BERKELEY TECHNOLOGY LAW JOURNAL

VOLUME 20 NUMBER 1 PART 1 ANNUAL REVIEW 2005

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BERKELEY TECHNOLOGY LAW JOURNAL
ANNUAL REVIEW OF LAW AND TECHNOLOGY

INTELLECTUAL PROPERTY

MORRIS COMMUNICATIONS V. PGA TOUR: BATTLE OVER THE RIGHTS TO REAL-TIME SPORTS SCORES

By Andrea Freeman

The new form of instantaneous communication made possible by the Internet has created an exciting attraction for sports enthusiasts: real-time sports scores. Now, fans stuck at work or lacking access to live or televised sporting events can follow sports in real time by logging on to any number of sports websites. Major producers of sports news, such as Sports Illustrated and ESPN, sponsor websites that provide real-time sports scores, as do all of the major sports franchises, such as the National Basketball Association (NBA), the National Football League (NFL), the National Hockey League (NHL), and Major League Baseball (MLB). These sites appeal to a wide range of sports consumers, from high-stakes gamblers to casual fans.

Real-time scores represent a significant potential source of revenues for sports conglomerates.[1] This potential has created a competitive market for the scores and has led to litigation over who controls the right to disseminate and thereby profit from the information. Parties seeking to compete in the market have proceeded on different legal theories, including misappropriation, anticompetitive behavior, and copyright infringement.[2] Sports scores do not fit neatly into any intellectual property definition, and the only two cases to address the issue to date—*NBA v. Motorola, Inc.* and *Morris Communications v. PGA Tour*—drew different conclusions as to the proper categorization. While the *Motorola* court determined that real-time sports scores are mere facts that no one can own,[3] the *PGA Tour*

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1. *See* Louis Klein, *Misappropriation Doctrine:* National Basketball Association v. Motorola, Inc.*: Future Prospects for Protecting Real-Time Information*, 64 BROOK. L. REV. 585, 585 (1998) ("[R]eal-time information . . . may be the most sought after, highly prized species of information available."); Gary R. Roberts, *The Scope of the Exclusive Right to Control Dissemination of Real-Time Sports Event Information*, 15 STAN. L. & POL'Y REV. 167, 168 (2004) (arguing that the ability to profit from the sale of real-time information hinges on sports promoters' ability to gain exclusive rights to the information).

2. Bruce Keller argues that statutory law is inadequate to address the demands of high technology represented by real-time sports scores. Bruce P. Keller, *Condemned to Repeat the Past: The Reemergence of Misappropriation and Other Common Law Theories of Protection for Intellectual Property*, 11 HARV. J.L. & TECH. 401, 428 (1998).

3. Nat'l Basketball Ass'n v. Motorola, Inc., 105 F.3d 841, 847 (2d Cir. 1997).

court suggested that a compilation of scores constitutes property that the company who created the compilation may legally protect.[4]

This Note explores legal tactics and theories applicable to controversies over real-time sports scores. Part I describes the most recent case in the field, *PGA Tour*. Part II discusses two legal regimes that parties have used in attempts to create or deny ownership of real-time sports scores: the Sherman Act and the doctrine of misappropriation. In Part III, this Note compares the Second Circuit's treatment of real-time sports scores in *Motorola* to the Eleventh Circuit's analysis in *PGA Tour*, and concludes that, although both emphasized free-riding as central to their holdings, the courts ultimately based their decisions on varying interpretations of property issues. Next, the Part addresses these underlying property issues and contemplates how they may inform future attempts to protect real-time sports scores. Finally, this Note examines the broader interests of consumers and producers in the dissemination of real-time sports scores and how the courts might best serve those interests.

I. CASE SUMMARY

A. Facts

Plaintiff Morris Communications is a media company that publishes print and electronic newspapers;[5] defendant PGA Tours ("PGA") sponsors the most popular series of professional golf tournaments in the world.[6] PGA invested a substantial sum to develop a Real-Time Scoring System ("RTSS") to compile tournament scores. To operate the RTSS, PGA engaged volunteer "walking scorers" to follow each group of golfers on the course and tabulate the scores of each player.[7] "Hole reporters" then relayed this information to a production truck that compiled the scores and transmitted them to electronic leaderboards, distributed along the golf course, which typically reflected the scores of only the top ten or fifteen players, as well as to the on-site "media center" and the webpage "pgatour.com."[8] PGA prohibited the use of wireless devices by the press or public during tournaments, making the RTSS the sole source of compiled golf scores for the full list of tournament players.[9]

4. Morris Communications Corp. v. PGA Tour, Inc., 364 F.3d 1288, 1296 n.13 (11th Cir. 2004) [hereinafter *PGA Tour III*].

5. *Id.* at 1290.

6. *Id.*

7. *Id.* at 1290-91.

8. *Id.* at 1291.

9. *Id.*

PGA required media organizations to agree to a set of terms and conditions called the On-Line Service Regulations ("OLSR") to gain access to the media center. The OLSR mandated a delay in publishing scoring information until (1) thirty minutes after a player's shot or (2) PGA published scoring information on pgatour.com.[10] PGA revised the OLSR in January 2000 to prohibit credentialed media from selling or syndicating scoring information to uncredentialed third-party website publishers without a special license purchased from PGA.[11]

Prior to PGA's revision of the OLSR, Morris Communications—PGA's only major competitor in the syndication market for real-time golf scores[12]—had contracted with several Internet publishers to sell real-time scores from PGA tournaments.[13] In an effort to retain the potential profits from these agreements,[14] Morris Communications sought to enjoin PGA from enforcing the OLSR, alleging that the rules constituted four separate violations of section 2 of the Sherman Act: (1) a monopolization of the Internet markets; (2) an unlawful refusal to deal; (3) monopoly leveraging; and (4) an attempted monopolization of the Internet markets.[15]

B. Procedural History

Morris Communications filed a complaint and motion for a preliminary injunction in the district court in October 2000, seeking to prevent PGA from conditioning Morris Communications' accreditation for the Tampa Bay Classic on an agreement not to syndicate real-time scores.[16] Finding that "real-time golf scores represent the end product of a system which defendant has deliberately designed for their production," and that Morris Communications' claims constituted an attempt to free-ride on PGA's RTSS technology, the court denied Morris Communications' motion.[17]

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10. *Id.*

11. *Id.*

12. In fact, Morris Communications published real-time golf scores on the Internet before PGA. Initial Brief of Appellant at 8, Morris Communications Corp. v. PGA Tour, Inc., 364 F.3d 1288 (11th Cir. 2004) (Nos. 03-10226, 03-11502).

13. Morris Communications Corp. v. PGA Tour, Inc., 117 F. Supp. 2d 1322, 1325 (M.D. Fla. 2000) [hereinafter *PGA Tour I*].

14. Morris stood to lose approximately $280,000 due to the change in PGA's terms. *See* Jonathan Ringel, *PGA Media Fight Set to Tee Off at 11th Circuit*, FULTON COUNTY DAILY REP., Jan. 5, 2004 (reporting that Morris' contracts with CNN dropped from $430,000 to $150,000 under the new rules), http://www.law.com/jsp/article.jsp?id=1071719761758.

15. *PGA Tour III*, 364 F.3d at 1292.

16. *PGA Tour I*, 117 F. Supp. 2d at 1326.

17. *Id.* at 1329.

In December 2002, the district court granted PGA's motion for summary judgment on all counts, finding that PGA's desire to prevent Morris Communications from free-riding on PGA's investment in the RTSS constituted a valid business justification for the OLSR.[18] Morris Communications subsequently filed a motion for relief from judgment based on PGA's adoption of new terms of service.[19] Finding these new conditions beyond the scope of the initial lawsuit, the court denied the motion.[20]

C. The Eleventh Circuit's Analysis

The Eleventh Circuit reviewed *de novo* the district court's decision to grant PGA's motion for summary judgment on all counts, and further reviewed the court's denial of Morris Communications' motion for relief from judgment due to abuse of discretion.[21] Declaring intellectual property and First Amendment issues irrelevant, the court considered only whether PGA's restrictions on Morris Communications violated section 2 of the Sherman Act.[22] The court found that they did not.

Asserting that any company, even a monopolist, that invests in a valuable product has a right not to provide that product to competitors for free, the court labeled Morris Communications' demands to syndicate the scores compiled by the RTSS without paying a license fee a "classic example of free-riding."[23] The prevention of free-riding provided PGA with a legitimate, pro-competitive reason to impose restrictions on the media's access to its events;[24] the court's finding of a legitimate business justification for PGA's conduct effectively disposed of Morris Communications' claims.

The court only briefly reviewed each of Morris Communications' four antitrust claims. Referring to the first claim—monopolization of Internet markets—the court merely described the rules and elements of monopolization. It then concluded that "even if PGA is monopolistic, and even if

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18. *See* Morris Communications Corp. v. PGA Tour, Inc., 235 F. Supp. 2d 1269, 1285-87 (M.D. Fla. 2002) [hereinafter *PGA Tour II*].

19. The new terms required organizations wishing to use the information displayed on the PGA website for commercial purposes to purchase a license from PGA. *See PGA Tour III*, 364 F.3d at 1291.

20. *Id.* at 1292.

