction and its operators were aware that vendors in their swap meet were selling counterfeit recordings."); see also Gershwin, 443 F.2d at 1162 (citing Shapiro, Bernstein & Co. v. H.L. Green Co., 316 F.2d 304 (2d Cir. 1963), for the proposition that failure to police the conduct of the primary infringer leads to imposition of vicarious liability for copyright infringement).
As discussed above and reiterated by a substantial number of courts, a lack of knowledge is no defense to traditional vicarious copyright infringement.\[165\] However, in the parent-subsidiary context, knowledge of the infringement should be a relevant consideration. While in an employer-employee relationship there is a presumption that the parties are "intimately linked," and one party's acts are attributable to the other party, this is not so in the landlord-tenant relationship.\[166\] In the landlord-tenant relationship, lack of knowledge of the infringement is a factor in determining liability.\[167\] The decision in Banff explicitly noted that parent-subsidiary relationships are more analogous to landlord-tenant relationships than employer-employee relationships because in a parent-subsidiary relationship, "[a] subsidiary possesses an independent legal existence; it may organize its affairs and make its decisions completely independently of its parent."\[168\] Furthermore, while courts have found vicarious liability even when the defendant has no knowledge of the infringement or gives explicit instructions not to infringe, they have done so only when the parties are closely associated with each other.\[169\]

3. The Percentage of Stock Ownership Should Only be Determinative of the Financial Interest Prong

Notably absent from this analysis is the percentage of the parent's share ownership of its subsidiary.

165. See supra Part II.B.2.
167. See Shapiro, 316 F.2d at 307 (explaining that a landlord is not vicariously liable for a tenant's infringement where he does not have knowledge of the violation); see also Deutsch v. Arnold, 98 F.2d 686, 688 (2d Cir. 1938) (noting that more than just a landlord-tenant relationship must exist to impose vicarious liability); cf. Fromat v. Aeolian Co., 254 F. 592, 593 (S.D.N.Y. 1918) (holding that an innocent landlord cannot be liable for copyright infringement).
169. See, e.g., Rexnord, Inc. v. Modern Handling Systems, Inc., 379 F. Supp. 1190 (D. Del. 1974) (holding a defendant furnishing materials to a printer is liable if printer chooses to reproduce infringing matter from the materials even if defendant had instructed the printer not to do so); Bourne v. Fauche, 238 F. Supp. 745, 746-47 (E.D.S.C. 1965) (holding night club owners liable for performance of infringing songs, even though they had no knowledge or intent to infringe). Note that in Chappel & Co. v. Frankel, 285 F. Supp. 798, 800-01 (S.D.N.Y. 1968), and in Morser v. Bengor Prods. Co., 283 F. Supp. 926, 928 (S.D.N.Y. 1968), corporate officers were held liable as related defendants, although in Chappel, the defendant was unaware that the activities he directed were infringing, and in Morser, the infringing sales were made contrary to the defendant's instructions. However, in both of these cases, the defendants, by their acts, also caused the infringement. See Chappel & Co., 285 F. Supp. at 801; Morser, 283 F. Supp. at 928.
Contrary to many courts' evaluations of parent-subsidiary vicarious copyright liability, including the "substantial and continuing connection" standard as applied in *Frank Music*, the percentage of share ownership is irrelevant to a determination of actual control. Under the test proposed here, it has no part in the analysis. As is the case with individual controlling shareholders, courts should not infer that a parent corporation has control of a subsidiary merely because of its percentage of stock ownership.

