



Suing Your Customers: A Winning Business Strategy?

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The recording industry has a pricing problem. People do not want to pay \$15-20 for a compact disc when they can download the same music for free over the Internet. The industry's solution appears as novel as the technology that is giving it such headaches: launch hundreds of lawsuits against otherwise law-abiding consumers who download music. But, as Wharton legal studies professor [G. Richard Shell](#) writes below, this same tactic was tried 100 years ago against Henry Ford. It didn't work then, and it won't work today. Shell is author of a forthcoming book on legal and business strategy.



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After all, the music industry has invested billions of dollars in its product and thought it had iron-clad intellectual property protection for these investments – copyrights in recorded songs issued by the United States government. But having a strong legal claim on the merits is only one factor in legal strategy success. Indeed, this factor is often the least important one from a business point of view. Other key strategic considerations include the public legitimacy of an industry's legal attack (i.e. how the move will play in the court of public opinion), the vulnerability of an industry's strategic position in its market, the resources it has available to sustain a legal war, and the access an industry has to important legal decision makers such as regulators and legislators who can make new rules in the industry's favor.

The recording industry balanced these factors well in its initial legal strategy – suing online distribution companies such as Napster. Napster was a direct threat with no legitimacy of its own. Its only appeal was whimsy: Average citizens thought its creator, Shawn Fanning, had a neat, new technology. But they also recognized that Fanning was selling the key to somebody else's candy store. Nobody formed a "Free Fanning" committee to bail him out of legal trouble.

The recording industry, however, has gone one step too far with its latest legal move. Suing your customers is not a winning business strategy. Industries have a completely different strategic relationship with customers than they do with rivals. And this sort of strategy does not play well in the court of public opinion.

But it's hardly the first time an industry has tried to solve strategic problems using litigation against its customers. And the strategy is no more likely to work today for the recording industry than it did 100 years ago, when the leading automobile manufacturers in 1903 tried to put down the threat of cheap, mass-produced cars by suing consumers who bought Henry Ford's automobiles. Napster founder Shawn Fanning may have little else in common with Henry Ford, but both men sparked a wave of innovation that transformed their worlds. And both brought down the wrath of incumbent industry associations which tried to stop their new technologies with litigation. The story of Henry Ford's eight-year legal battle with the "Association of Licensed Automobile Manufacturers" is a cautionary tale for today's Recording Industry Association of America.

In 1903, when Henry Ford launched the Ford Motor Company, his third attempt at making cars, automobiles were high-priced, custom-made playthings for the rich. What's more, the major manufacturers had figured out a way to keep it that way. They had acquired a strategic property right very much like the recording industry's copyrights on recorded songs. It was called the Selden Patent and it gave its owners the exclusive right to sell a very basic invention: self-propelled vehicles powered by

internal combustion engines. Many people in the car business thought this patent was an outrage – much as some online retailers today are angry that Amazon.com received a patent on its “One-Click” checkout system. But the U.S. Patent Office had issued the Selden Patent and a group of powerful incumbents had purchased it and formed an association to enforce it. Litigation, then as now, was very expensive – especially for start-up companies with limited working capital. Nearly every car company fell into line to pay royalties to the Association for the privilege of making and selling cars.

Except Henry Ford. The association did not want another competitor in Detroit and it did not like his idea of driving prices down to where average people could afford a car. So it refused to license him. For Ford, it was either exit the industry or fight the Selden Patent in court. He decided to raise a legal war chest and fight the incumbents. The litigation lasted from 1903 until 1911 and along the way, the association launched hundreds of lawsuits against Ford’s customers to scare them away from his showrooms for buying “unlicensed vehicles.”

Most ordinary people of Ford’s era had been content to stand by and watch the automobile makers slug it out over the Selden Patent. It was just an industry cat fight. But when the big “money men” started suing ordinary people who were just trying to buy a cheap car, public sympathy shifted against the incumbents. People rallied to Ford’s side against the bullies. Editorials weighed in against the industry’s heavy-handed lawsuits, and Ford helped his own case by purchasing litigation insurance for his customers. By the time the patent litigation was over – Ford won on appeal in 1911 when the court ruled that the Selden Patent covered only cars made with a special type of engine nobody was using anymore – Ford was a hero, and the largest car manufacturer in America.

What can the Recording Industry Association of America take from Henry Ford’s story? First, you will never win your market by suing your customers. Quite the opposite: you will rally ordinary people to your opponents and alienate a generation of buyers. Exactly what has the industry gained by suing, among others, a 12-year-old girl in New York for downloading songs? A raft of bad publicity, a reputation for being a bully, and a new litigation insurance scheme devised by peer-to-peer software companies who can now cloak themselves in Robin-Hood green.

Worse still, the RIAA’s wholesale use of the Digital Millennium Copyright Act to obtain the names of telephone company customers for its lawsuit program has sparked a legislative reaction based on privacy concerns. Republican Senator Sam Brownback of Kansas recently introduced a new bill in the Senate to require judicial review of subpoenas such as those used by the recording industry to fuel its downloading cases. When Kansas Republicans start lining up with liberal Democrats against your industry, you’ve got a whole new kind of legal strategy problem.

Second, no legal rule is strong enough to overcome a radical technical innovation. Courts can delay progress but they cannot stop it. Unlike the automobile cartel that tried to stop Henry Ford, the recording industry’s copyrights are perfectly valid. But so are the speed limits on the interstate highway system. The fact that cars are designed to go faster than those speed limits explains why most people do so, regardless of the law. The Internet is designed to transfer data at zero marginal cost, so people want to download all kinds of things, including songs. Ultimately, no copyrights can stop that.

Third, innovation always drives the prices of yesterday’s technology into the dirt. The way to respond to the demise of the commercial CD is not to sue Internet-users. It is to figure out new ways to make money on music. Maybe concert ticket prices will have to rise. Perhaps groups should be giving more live performances on the web for premium prices. Innovative companies are beginning to sprout up all over the place with new ideas that incorporate digital music – such as selling customized CDs with mixes of a consumer’s favorite songs, video clips, and messages for friends. An Indian company called Saregama India is already doing this with music from old Hindi films and classical Indian artists. The U.S. music industry should be leading the way toward such new concepts, not lashing out at its customers like the angry, injured giant that chased Jack down his bean stalk.

As Henry Ford once summed it up, lawsuits against new technologies provide “opportunities for little minds ... to usurp the gains of genuine inventors ... and under the smug protest of righteousness, work a hold-up game in the most approved fashion.” What the recording industry needs now are new business models, not outdated legal strategies.

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