21. *Id.*

22. A summary of Morris Communications' attorney's arguments on these issues appears in John Hanusz, *11th Circuit Takes Swing at Real-time Golf Score Dispute*, FULTON COUNTY DAILY REP., Jan. 22, 2004, http://www.law.com/jsp/article.jsp?id=1074259249111.

23. *PGA Tour III*, 364 F.3d at 1298.

24. *Id.*

PGA refused to deal with Morris Communications, it has not violated section 2 of the Sherman Act" because PGA had a legitimate business justification for its actions.[25] The court then quickly disposed of the fourth claim—attempt to monopolize—in a footnote, explaining that its dismissal of the monopolization claim rendered this claim irrelevant.[26] The court then proceeded to the second claim: refusal to deal. As with the first claim, the court merely set out the attributes of a refusal to deal claim and then dismissed the claim without further analysis. Finally, the court declined to examine the monopoly leveraging claim, due to its similarity to the refusal to deal claim.[27]

For the claim of monopolization, once the court found that PGA's efforts to prevent Morris Communications from free-riding constituted a valid business justification for creating and enforcing the OLSR, the burden shifted to Morris Communications to show that PGA's proffered justification was merely pretextual. To meet this burden, Morris Communications relied on a series of cases involving defendants who prevented the sale of products that the plaintiffs had created or purchased themselves.[28] The court found these cases distinguishable because it was PGA, not Morris Communications, who compiled the golf scores.[29] The court also contrasted cases where defendants refused to sell to plaintiffs with the case at bar, where PGA had in fact demonstrated its willingness to sell by offering Morris Communications a license.[30] The Eleventh Circuit affirmed both the district court's summary judgment in favor of PGA on all counts and its denial of Morris Communications' motion for relief from judgment.[31]

II. LEGAL BACKGROUND

A. Section 2 of the Sherman Act

In *PGA Tour*, Morris Communications attempted to foreclose PGA's imposition of restrictions on Morris Communications' ability to sell compiled real-time golf scores to third parties by alleging violations of the

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25. *Id.* at 1295.

26. *See id.* at 1293 n.10. The court also indicated that the attempt to monopolize claim was harder to prove because of the additional intent requirement. *Id.*

27. *Id.* at 1294 n.11.

28. *Id.* at 1297 (citing Eastman Kodak v. Image Technical Servs., Inc., 504 U.S. 451 (1992); Aspen Skiing v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985); Lorain Journal v. United States, 342 U.S. 143 (1951); and others).

29. *Id.*

30. *Id.*

31. *Id.* at 1298.

Sherman Act.[32] Section 2 of the Sherman Act ensures that "[e]very person who shall monopolize, or attempt to monopolize . . . any part of the trade or commerce among the several States . . . shall be deemed guilty of a felony."[33] Monopolization has two elements: "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power, as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."[34] The plaintiff need not show that an attempt was successful; the Sherman Act also protects against "dangerous probability."[35]

With respect to the first element of monopolization, courts have defined monopoly power as the ability to control prices or exclude competition.[36] The relevant market generally refers to "commodities reasonably interchangeable by consumers for the same purposes."[37] To identify the relevant market, a trier of fact must decide whether a product is unique or has suitable substitutes.[38] Parties may be competing with each other either in or for the relevant market.[39]

As for the second element, "willful acquisition" requires predatory or unreasonably exclusionary acts or practices that prevent or exclude competition.[40] An act is predatory if it attempts to exclude rivals on a basis other than efficiency.[41] Finally, to satisfy an attempt to monopolize claim, a plaintiff must prove (1) predatory or anticompetitive conduct; (2) specific intent to monopolize; and (3) dangerous probability of achieving monopoly power.[42]

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32. These claims were: (1) monopolization of the Internet markets; (2) unlawful refusal to deal; (3) monopoly leveraging; and (4) attempted monopolization of the Internet markets. *See id.* at 1292.

33. 15 U.S.C. § 2 (2000).

34. United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966).

35. Lorain Journal Co. v. United States, 342 U.S. 143, 153 (1951).

36. United States v. Griffith, 344 U.S. 100, 107 (1948) (citing Am. Tobacco Co. V. United States, 328 U.S. 781, 809, 811, 814 (1946)).

37. United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 395 (1956).

38. Fishman v. Estate of Wirtz, 807 F.2d 520, 531 (7th Cir. 1986).

39. *Id.*

40. *See* Trans Sport Inc. v. Starter Sportswear, Inc., 964 F.2d 186, 188 (2d Cir. 1992).

41. *Id.* at 189 (citing Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 (1985)).

42. *See* United States v. Microsoft Corp., 253 F.3d 34, 80 (D.D.C. 2001).

Under the Sherman Act, possession of monopoly power is not unlawful unless the second element of monopolization is satisfied.[43] A defendant may also escape section 2 liability by demonstrating a valid business justification for its anticompetitive acts.[44] Under these circumstances, the burden shifts to the plaintiff to show that the justification is merely pretextual.[45] Consumer welfare is often a significant consideration when analyzing the validity of business practices.[46] By protecting competition, antitrust law ensures that a free-market system benefits consumers with prices regulated naturally by the marketplace.[47]

Generally, "a firm possessing monopoly power has no duty to cooperate with its business rivals."[48] However, some refusals to deal that extend monopoly power from one market into another violate the Sherman Act.[49] Courts have analyzed these types of claims using two primary tests: the essential facilities doctrine and the intent test.[50] Under the essential facilities doctrine, the owner of a facility that cannot easily be duplicated and to which access is necessary in order to compete in the relevant market must make that facility available to competitors on nondiscriminatory terms.[51] The facility in question need not be completely indispensable, but its duplication should be economically infeasible and denial of its use must inflict a "severe handicap" on potential competitors.[52] Under the intent test, a monopolist may not impair competition by intentionally excluding competitors unnecessarily.[53]

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43. Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP, 124 S. Ct. 872, 879 (2004) ("[T]he possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive *conduct*.").

44. *See Aspen Skiing*, 472 U.S. at 597. However, in a later decision, the Court determined that a defendant need not demonstrate valid business justification to escape section 2 liability in refusal to deal cases. *Trinko*, 124 S. Ct. at 881.

45. *Starter Sportswear*, 964 F.2d at 191.

46. Fishman v. Wirtz, 807 F.2d 520, 535 (7th Cir. 1986).

47. *Id.* at 536.

48. *Aspen Skiing*, 472 U.S. at 600.

49. *Fishman*, 807 F.2d at 539 (explaining that control of an essential facility may violate section 2 because it extends monopoly power beyond one market or production stage).

50. The Supreme Court has never explicitly approved of the essential facilities doctrine. *See Aspen Skiing,* 472 U.S. at 611 n.44 ("Given our conclusion that the evidence amply supports the verdict . . . we find it unnecessary to consider the possible relevance of the 'essential facilities' doctrine.").

51. *Fishman*, 807 F.2d at 539.

52. *Id.* (quoting Hecht v. Pro-Football, Inc., 570 F.2d 982, 992 (D.D.C. 1977)).

53. *See PGA Tour III*, 364 F.3d 1288, 1294 (11th Cir. 2004) (citing Mid-Texas Communications Sys. v. AT&T, 615 F.2d 1372, 1388 (5th Cir. 1980)).

B. Misappropriation

The Second Circuit used the doctrine of misappropriation to analyze claims involving real-time sports scores in *NBA v. Motorola, Inc.*[54] The doctrine of misappropriation, first declared in 1918, underwent a series of significant changes throughout the twentieth century and nearly disappeared after the abolition of federal common law in 1938.[55] In 1997, the *Motorola* court revitalized the doctrine, setting forth a list of elements for a "hot news" misappropriation claim.[56]

The Supreme Court created the federal common law claim of misappropriation in *International News Service v. Associated Press* ("*INS*").[57] In *INS*, defendant International News Service's (INS) copied news stories from the bulletins and early editions of plaintiff Associated Press (AP) east coast newspapers, selling the stories as its own in west coast markets.[58] The Court analyzed the case according to the principles of unfair competition law and determined that although news generally is not copyrightable, under the facts of the case, where AP had invested great effort and expense in its product, AP could enjoin INS from replicating and selling its stories.[59] Significantly, the Court afforded AP protection of its news stories only as long as the stories retained commercial value due to their newsworthiness.[60] Courts later interpreted this condition to mean that only parties in direct competition with each other that derive value from the de-

54. 105 F.3d 841, 852 (2d Cir. 1997). A number of interesting articles explore the significance of the *Motorola* decision. *See generally* Alan D. Lieb, NBA v. Motorola and Stats, Inc.: *The Second Circuit Properly Limits the "Hot News Doctrine"*, 16 J. MARSHALL J. COMPUTER & INFO. L. 197 (1999) (predicting that sports leagues will never be able to claim exclusive rights over real-time game information); Clifford N. MacDonald, *Gamecasts and* NBA v. Motorola*: Do They Still Love This Game?*, 5 N.C. J.L. & Tech. 329 (2004) (arguing that Congress should amend the Copyright Act to protect gamecasting).