The term "parent corporation" refers to a corporation that has effective control through majority or complete stock ownership of one or more subsidiary corporations.\(^{170}\) Courts generally treat a person or entity as having such power, and therefore as a controlling shareholder, in two situations: (1) when the person or entity owns a majority of the corporation's outstanding voting stock, and (2) when the person or entity does not own a majority interest but nevertheless exercises effective control over the corporation's business.\(^{171}\) Even assuming a parent corporation has full ownership of a subsidiary, or at least a number of shares sufficient to appoint the subsidiary's board of directors, this fact alone is insufficient to infer actual control over the decisions of the subsidiary. A controlling shareholder normally has the power to elect and remove the corporation's board of directors, who will, it is assumed, show allegiance to the interests of the shareholder who elected them.\(^{172}\)

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171. See, e.g., *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987); *Locati v. Johnson*, 980 P.2d 173, 176 (Or. Ct. App. 1999). If a shareholder holds less than a majority of the corporation's voting stock, the shareholder might still have effective control over the corporation. For example, the shareholder could have the effective ability to determine who serves on the board because the shareholder owns a significant portion of the corporation's stock and the remaining ownership of the corporation is widely dispersed. See, e.g., *Gottesman v. Gen. Motors Corp.*, 279 F. Supp. 361, 367-68 (S.D.N.Y. 1967) (holding that DuPont had the power to control General Motors despite the fact that DuPont only held 23% of the stock in the corporation), *remanded on other grounds*, 414 F.2d 956 (2d Cir. 1969).

172. See *Howing Co. v. Nationwide Corp.*, 927 F.2d 263, 268 (6th Cir. 1991) (stating that "a majority shareholder can control the corporation for its own benefit ... through the election of directors who favor its interests"), *vacated and remanded on other grounds*, 502 U.S. 801 (1991). However, some commentators have argued that in the case of wholly owned or nearly wholly owned subsidiaries, the "practical reality" is that the subsidiary is not very independent. Mendelson, *supra* note 14, at 1213-14. However, "a presumption that a parent can control its subsidiary would be unworkable. ... The need to determine whether actual control is exercised is inevitable." *Banff, Ltd. v. Limited, Inc.*, 869 F. Supp. 1103, 1110 n.6 (S.D.N.Y. 1994).
of the corporation. However, in each step the shareholder is further removed from the decision that ultimately results in copyright infringement. The directors and officers each have a fiduciary duty to act in the best interests of the corporation that is their employer.\textsuperscript{173} Thus, the directors and officers of a subsidiary are presumed to be acting in the best interests of the subsidiary, or the shareholders as a whole. Even in the case of staggered boards, where the parent and subsidiary have common directors, courts presume "that the directors are wearing their 'subsidiary hats' and not their 'parent hats' when acting for the subsidiary."\textsuperscript{174}

Furthermore, percent of stock ownership is misleading because it does not take into consideration the rights and powers of minority shareholders. Control over a board of directors does not depend merely on a percentage of shares, but rather depends on the percentage of shares owned when viewed in the context of the voting arrangements between the shareholders. For example, supermajority provisions and tenured shares can limit the ability of majority shareholders to "control" a corporation by requiring the consent or vote of minority shareholders. Also, often the only control minority shareholders can exercise is negative control indirectly related to any infringing acts.\textsuperscript{175} Investment companies and minority shareholders should not be required to "go to war to avoid vicarious liability, whenever a company in which it invests

\textsuperscript{173} In accepting the office, directors and officers impliedly undertake to give to the enterprise the benefit of their care and best judgment and to exercise the powers conferred solely in the interest of the corporation or the stockholders as a body or corporate entity and not for their own personal interests. See Glass v. Glass, 321 S.E.2d 69, 74 (Va. 1984); C.H. Leavell & Co. v. Leavell Co., 676 S.W.2d 693 (Tex. App. 1984); Wisconsin Ave. Assocs., Inc. v. 2720 Wisconsin Ave. Coop. Ass'n, Inc., 441 A.2d 956, 962–63 (D.C. 1982).

\textsuperscript{174} PHILLIP I. BLUMBERG, LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS § 1.02.1, at 12 (1992). But see Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 771 (1984) ("[A] parent and its wholly owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousnesses, but one.").