55. *See, e.g.*, Erie R.R. v. Tompkins, 304 U.S. 64 (1938). For an extensive history of the misappropriation doctrine, see Edmund J. Sease, *Misappropriation Is Seventy-Five Years Old; Should We Bury It or Revive It?*, 70 N.D. L. REV. 781 (1994). Some commentators lament both the creation and return of the misappropriation doctrine. *See* Richard A. Posner, *Misappropriation: A Dirge*, 40 HOUS. L. REV. 621 (2003); Leo J. Raskind, *The Misappropriation Doctrine as a Competitive Norm of Intellectual Property Law*, 75 MINN. L. REV. 875 (1991) (suggesting a revision of the misappropriation doctrine based on the incorporation of competitive principles).

56. *Motorola*, 105 F.3d at 852.

57. 248 U.S. 215 (1918)

58. *Id.* at 231.

59. *Id.* at 242.

60. *See id.* at 245.

lay in the dissemination of information may succeed on a misappropriation claim.[61]

INS remained good law until 1938, when *Erie Railroad v. Tompkins* abolished federal common law, making federal misappropriation claims obsolete.[62] The tort of misappropriation survived as state law in many states, where courts often allowed it as a cause of action in cases involving copyright law.[63] Subsequent cases developed the "competitive injury requirement" more fully. In *National Football League v. Governor of Delaware*, the court refused to find misappropriation of the NFL's investments and reputation by a state football lottery, partly because the parties' businesses did not compete with each other and thus the defendants' actions did not harm the plaintiff in its primary market.[64] Later, in an influential dissent in *Board of Trade v. Dow Jones & Co.*, Justice Simon argued that in misappropriation cases, to preserve intellectual property's policy goal of balancing the incentives of authors and inventors with the public good, the owner of the property at issue must show that defendant's free-riding will inhibit the owner's continued production of the product or service at issue.[65]

In *Motorola*, the Second Circuit further clarified what remains of the misappropriation doctrine created in *INS*. The NBA sought to enjoin Motorola from disseminating real-time basketball scores and other statistics on a "Sportstrax" pager, which Motorola designed specifically for this purpose.[66] Motorola gathered information through reporters who watched games on television or listened to the games on the radio, sending information to a host computer that retransmitted the data via satellite to individual pagers.[67] Claiming that Motorola's actions infringed its rights to the scores, the NBA filed a claim of misappropriation. Because Motorola used its own resources to collect the data it transmitted on Sportstrax, the Second Circuit found that Motorola did not free-ride on the NBA's "hot news" property.[68]

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61. *See* Nat'l Football League v. Governor of Delaware, 435 F. Supp. 1372, 1377 (D. Del. 1977).

62. 304 U.S. 64 (1938).

63. For example, in *Del Madera Properties v. Rhodes & Gardner, Inc.*, 820 F.2d 973, 976 (9th Cir. 1987), plaintiffs accused defendants of misappropriating plaintiff's "time and effort" in creating a map and document.

64. *See* 435 F. Supp. at 1378.

65. 456 N.E.2d 84, 91-92 (Ill. 1983) (Simon, J., dissenting).

66. Nat'l Basketball Ass'n v. Motorola, Inc., 105 F.3d 841, 843 (2d Cir. 1997).

67. *Id.* at 844.

68. Free-riding is the third essential element of a "hot news" misappropriation claim. *Id.* at 845.

After surveying the history of misappropriation claims, the Second Circuit laid out the elements of a "hot news" misappropriation claim:

> (i) the plaintiff generates or collects information at some cost or expense,
>
> (ii) the value of the information is highly time-sensitive,
>
> (iii) the defendant's use of the information constitutes free-riding on the plaintiff's costly efforts to generate or collect it,
>
> (iv) the defendant's use of the information is in direct competition with a product or service offered by the plaintiff,
>
> (v) the ability of other parties to free-ride on the efforts of the plaintiff would so reduce the incentive to produce the product or service that its existence or quality would be substantially threatened[.][69]

Analyzing the NBA's claims according to these elements, the court found that Motorola's Sportstrax product did not interfere in any way with the NBA's primary markets, namely, live and television audiences for basketball games.[70] In fact, Motorola designed its product specifically to appeal to individuals unable to participate in either of these markets. Recognizing the existence of a separate market for "real-time transmission of factual information," the court determined that Motorola's Sportstrax did not free-ride on the NBA's similar Gamestats product because each company bore its own costs of collecting the information and the NBA did not demonstrate any damage arising from Motorola's alleged free-riding.[71]

Generally, courts analyzing claims under both the misappropriation doctrine and the Sherman Act have struggled to find a balance between regulating inappropriate behavior and allowing the free market to flourish.[72]

III. DISCUSSION

A. Sherman Act Violations

The *PGA Tour* court's determination that the prevention of free-riding constituted a valid business justification precluded any analysis of Morris

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69. *Id.* at 852.
70. *Id.* at 853-54.
71. *Id.* at 854.
72. First Amendment concerns may also weigh against findings of misappropriation in real-time sports score cases. *See* Note, *Nothing But Internet*, 110 HARV. L. REV. 1143 (1997).

Communications' antitrust claims, and thus left open the question of how a court would rule on the allegations if this justification did not exist. Additionally, the court's decision not to apply the essential facilities doctrine to the facts foreclosed an examination into whether denying Morris Communications access to the media center represented an exclusionary act that Morris Communications might have had better success litigating under the Sherman Act. This Note argues that because Morris Communications had the right to copy a compilation of facts under copyright law, the court should have rejected the prevention of free-riding as a valid business justification and proceeded with a thorough analysis of all of Morris Communications' claims.

1. Monopolization

Had the court analyzed Morris Communications' Sherman Act claims instead of relying on PGA's proffered business justification to dispose of them, the court would have concluded that PGA's monopoly of the compiled real-time scores was not unlawful.

When analyzing a monopolization claim, a court must identify the relevant market.[73] Although PGA's primary market was the market for golf tournaments or, more generally, large sporting events (placing it in competition with other popular spectator sports such as tennis and hockey), its success in these markets allowed it to expand and compete in other, related markets, such as the Internet. On the Internet, PGA competed for a share of the market for sports or golf-related websites and for dominance in the sub-market for real-time golf scores.

Morris Communications, whose primary market is print and electronic newspapers, competed with PGA in the market for real-time golf scores and its syndication. PGA held a monopoly in this market attributable either to its superior ability to satisfy consumers or to its exclusionary or predatory behavior towards its competitors. The court likely would not have found PGA's conduct to be predatory or exclusionary because PGA did not forcibly shut Morris Communications out of the syndication market for real-time scores. Instead, PGA used its position in the market to require a licensing fee from competitors in exchange for certain rights associated with access to PGA's private events. This conduct merely represents sharp business acumen, a lawful source of monopolization under the Sherman Act.

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73. *See* United States v. Grinnell Corp., 384 U.S. 563, 571 (1966).

An analysis of monopolization should also take into account potential harms or benefits to consumers flowing from the monopolist's actions.[74] In this case, different consumer interests would be served by PGA's monopoly than by Morris Communications' ability to compete for syndication, and it is unclear which would weigh more heavily.

On one hand, Morris Communications could decide not to pay PGA's licensing fee. Morris Communications might choose instead simply to abandon its contracts to syndicate the scores.[75] As a result, pgatour.com would have no competitors, and thus PGA would have little need to improve its site for an already captive audience of fans seeking real-time golf scores. The incentive for competitors to draw consumers by other means would increase, possibly creating more desirable golf-related websites, which would contribute to an overall increase in satisfaction for Internet-using golf fans.

On the other hand, Morris Communications could decide to pay the licensing fee. This would likely divert resources from other areas of its business that may have provided valuable services to consumers. However, if pgatour.com had to compete with other providers of real-time golf scores, PGA might devote more resources to its own website, thereby increasing consumer satisfaction. In light of these considerations, the court might have concluded that PGA's monopoly was not an unlawful one simply because it did not create a situation affecting consumers or the market greatly enough to satisfy the second element of monopolization. While this would dispose of the plaintiff's claims of monopolization and attempted monopolization, the court would still need to consider the refusal to deal and monopoly leveraging claims.

2. *Essential Facilities Doctrine*

Based on the property considerations discussed below, if the court had not accepted PGA's business justification, it might have applied the essential facilities doctrine to its analysis of Morris Communications' claims of refusal to deal and monopoly-leveraging. Morris Communications could make a persuasive argument that PGA's media center is an essential facility that PGA must make accessible to Morris Communications: without access to the center, Morris Communications simply cannot compete in the market for syndicated real-time golf scores. Moreover, the center cannot be duplicated; PGA's prohibition of the use of wireless devices elimi-

74. Fishman v. Estate of Wirtz, 807 F.2d 520, 535-36 (7th Cir. 1986).

75. This argument assumes that, under the circumstances, this decision would represent an efficient breach of contract.

nated any possibility of creating a system independent of the RTSS that would produce compiled real-time scores.

A finding that the media center is an essential facility would not only suggest that without PGA's valid business justification, Morris Communications would have succeeded on its refusal to deal claim. But, such a finding would also raise the issue of whether courts should allow businesses to deny the press the ability to cover events in order to preserve the organizers' own economic interests. This issue has arisen in relation to local coverage of Olympic events as well as in a recent European case disputing the rights to photographs of a soccer match.[76] *PGA Tour* suggests a leniency towards businesses engaging in self-help remedies and a reluctance to interfere with contracts freely made by independent parties—an approach later adopted by the Supreme Court in another refusal to deal case, *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*.[77]

B. Misappropriation

If the court had analyzed the facts of *PGA Tour* as a misappropriation claim brought by PGA, it would have found that the real-time golf scores do not meet the "hot news" exception and that PGA could not constrain Morris Communications from doing what it wished with the scores, including syndicating the information to third-party real-time sports scores providers. As plaintiff, PGA would probably meet the first four elements of a "hot news" claim: PGA generates and collects the information at some cost or expense; the value of the information is highly time-sensitive; Morris Communications' use of the information constitutes free-riding on PGA's costly efforts to generate or collect it; and Morris Communications' use of the information is in direct competition with a product or service offered by PGA.[78]

However, PGA would not succeed on the fifth element of the claim, which requires that Morris Communications' ability to free-ride on PGA's efforts would so reduce the incentive to produce the product or service that its existence or quality would be substantially threatened. PGA compiles

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76. *See* Doreen Carvajal, *Clash Over Internet Sports Photos*, INT'L HERALD TRIB., Oct. 25, 2004 (describing battles in Europe between soccer leagues and newspaper publishers over the right to control the release of photographs: "'What this is all about is football's awareness of the value of live or near-live publishing'"), http://www.nytimes.com/2004/10/25/technology/25photo.html?oref=login&th.

77. 124 S. Ct. 872, 881 (2004).

78. For the elements of a "hot news" misappropriation claim, see Nat'l Basketball Ass'n v. Motorola, Inc., 105 F.3d 841, 852 (2d Cir. 1997).

players' scores via the RTSS to determine the placement order of competitors and to reflect these scores to the players, the fans in attendance, and the general public. In fact, PGA created and maintained the RTSS to meet this essential business need for accurate scoring. Therefore, even if the court did not find misappropriation and allowed Morris Communications access to the real-time scores without requiring the payment of a licensing fee for the right to syndicate them, PGA would undoubtedly continue its operation of the system.

PGA did contend, however, that without the extra revenue it could generate by collecting licensing fees from Morris Communications and other potential competitors, it might not be inclined to invest in improvements to the RTSS.[79] Realistically, the licensing fee represents merely an extra opportunity for PGA to profit; PGA would continue to maintain the highest quality system possible to meet its own goals. Thus, because Morris Communications' actions would not "substantially threaten" the quality or existence of the RTSS, a misappropriation claim under these facts would fail.

C. Distinguishing *PGA Tour* from *Motorola*

The *Motorola* court based its holding on the fact that Motorola used its own resources to collect scores and thus was not free-riding on the NBA's efforts. Free-riding also informed the holding in *PGA Tour*, where the Eleventh Circuit found the prevention of free-riding to be a valid business justification for PGA's alleged anticompetitive acts.[80] The similarities between these two cases substantially end here.

Several facts distinguished *Motorola* from *PGA Tour*, causing the *PGA Tour* court to allow PGA to control the dissemination of real-time scores where the *Motorola* court refused to allow the NBA to do so. Whereas the public normally has access to basketball scores while a game is in progress, the scores of golfers participating in a PGA tournament are not as readily available.[81] Additionally, Motorola employed its own staff to collect the NBA scores; Morris Communications was unable to do this because PGA prohibited the use of wireless devices at tournaments.[82] This

79. Brief of Appellee at 11, *PGA Tour III*, 364 F.3d 1288 (11th Cir. 2004) (Nos. 02-10226c, 03-11503-cc) ("[T]o the extent we can't maximize or get some type of return on the investment that we're making in the scoring system, I think we would be less inclined to continue to try to improve it and make a better system.") (quoting PGA vice-president Edward Moorhouse).

80. *See PGA Tour III*, 364 F.3d at 1290.

81. *See Database Protection in the USA*, ius mentis, http://www.iusmentis.com/databases/us (last visited Jan. 24, 2005).

82. *PGA Tour III*, 364 F.3d at 1291.

prohibition gave PGA exclusive access to scores for the full list of players. Unlike the NBA, PGA also claimed a proprietary interest in both the system it used to compile scores and the results it produced. Furthermore, by predicating access to the media center on agreement to a set of rules requiring the payment of a licensing fee for the right to syndicate the scores, PGA maintained control over their dissemination.[83]

The Eleventh Circuit's holding in *PGA Tour* depended on PGA's "property interest" in its product.[84] Nonetheless, the court did not identify the source of this interest. In fact, in contrast to the *Motorola* court's in-depth discussion of copyright—the result of extensive briefing on the subject—the Eleventh Circuit began its analysis with an express rejection of copyright's relevance to the case.[85] Although the Eleventh Circuit declined to analyze copyright issues, these issues seem to lie at the heart of both the *Motorola* and *PGA Tour* decisions and to account for the tension that exists between them.[86] By failing to identify the source of the property interest it upheld, the *PGA Tour* court skirted the complex intellectual property issues underlying its holding—issues that the *Motorola* court expressly addressed.

D. Copyright Law

Had the Eleventh Circuit analyzed *PGA Tour* under copyright law, it would have found that PGA had no right to protect the real-time scores that it compiled. The compiled scores resemble the data compilations at issue in *Feist*. In that case, the Supreme Court held that despite the extensive labor and resources, or "sweat of the brow," invested in making data compilations such as telephone books, copyright law does not protect such compilations because they consist purely of uncopyrightable facts.[87] The *Feist* Court conceded that some elements of a data compilation, such as its

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83. *Id.*

84. *Id.* at 1296 n.13.

85. *Id.* at 1292 ("Before discussing the antitrust issues in this case, it is important to note what this case is *not* about. Contrary to the arguments of Morris and its *amici curiae*, this case is not about copyright law[.]").

86. For an analysis of *Motorola*'s effect on the protection of database contents, see David Djavaherian, *Hot News and No Cold Facts:* NBA v. Motorola *and the Protection of Database Contents*, 5 RICH. J.L. & TECH. 8 (1998). For commentary on preemption after *Motorola*, see Mark A. Feest, National Basketball Association v. Motorola, Inc.*: Does the Copyright Act Partially Preempt State Misappropriation Claims?*, 24 J. CONTEMP. L. 99 (1998); Jean Tibbetts, National Basketball Ass'n v. Motorola, Inc.*: Second Circuit Clarifies Copyright Preemption for New Technology*, 3 B.U. J. SCI. & TECH. L. 16 (1997).

87. Feist Publ'ns v. Rural Tel. Serv. Co., 499 U.S. 340, 363 (1991). Facts alone also are not copyrightable. Baker v. Selden, 101 U.S. 99, 102 (1880).

arrangement or presentation, could contain a spark of originality that afforded copyright protection to those specific elements.[88] However, the Court maintained that the law still would not protect the data itself.[89] The compiled scores produced by the RTSS were not arranged in any creative order, nor were they presented in a unique fashion; therefore, under copyright law, PGA could not protect these facts or their arrangement.

The *PGA Tour* court avoided this precedent by denying the relevance of any copyright case law. However, by allowing PGA to create and enforce a contract that let it ignore *Feist*'s holding, the court followed an alternate line of copyright cases. *ProCD v. Zeidenberg* and its progeny have condoned the expansion of copyright law through contract and rejected claims of federal preemption.[90] In *ProCD*, the Seventh Circuit upheld the plaintiff's right to control the use of facts contained in its database of telephone numbers by requiring purchasers to agree not to distribute or reproduce the numbers through a "shrinkwrap" license.[91] *ProCD* sparked a controversy over the scope of federal preemption and the extent to which parties may negotiate around the rules of copyright.[92]

Even if a party alleges state law claims that are facially unrelated to copyright, these claims may be preempted because copyright law bears on "all legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright."[93] Courts decide whether preemption comes into play by determining (1) whether the work falls under the subject matter of copyright[94] and (2) whether the rights granted

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88. *Feist*, 499 U.S. at 361-62.

89. *Id.*

90. *See, e.g.*, ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996) (upholding a contract prohibiting copying of plaintiff's telephone database even though plaintiff had no exclusive rights under the Copyright Act); Info. Handling Servs., Inc. v. LRP Publ'ns, Inc., No. Civ. A 00-1859, 2000 WL 433998, at *2 (E.D. Pa. Apr. 18, 2000) ("[T]he vast weight of authority holds that state law misappropriation and unfair competition claims that are really claims for unauthorized copying are preempted.").

91. *ProCD*, 86 F.3d at 1455. A shrinkwrap agreement is one that binds a consumer once she removes the packaging containing the product.

92. For more thorough analyses of the issues raised by this trend, see Mark A. Lemley, *Beyond Preemption: The Law and Policy of Intellectual Property Licensing*, 87 CALIF. L. REV. 111 (1999) (advocating the use of the copyright misuse doctrine and state and federal public policy to supplement contract preemption); David Nimmer et al., *The Metamorphosis of Contract into Expand*, 87 CALIF. L. REV. 17 (1999).

93. 17 U.S.C. § 301(a) (2000); *see also* Baltimore Orioles, Inc. v. Major League Baseball Players Ass'n., 805 F.2d 663, 676 (7th Cir. 1996) ("[Section] 301(a) preempts all equivalent state-law rights claimed in any work within the subject matter of copyright whether or not the work embodies any creativity.").