\textsuperscript{175} "Negative control includes, but is not limited to, instances where a minority shareholder has the ability under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of director's or shareholders." 13 C.F.R. § 121.03 (2006). There are various restrictions that companies enact during the planning stages of a corporation to secure minority shareholders' rights. See generally F. Hodge O'Neal, Minimizing Recurring Problems Through Prudent Planning Techniques, in MINORITY STOCKHOLDER RIGHTS: CORPORATE PLANNING AND LITIGATION STRATEGY 11–28 (1978).
plans to do something that might ultimately turn out to be a copyright infringement."\(^{176}\)

**B. Corporate Law Doctrines Allow Liability Where There is Overwhelming Control**

In practice, the degree of control that a parent actually exercises over a subsidiary varies. At one end of the spectrum, a parent may dictate major policy decisions but allow the subsidiary to act independently regarding its daily operations.\(^{177}\) In such a case, the percentage of share ownership does not resolve the "control" issue of vicarious copyright liability, and the analysis outlined above can be used to resolve liability. At the other end, a parent may dominate the subsidiary entirely and treat it merely as a division of the parent rather than as a separate corporation. In this instance, the corporate law doctrines of piercing the corporate veil and direct liability come into play, and are better suited to resolving liability in such a situation than copyright law.

**CONCLUSION**

The current tests courts employ to determine vicarious copyright infringement in parent-subsidiary relationships are ineffective, unreliable, and unsettled. The traditional Shapiro test does not differentiate "actual control" from "legal control," and in many cases, a parent corporation could be found liable under both

\(^{176}\) Shady Records, Inc. v. Source Enters., Inc., No. 03 Civ. 9944, 2005 WL 14920, at *26 (S.D.N.Y. Jan. 3, 2005). The test set forth in Part IV.A.2 would still be relevant even in the case of wholly owned subsidiaries. The argument that a parent corporation should face liability under traditional vicarious liability when its wholly owned subsidiary commits copyright infringement is appealing. However, several considerations weigh against this argument. First, the percentage of shares owned, even if one hundred percent, still does not determine "control." A parent may still allow a wholly owned subsidiary to independently conduct its daily operations and dictate only major policy. Also, the directors and officers of the subsidiary may be disregarding parental directives, even in the face of explicit instructions not to engage in the infringement. Second, the directors and officers of the subsidiary would still have a fiduciary duty to the subsidiary, and would be presumed to act in its best interests. Finally, if traditional vicarious copyright liability applied in the case of wholly owned subsidiaries, but the test set forth in Part IV.A.2 applied in the case of non-wholly owned subsidiaries, the parent could escape the traditional test for liability by merely selling nominal shares to a third party. If the parent was no longer the sole owner of the subsidiary, a fact-based determination of control would be inevitable, and the test set forth in Part IV would apply.

prongs of the test by virtue of its mere legal relationship to its subsidiary. The "substantial and continuing connection" standard under Frank Music is more effective, but it is imprecise and improperly considers the parent's percentage of stock ownership. Finally, the Banff test is the most useful, but it does not consider various factors that should be determinative of liability, and does not recognize knowledge of the parent corporation as a factor in determining liability.

A more effective test looks to factors evidencing actual control, including the extent of parental participation in the infringement, the purpose of the infringing activity, and whether the parent explicitly or implicitly approved or endorsed the activity that resulted in infringement. This test would dissuade both overbearing corporate control and willful ignorance, and create incentives for the limited supervision of subsidiary corporations to prevent copyright infringement, thus satisfying both the needs of copyright enforcement and corporate law doctrines. When parental supervision is too heavy, the corporate doctrines of piercing the corporate veil and direct liability serve to hold the parties involved responsible. When parental supervision is too light, a parent risks damaging its investment by allowing copyright infringement, and copyrights will still be enforced to the extent that the formal relationship between the parent and subsidiary is not the driving force behind the liability.

Even if this standard somewhat favors shareholder protection, the law must ensure that it encourages investment without excessively holding related defendants liable. Such a doctrinal framework guarantees the realization of the ultimate aim of copyright, which is not to reward authors, but rather to "serve the cause of promoting broad public availability of literature, music, and the other arts."178

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178. Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975).