94. 17 U.S.C. §§ 102-103.

under state law are equivalent to any of the exclusive rights granted in § 106 of the Copyright Act.[95]

Although the Copyright Act states that facts fall outside of its protection,[96] courts have determined that the Act may nonetheless preempt state laws that protect uncopyrightable facts with copyright-like protection.[97] In such cases, courts have developed the extra element test to analyze the second, or equivalency requirement of preemption. This test asks whether a state law claim requires an element instead of or in addition to any of the exclusive rights listed in § 106 and whether this element transforms the action into something qualitatively different from a copyright infringement claim.[98] If an extra element exists, the claim, such as for breach of contract, survives federal preemption.[99]

Some courts have stated that the mere element of a promise in contract claims, that is, the need to show an offer, acceptance, and bargain during the formation of a contract, constitutes an extra element that allows state law to adjudicate all contract cases dealing with copyright.[100] Other courts, following *ProCD*, have distinguished contract claims from copyright claims based on their differing scopes: "A copyright is a right against the world. Contracts, by contrast, generally affect only their parties; strangers may do as they please, so contracts do not create 'exclusive rights.'"[101] However, even courts that have recognized the inherent presence of extra elements in contracts have acknowledged that no blanket rule about preemption in contract cases exists.[102]

Applying the extra element test to *PGA Tour*, the court might have found that the licensing agreement embodied in the OLSR constituted an extra element because it regulated activities, such as access to the media

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95. These rights include reproduction, preparation of derivative works, distribution and public performance. *Id.* § 106 (1)-(4).

96. *Id.* § 102(b).

97. *See, e.g.*, Selby v. New Line Cinema Corp., 96 F. Supp. 2d 1053, 1058 (C.D. Cal. 2000) ("An item . . . such as an idea, procedure, process, etc., does not receive copyright protection but is nevertheless within the subject matter of copyright for purposes of preemption.").

98. Wrench LLC v. Taco Bell Corp., 256 F.3d 446, 456 (6th Cir. 2001)

99. *See id.*; *see also* Ballas v. Tedesco, 41 F. Supp. 2d 531, 536 n.14 (D.N.J. 1999) (listing cases where courts found no preemption in breach of contract actions).

100. *Taco Bell*, 256 F.3d at 456 ("The extra element is the promise to pay.").

101. ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1454 (7th Cir. 1996); *cf.* Kabehie v. Zoland, 125 Cal. Rptr. 2d 721, 731 (Ct. App. 2002).

102. *See* Bowers v. Baystate Techs., Inc., 320 F.3d 1317, 1338 (Fed. Cir. 2003) ("*ProCD* and the other contract cases are . . . careful not to create a blanket rule that all contracts will escape preemption.").

center, that do not constitute copyrightable subject matter. However, the central issue—syndication of the scores—falls under at least two of copyright's exclusive rights, namely, reproduction and distribution.[103] Furthermore, PGA's licensing agreement would not transform Morris Communications' cause of action into something qualitatively different from an issue that would be litigated under copyright law. Therefore, courts that have been lenient with the test, allowing almost anything to constitute an extra element, would not find preemption. In contrast, courts requiring a significant departure from copyright issues to satisfy the extra element test likely would find preemption under these facts.

Therefore, if the real-time sports scores compiled by PGA were classified as facts, PGA could not use copyright law to prevent Morris Communications from doing with them what it desired, including syndication. Although this result might seem unfair in light of PGA's investment in the RTSS, in the greater context of copyright law, unfair results occasionally must balance out correct decisions that arise from the same law applied to different sets of facts. Important policy considerations underlie copyright law: it is designed to maintain a rich public domain, while creating incentives for the development of human knowledge and creativity.[104] PGA's inability to add to its annual revenue by collecting licensing fees for real-time golf scores seems like a small sacrifice to make in light of these greater goals.

IV. CONCLUSION

To avoid granting too much power over information to sports monopolies, courts deciding future cases concerning real-time sports scores should interpret *PGA Tour*'s holding narrowly—thus applying solely to the unique set of facts presented by a golf tournament—where it is impossible for individuals independently to observe and record all of the event's activities. Although a similar set of circumstances might arise at a tennis tournament or other sporting events that take place in several locations simultaneously, applying *PGA Tour*'s holding to other sports could harmfully aggrandize sports monopolies such as the NFL and MLB. Taken even further, this type of control over information also raises legitimate concerns regarding the freedom of the press guaranteed by the First

103. For another point of view, see Marc S. Williams, *Copyright Preemption: Real-Time Dissemination of Sports Scores and Information*, 71 S. CAL. L. REV. 445 (1998) (arguing that the scores and statistics of sporting events do not fall within the subject matter of copyright).

104. U.S. CONST. art. I, § 8, cl. 8.

Amendment. Therefore, courts should constantly guard against removing too much information from the public domain and imposing excessive restrictions on Internet publication. To accomplish this goal, courts should be vigilant about identifying claims preempted by copyright law.

DATABASE PROTECTION IN THEORY AND PRACTICE: THREE RECENT CASES

By Charles C. Huse

Database developers seeking to protect the data they have compiled face a challenge: facts cannot be copyrighted. An arrangement of facts, such as a database, can be copyrighted, but only if it "features an original selection or arrangement" that "possesses at least some minimal degree of creativity."[1] Even then, the copyright in a database only applies to the original selection or arrangement and does not extend to the underlying facts. Thus, others are free to extract facts from the database. If necessary, the entire database may be copied to get the information it contains; such copying is allowed as long as it is done only to extract data for subsequent fair use.[2] Although these principles are well established, companies continue to invoke copyright law to prevent competitors from copying their databases. Three recent cases involving electronic databases show that this tactic, while popular, is ineffective.[3]

The Supreme Court rejected copyright protection for "sweat of the brow" in *Feist*. The Court allowed Feist to copy data from Rural's telephone books to create a single directory covering multiple calling areas. While *Feist* involved paper telephone directories, its holding extends to the copying of electronic databases. The increasing prevalence of electronic databases, combined with the near-zero cost of copying provided by digital technology, ensures that disputes over copying only will become more frequent. Still, these cases are not strong examples of the need for new legislation that would provide sui generis database protection.[4] In-

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1. Feist Publ'ns, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 345, 350 (1991); *see also* Jane C. Ginsburg, *No "Sweat"? Copyright and Other Protection of Works of Information After* Feist v. Rural Telephone, 92 COLUM. L. REV. 338, 343-48 (1992).

2. *See* Sega Enters. v. Accolade, Inc., 977 F.2d 1510 (9th Cir. 1992); Ticketmaster Corp. v. Tickets.com, Inc., No. CV997654HLHVBKX, 2003 WL 21406289, at *5 (C.D. Cal. Mar. 7, 2003) (allowing temporary copying of "electronic information for the limited purpose of extracting unprotected public facts" as fair use).

3. MyWebGrocer, L.L.C. v. Hometown Info, Inc., 375 F.3d 190 (2d Cir. 2004); Assessment Techs. of Wis., L.L.C. v. WIREdata, Inc., 350 F.3d 640 (7th Cir. 2003); Nautical Solutions Mktg., Inc. v. Boats.com, No. 8:02-cv-760-T-23TGW, 2004 U.S. Dist. LEXIS 6304 (M.D. Fla. Apr. 1, 2004).

4. The European Union enacted sui generis database protection in 1996. Directive 96/9/EC of the European Parliament and of the Council of 11 March 1996 on the Legal Protection of Databases, 1996 O.J. (L 78) 20, http://europa.eu.int/ISPO/infosoc/legreg/

stead, they illustrate the factual variations that are possible in database disputes, and warn against simplistic analyses of database copying.

Part I of this Note describes the case law establishing that copyright protection does not extend to data and also describes state law doctrines that might offer protection for certain databases. Part II examines the economic arguments for and against sui generis database protection. Part III summarizes the three recent electronic database cases. Part IV discusses how state law doctrines might apply to these cases, while Part V discusses whether the databases in these cases deserve protection in light of the economic arguments in Part II. This Note concludes that, while a free-rider problem exists, it is not always relevant to database disputes. Therefore, any proposed sui generis database protection should be narrowly tailored to apply only to acts of copying that threaten to chill database development.

I. LEGAL BACKGROUND

This Part first discusses two key cases denying copyright protection to databases. *Feist* requires creativity in arrangement or selection for a database to merit copyright protection. *Sega* allows a database to be copied, even if it qualifies for copyright protection, to make fair use of raw data within the database. Next, this Part discusses other legal doctrines that might be used to protect databases, including licensing, trespass to chattels, and misappropriation.

A. Copyright

1. Feist *Requires Minimal Creativity*

In *Feist*, the Supreme Court held that, while individual facts cannot be copyrighted, a compilation of facts such as a database may be copyrighted if the compilation shows "even a slight amount" of creativity.[5] The copyright only applies to the creative elements of the compilation, not to the underlying facts. Another party can lift the facts from the copyrighted database and use them in a separate database, as long as the new database is arranged differently. This rule reflects the policy that copyright is meant "to promote the Progress of Science and useful Arts,"[6] rather than to re-

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docs/969ec.html (last viewed Sept. 30, 2004). For an overview of the Directive, see Rebecca Lubens, Note, *Survey of Developments in European Database Protection*, 18 BERKELEY TECH. L.J. 447, 452-56 (2003).

5. *Feist*, 499 U.S. at 345.

6. U.S. CONST. art. I, § 8, cl. 8.

ward hard work. As a result, data compiled through "sweat of the brow" is not protected.

In *Feist*, the defendant ("Feist") took listings from a series of phone books compiled by Rural Telephone Service ("Rural") to create a single directory covering a much wider area than standard phone books. Both Feist and Rural distributed their listings for free and competed for yellow pages advertising. Rural sued, claiming that Feist had infringed Rural's copyright on the local phone listings.[7] The Court rejected Rural's claim. The raw data contained in the listings lacked copyright protection, since facts cannot be copyrighted.[8] The selection and arrangement of the listings also lacked copyright protection, since they did not involve any creativity. Specifically, the selection included all phone numbers in a particular area and the arrangement was merely alphabetical.[9] Feist therefore was able to take advantage of Rural's hard work in compiling the data without having to compensate Rural.

2. Sega *Allows Fair Use Intermediate Copying*

Even a work with the necessary creativity to qualify for copyright protection can be copied, so long as the resulting use of the copied data is fair use. In *Sega*, a video game developer ("Accolade") copied Sega video games in order to reverse-engineer a lock-out code needed to make games compatible with the Sega Genesis game console.[10] Sega only provided the code to licensed developers, and Accolade was unwilling to accept Sega's onerous licensing terms.[11] The purely functional lock-out code was not protected by copyright, and Accolade made no other use of the copied programs.[12] Accolade simply incorporated the code into its own video games so that they would run on the Genesis console. This type of copying, in which the entire program is copied but no protected elements are used in the final product, is called intermediate copying.

The Ninth Circuit held that Accolade's intermediate copying was a prima facie copyright violation, even though the end product did not violate the copyright.[13] But the copying still was permitted if it qualified as fair use,[14] as defined by the four-factor balancing test in 17 U.S.C. § 107.[15]

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7. *Feist*, 499 U.S. at 342-44.
8. *Id.* at 344-45.
9. *Id.* at 361-63.
10. Sega Enters. v. Accolade, Inc., 977 F.2d 1510, 1514-17 (9th Cir. 1992).
11. *Id.* at 1514.
12. *Id.* at 1522-23.
13. *Id.* at 1519-20.
14. *Id.* at 1520.

The court concluded that Accolade satisfied this test. The court began by analyzing the first factor, the purpose and character of the use, and the fourth factor, the market impact of the use. The purpose and character of Accolade's actions weighed strongly in favor of fair use: its "legitimate, essentially nonexploitative" copying resulted in the creation of a new video game, precisely the kind of "growth in creative expression . . . that the Copyright Act was intended to promote."[16] Market impact also favored fair use: Accolade had created a new game with unique characteristics, and the success of that game depended on these characteristics, which were not copied. Also, gamers typically buy more than one game. Therefore, "[t]here is no basis for assuming that Accolade's [game] has significantly affected the market for Sega's [game]."[17] The court next analyzed the second factor, the nature of the copyrighted work, and the third factor, the amount copied. The nature of copyrighted work further supported the argument for fair use: the presence of unprotected elements in Sega's program gave it less protection than a more "traditional literary work."[18] The fact that Accolade copied the entire program weighed little against fair use since Accolade only used the lock-out code.[19] Taken together, the four factors strongly favored fair use; therefore, Accolade's copying was allowed.

B. Other Means of Database Protection

1. *Licensing:* ProCD

Database developers seeking to protect their data from copying allowed by *Feist* and *Sega* can use licensing to restrict copying. In *ProCD, Inc. v. Zeidenberg*,[20] the Seventh Circuit held that a database vendor could sell a database under licensing terms that prohibited the user from copying the raw data, even though copyright law allowed copying. The court upheld a shrinkwrap license containing restrictions on the defendant purchaser's use of ProCD's compilation of several thousand telephone direc-

15. 17 U.S.C. § 107 (2000) ("[F]actors to be considered shall include (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.").

16. *Sega*, 977 F.2d at 1523.

17. *Id.*

18. *Id.* at 1526.

19. *Id.* at 1526-27.

20. 86 F.3d 1447 (7th Cir. 1996).

tories. The defendant ignored the restrictions and used the data to create a web-based directory in head-to-head competition with ProCD, thus violating a valid contract.[21]

However, the protection offered by licensing is not particularly robust. First, licenses only bind the contracting parties, whereas copyright is good against the world. Once a single licensee makes restricted data available to others in violation of the license, third parties who then copy the data may use it as they please. The ease of digital copying makes this scenario likely.

Second, the leading copyright commentator has strongly criticized *ProCD*'s holding that licenses extending beyond the rights granted by copyright law are not preempted by copyright law,[22] and other circuits might decline to follow the holding, particularly in cases involving fair use. Preemption applies when a state law claim regarding material "within the subject matter of copyright" involves "legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright."[23] In *ProCD*, the Seventh Circuit held that a contractual obligation cannot create an exclusive right "within the general scope of copyright" because the obligation is good only against the licensee and not against the world.[24] Therefore, licensing terms prohibiting copying that copyright law would allow are not preempted. This distinction between the licensee and the wider world is specious with regards to shrinkwrap and clickwrap licenses, since the only way for someone in the wider world to use the product is to become a licensee.[25] Further, this logic would prevent licensees from using data in ways prohibited by the license that otherwise would be fair use. The defendant in *ProCD* did not have a viable fair use claim: he copied ProCD's entire database; his use of the copied data was neither creative nor transformative; and his head-to-head competition with ProCD threatened the market for the original database. However, by the logic of *ProCD*, *Sega* would have come out differently if Sega had merely

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21. *Id.* at 1449-50.

22. *See* 1 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 3.04[B][3][a] (2004).

23. 17 U.S.C. § 301(a) (2000).

24. *ProCD*, 86 F.3d at 1454 ("A copyright is a right against the world. Contracts, by contrast, generally affect only their parties; strangers may do as they please, so contracts do not create 'exclusive rights.'").

25. *See* Jane C. Ginsburg, *Copyright, Common Law, and Sui Generis Protection of Databases in the United States and Abroad*, 66 U. CIN. L. REV. 151, 167 (1997) [hereinafter Ginsburg, *Sui Generis Protection*] ("The classic distinction between a contract right *inter partes* and a property right *erga omnes* dissolves when all users must become the information provider's co-contractants.").

shrink-wrapped its game with a license banning reverse-engineering.[26] Courts confronted with this situation might refuse to follow *ProCD* and instead reject the license as preempted by copyright law.

Third, licenses that extend beyond the rights offered by copyright law risk being rejected as copyright misuse. In *Lasercomb*, the Fourth Circuit held that a license requiring the licensee not to make competing products constituted misuse.[27] Plaintiff Lasercomb sold copies of a software program to defendant Holiday Steel ("Holiday") under a license that not only barred Holiday from making more copies but also forbade Holiday from independently developing similar programs. Holiday never signed and returned the license, so it was not bound by it. Nevertheless, Lasercomb proceeded with the transaction. Holiday hacked the Lasercomb program's anti-copying protections, made more copies for its own use, and then created and marketed a new program that basically was a copy of Lasercomb's program. Holiday pleaded misuse as a defense to the resulting copyright infringement lawsuit.[28] The Fourth Circuit accepted this defense, defining copyright misuse as "the use of the [copyright] to secure an exclusive right or limited monopoly not granted by the [Copyright] Office and which it is contrary to public policy to grant."[29] License terms such as Lasercomb's ban on competition violate public policy because they threaten to deny the public the innovative efforts of the licensees.[30] Since Lasercomb had tried to use its copyright to stifle innovation, the court rejected its infringement claim. The court further held that misuse did not have to rise to the level of an antitrust violation and that the defendants need not have been parties to the license to invoke the misuse defense.[31]

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26. *See* 1 NIMMER & NIMMER, *supra* note 22, § 3.04[B][3][a], at 3-34.8(1).

> [N]ot only are *Sony* and *Feist* nullified under [*ProCD*'s] approach, but so is virtually every other Supreme Court (and inferior court) decision ever to rule in a defendant's favor. Consider, for example, those circuit courts that have validated reverse engineering of software when undertaken for proper purposes. Merely by prohibiting that conduct under a shrinkwrap license, the nominally "fair use" is constricted out of existence.

Id. (citations omitted).

27. Lasercomb Am., Inc. v. Reynolds, 911 F.2d 970 (4th Cir. 1990); *see also* Practice Mgmt. Info. Corp. v. AMA, 121 F.3d 516 (9th Cir. 1997) (finding an agreement requiring the licensee not to do business with the licensor's competitors to be copyright misuse).

28. *Lasercomb*, 911 F.2d at 971-72.

29. *Id.* at 977 (applying the language of Morton Salt Co. v. G.S. Suppiger, 314 U.S. 488, 492 (1942), as regards patent misuse, to copyright misuse) (alterations in original).

30. *Id.* at 978.

31. *Id.* at 978-79.

2. *Trespass to Chattels:* eBay

Online providers of data can try to protect their data from pervasive unauthorized copying through the state law doctrine of trespass to chattels. Trespass to chattels "lies where an intentional interference with the possession of personal property has proximately caused injury."[32] The injury must be "to the chattel or to the plaintiff's rights in it."[33] In *eBay, Inc. v. Bidder's Edge, Inc.*, eBay invoked this doctrine to prevent a "spider program" written by Bidder's Edge from repeatedly "crawling" eBay's website.[34] Spider programs automatically copy data posted on targeted web pages, a process referred to as "crawling the web."[35] The Bidder's Edge spider was responsible for approximately 1% of the activity on eBay's servers, amounting to over 100,000 hits per day.[36]

The district court held that trespass to chattels could be applied to use of a computer system if "(1) [a] defendant intentionally and without authorization interfered with plaintiff's possessory interest in the computer system; and (2) [the] defendant's unauthorized use proximately resulted in damage to plaintiff."[37] Bidder's Edge's activities satisfied the first element: although eBay had refused to grant Bidder's Edge a license to crawl its website, had demanded that Bidder's Edge halt its crawling, and had tried to block the spider program, Bidder's Edge continued to crawl the site.[38] The court held that this web crawling also satisfied the second element: even though the spider program's 1% usage of eBay's servers did not cause any disruptions of service, it did deny eBay the use of that portion of its processing bandwidth.[39] Further, allowing such copying would prompt other potential competitors to crawl eBay's website, "potentially to the point of denying effective access to eBay's customers."[40] This threat of irreparable harm justified granting eBay an injunction.[41]

The breadth of the holding in *eBay* has been limited by *Intel Corp. v. Hamidi*.[42] Intel brought a trespass to chattels claim to prevent a former In-

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32. Thrifty-Tel v. Bezenek, 54 Cal. Rptr. 2d 468, 473 (Ct. App. 1996).
33. Intel Corp. v. Hamidi, 71 P.3d 296, 302 (Cal. 2003).
34. 100 F. Supp. 2d 1058 (N.D. Cal. 2000).
35. For more information on spiders and similar programs known as "bots," see Matthew C. Staples, Note, Kelly v. Ariba Soft Corp., 18 BERKELEY TECH. L.J. 69, 71 (2003).
36. *eBay*, 100 F. Supp. 2d at 1063.
37. *Id.* at 1069-70.
38. *Id.* at 1062-63, 1070.
39. *Id.* at 1071.
40. *Id.*
41. *Id.* at 1071-72.
42. 71 P.3d 296 (Cal. 2003).

tel engineer from sending unsolicited e-mails criticizing Intel's employment practice to current employees. Hamidi sent these e-mails six times over nearly two years, sending as many as 35,000 messages at a time.[43] The California Supreme Court noted that while *eBay* and other precedents involved "some interference with the efficient functioning of its computer system,"[44] Intel's claim did not. Intel offered no evidence that the e-mails disrupted its servers. Further, Intel had not established any threat of similar mass mailings by others if Hamidi were not enjoined from sending e-mails.[45] Therefore, the court denied Intel's request for an injunction.[46]

As with restrictive licensing terms, a trespass to chattels claim could be challenged under copyright preemption. The *eBay* court held that eBay's claim was not preempted because "[t]he right to exclude others from using physical personal property" is an extra element not present in a copyright infringement claim.[47] This language seems overly broad: since websites almost always are hosted on privately owned servers, preemption could never apply to most online copying. Even copying that would be allowed under copyright law as fair use could be subject to a trespass to chattels claim, since accessing a website hosted on a privately owned server would satisfy the extra element of "using physical personal property." However, the *eBay* court's consideration of the danger of similar copying by other potential competitors as a factor for determining liability suggests that activity amounting to trespass to chattels usually would not qualify as fair use. The threat of widespread similar copying also is considered as part of the fourth element of fair use, market impact, and weighs against a finding of fair use.[48]

3. *Misappropriation:* INS *and* Motorola

The tort of misappropriation has been used to prevent copying of raw facts in situations where the information was time-sensitive. In *International News Service v. Associated Press*,[49] the Supreme Court barred INS from copying news collected by AP until AP-affiliated newspapers were able to publish the news in question. Prior to this ruling, INS would copy news from AP-affiliated papers on the East Coast and wire it to INS-affiliated papers on the West Coast. West Coast INS affiliates thus were

43. *Id.* at 301.
44. *Id.* at 304.
45. *Id.* at 306.
46. *Id.* at 311.
47. eBay, Inc. v. Bidder's Edge, Inc., 100 F. Supp. 2d 1058, 1072 (N.D. Cal. 2000).
48. *See* Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 590 (1994).
49. 248 U.S. 215 (1918).

able to publish news collected by the AP at the same time as or even possibly before their AP-affiliated rivals. The Court conceded that the news was not copyrighted; rather, "it [was] the history of the day."[50] Still, even though the AP had no formal property interest in the news it collected, the Court found that copying of that news by INS was "unfair competition": "the process amounts to an unauthorized interference with the normal operation of complainant's legitimate business precisely at the point where the profit is to be reaped."[51] Read broadly, this passage implies that free-riding done to compete directly with the original compiler of data is unfair competition by definition. However, the Court then held that copying by INS was not permanently barred, but instead was postponed "only to the extent necessary to prevent that competitor from reaping the fruits of complainant's efforts and expenditure."[52] Presumably, this holding meant that INS was free to copy news collected by the AP once all AP-associated papers had a chance to go to press.

The *INS* holding did not survive the abolition of federal substantive common law in *Erie Railroad v. Tompkins*.[53] Misappropriation still is available as a state law claim, however. In *NBA v. Motorola, Inc.*,[54] the Second Circuit recognized misappropriation as a valid cause of action under New York law, although it rejected the NBA's claim. The NBA sought an injunction against Motorola for selling pagers that provided up-to-date scores for ongoing basketball games. Motorola collected the scores through its own network of employees who watched or listened to broadcasts of the games.[55] The court noted that sports scores were facts that were not protected by copyright,[56] but held that a misappropriation claim still would stand if the following elements were met:

> (i) a plaintiff generates or gathers information at a cost;
>
> (ii) the information is time-sensitive;
>
> (iii) a defendant's use of the information constitutes free riding on the plaintiff's efforts;
>
> (iv) the defendant is in direct competition with a product or service offered by the plaintiffs; and
>
> (iv) the ability of other parties to free-ride on the efforts of the plaintiff or others would so reduce the incentive to produce the

50. *Id.* at 234.
51. *Id.* at 240.
52. *Id.* at 241.
53. 304 U.S. 64 (1938).
54. 105 F.3d 841 (2d Cir. 1997).
55. *Id.* at 844.
56. *Id.* at 847.

> product or service that its existence or quality would be substantially threatened.[57]

Thus defined, misappropriation avoids preemption by federal copyright law under 17 U.S.C. § 301 because it contains extra elements compared to a copyright claim: time-sensitive value; free-riding; and an existential threat to the plaintiff.[58]

These extra elements limit the utility of misappropriation claims to information providers. The court rejected the NBA's claim on the grounds that Motorola's product did not threaten the NBA's core businesses of putting on and broadcasting basketball games, and that Motorola did not free-ride, but rather expended its own resources to collect the scores.[59] In other words, elements (iii) and (v) were missing. Thus, a misappropriation claim only will succeed when a defendant copies from a plaintiff to create a product that directly competes with the plaintiff's product. The requirement that information be "highly time-sensitive"[60] also limits the applicability of this doctrine. The court did not elaborate on the meaning of this phrase. However, to qualify as an extra element not present in a copyright claim, "highly time-sensitive" must refer to a much narrower duration than simply the length of time during which information remains valuable or useful.

II. THE ECONOMICS OF DATABASE PROTECTION

Proponents of sui generis database protection fear that the above state law doctrines provide insufficient protection to database developers.[61] This Part outlines the economic theories used by proponents and opponents of database protection. These theories draw a distinction between copying that is done to compete directly with the original database and copying done to create value-added products that do not compete directly with the original database. Finally, this Part summarizes two concerns of opponents to database protection: that certain types of databases do not

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57. *Id.* at 845.

58. *Id.* at 853. The court's designation of free-riding as an extra element conflicts with *Feist*'s explicit allowance of free-riding. *Cf.* Feist Publ'ns, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 349-50 (1991).

59. *NBA*, 105 F.3d at 854.

60. *Id.* at 852.

61. For an argument that sui generis protection is appropriate because state law doctrines are too effective, see Ginsburg, *Sui Generis Protection*, *supra* note 25, at 152 ("[E]xtra-copyright protection may be so effective that sui generis regulation may afford a desirable readjustment of the balance between incentives to produce initial compilations, and access to create new, and especially derivative, information products.").

deserve protection and that empirical evidence in support of database protection is lacking.

The strongest argument for database protection is the prevention of copying by a competitor seeking to compete head-to-head with the original compiler. Compiling a database is an expensive, time-consuming proposition; copying a database is cheap, particularly when digital technology can automate the copying. The copyist therefore does not share the original compiler's development costs and can undercut the original compiler's price.[62] The original compiler must match this lower price to remain competitive, and may not be able to recoup its development costs as a result. Knowing that this outcome is possible, companies may not bother to compile databases in the first place, thus denying the public the benefit of useful products. "The risk of market failure inherent in this state of chronic under-protection tends to keep the production of information goods at suboptimal levels."[63]

More contentious is the question of whether database protection should extend to "value-added" goods. Some value-added goods still compete with the original product: they add value by offering additional features compared to the original, but still serve as substitutes for the original.[64] Other value-added goods, however, do not compete with the original. These goods may complement the database—for example, by providing an improved search engine that makes the original database more useful[65]—or may be independent of the original database, perhaps using the raw data for an application unforeseen by the original compiler.[66] Part of the value of these goods comes from the original compilations of facts, but the creation of these goods does not threaten the market

62. *See* LAURA D'ANDREA TYSON & EDWARD F. SHERRY, STATUTORY PROTECTION FOR DATABASES: ECONOMIC & PUBLIC POLICY ISSUES § 3 (1997), *available at* http://www.house.gov/judiciary/41118.htm. This report was funded by British publisher Reed Elsevier, Inc. and Canadian publisher Thomson Corp. Letter from Professor Pamela Samuelson, University of California at Berkeley, School of Law (Boalt Hall), to Representative Howard Coble, Chairman, Subcommittee on Courts and Intellectual Property § VII (Oct. 23, 1997) [hereinafter Samuelson Letter], http://www.arl.org/info/frn/copy/psamlet.html.

63. J.H. Reichman & Pamela Samuelson, *Intellectual Property Rights in Data?*, 50 VAND. L. REV. 51, 55 (1997).

64. For example, Feist's single large directory added value by providing phone numbers from many of Rural's listings in a single source. Feist's directory still competed directly with Rural's listings for yellow pages advertising.

65. TYSON & SHERRY, *supra* note 62, § 6.7.

66. Reichmann & Samuelson, *supra* note 63, at 124.

for the original compilations. Instead, the markets for these goods are separate from the markets for the original compilations.

Tyson and Sherry argue that database property rights should extend to value-added products. They argue that a second-comer desiring to create a value-added product can license the rights from the original database compiler. The original compiler will be motivated to license the rights on reasonable terms, knowing that the second-comer could always recompile the relevant data.[67] Indeed, the original compiler often will desire to promote value-added products, since these products may create more demand for the original database.[68] Tyson and Sherry reject calls for compulsory reasonable licensing of database rights for value-added products: they view such licenses as a form of price control that also would threaten to overwhelm the courts with disputes about the definition of what is "reasonable."[69]

Critics of database protection proposals do not share Tyson and Sherry's faith in free-market licensing negotiations. First, licensing negotiations involve high transaction costs,[70] particularly when the second-comer faces a thicket of multiple rights that must be secured.[71] Second, companies are less likely to grant licenses than Tyson and Sherry anticipate; they may prefer to deny licenses to would-be second-comers and instead keep the ancillary markets for value-added products to themselves.[72] A property right over value-added goods could promote "reverse misappropriation," whereby the original compiler denies the second-comer a license and then creates a product based on the second-comer's idea. Third, even when companies are willing to license their database rights, licensing still involves economic waste. The belief that parties simply can negotiate around an assigned property right is an example of what Scotchmer describes as the fallacy that "intellectual property has benefits without costs."[73] Scotchmer rejects the view that "intellectual property re-

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67. TYSON & SHERRY, *supra* note 62, § 4.1.

68. *Id.* § 6.7.

69. *Id.* § 6.8.

70. *See* Wendy J. Gordon, *A Property Right in Self-Expression: Equality and Individualism in the Natural Law of Intellectual Property*, 102 YALE L.J. 1533, 1556-57 (1993) ("Because of transaction costs, the possibility of transferring rights through the market would not help substantially.").

71. *See* Stephen M. Maurer & Suzanne Scotchmer, *Database Protection: Is It Broke and Should We Fix It?*, 284 SCIENCE 1129, 1130 (1999) (describing how "[s]ome biotechnology databases would have to negotiate more than 100 separate contracts").

72. *See* Samuelson Letter, *supra* note 62, § II.

73. Suzanne Scotchmer, *Intellectual Property—When Is It the Best Incentive Mechanism for S&T Data and Information*, *in* THE ROLE OF SCIENTIFIC AND TECHNICAL

wards inventors, and doesn't hurt users provided it is licensed," claiming instead that "even if licensed, intellectual property still creates deadweight loss."[74] Specifically, the need to license the original database drives up the cost of the value-added product, thereby excluding some potential users.

Scotchmer's criticism reflects the view that monopolies are inherently harmful and only should be tolerated when necessary.[75] Under this view, monopoly protection should not extend to databases that would be created even without protection.[76] For example, a database property right should not cover value-added products that do not compete with the original product: since these products do not threaten the market for the original product, the original compiler is able to earn its anticipated returns. Therefore, copying done to create these products does not chill further compilation of data since the original compiler would have collected the original data regardless. No monopoly is necessary to ensure creation of the original database. As a second example, a database property right is not appropriate for data collected by a government contractor.[77] Even Tyson and Sherry concede that such data should be "made available on a nonexclusive basis to all users."[78] Free-riding poses no threat to the collection of data if its collection is ordered by the government.

Proponents of database protection face not only the above theoretical critiques, but also a lack of empirical data supporting their arguments. The U.S. database industry seems healthy and consumers do not lack information products. Proponents must argue, based on "economic logic,"[79] that the industry would be even healthier and information products would be even more widely available if database protection was enacted. Critics reply that "economic logic" alone, in the absence of empirical evidence, is

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DATA AND INFORMATION IN THE PUBLIC DOMAIN 15, 15 (Julie M. Esanu & Paul F. Uhlir eds., 2003).

74. *Id.* at 16.

75. *See also* James Boyle, *A Natural Experiment*, FIN. TIMES, Nov. 22, 2004 ("Monopolies are an evil, but they must sometimes be accepted when they are necessary to the production of some good, some particular social goal."), http://news.ft.com/cms/s/4cd4941e-3cab-11d9-bb7b-00000e2511c8.html.

76. Boyle complains that much of the litigation under the European Database Directive has been over databases that "would have been created anyway—telephone numbers, television schedules, concert times. . . . These databases are inevitably generated by the operation of the business in question and cannot be independently compiled by a competitor. The database right simply serves to limit competition in the provision of the information." *Id.*

77. This principle is applied to *WIREdata* in Part V.

78. TYSON & SHERRY, *supra* note 62, § 4.2.

79. TYSON & SHERRY, *supra* note 62, *passim*.

an inadequate basis for changing the law.[80] The alleged benefits of database protection should be observable by comparing the database industries in the European Union, which enacted its Database Directive in 1996,[81] with those in the United States, which does not offer database protection. An analysis by Maurer shows that a one-time spike in the number of available European databases followed adoption of the E.U. Database Directive.[82] The United States, on the other hand, has enjoyed steady growth in the number of available databases, without offering protection.[83]

Arguments against sui generis database protection seem to have the upper hand. Marybeth Peters, the U.S. Register of Copyrights, who is closely involved in congressional negotiations over intellectual property legislation, recently commented, "I don't think you'll ever see database protection."[84] The following three recent cases demonstrate that not all database disputes show the need for database protection. Disputes can be considerably more complex than simple free-riding that prevents database compilers from recouping their original investments.

III. CASE REPORTS

Three recent cases illustrate possible scenarios for database disputes. This Part describes the facts and holdings of these cases. Following parts discuss whether protection might have been available under the state law doctrines described in Part I and whether protection should be available according to the economic logic explored in Part II. The analysis concludes that none of these cases presents a pressing need for legislation to provide sui generis database protection.

A. *Assessment Techs. of Wis., L.L.C., v. WIREdata, Inc.*[85]

Plaintiff Assessment Technologies ("AT") sold a database program ("Market Drive") that three Wisconsin municipalities used to store and process property-tax data. The data were collected and entered into the

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80. *See* Boyle, *supra* note 75 ("Extensions of rights can help or hurt, but without economic evidence beforehand and review afterwards, we will never know."); Samuelson Letter, *supra* note 62, para. 2 ("Congress would be remiss in relying on abstract "economic logic" alone as a basis for action . . . .").

81. *See supra* note 4.

82. STEPHEN M. MAURER, ACROSS TWO WORLDS: DATABASE PROTECTION IN THE U.S. AND EUROPE 10 (2001), http://strategis.ic.gc.ca/pics/ipf/maurer.pdf.

83. *Id.*

84. Declan McCullagh, *Anti-P2P Bill May Slip Past Legislative Rush*, CNET NEWS.COM, Nov. 18, 2004, *at* http://news.com.com/2100-1028_3-5458680.html.

85. 350 F.3d 640 (7th Cir. 2003).

database by tax assessors employed by the municipalities, not by AT. AT's role was limited to the design of the database, which comprised 456 fields grouped into thirty-four separate tables.[86] AT claimed a copyright in this arrangement, which it designed specifically to meet the needs of tax assessors, and sold Market Drive under a license that possibly prohibited releasing raw data stored in the database.[87]

WIREdata asked the municipalities to provide it with the data stored in Market Drive, for use in real estate listings. Wisconsin's open records law required the municipalities to provide the requested data, but contained an exception for copyrighted material.[88] The municipalities refused WIREdata's requests out of fear that supplying the data would violate AT's copyright. WIREdata sued the municipalities in state court to force them to disclose the data. AT responded by suing WIREdata in federal court for copyright infringement. The district court granted a permanent injunction against WIREdata; WIREdata appealed.[89]

The Seventh Circuit rejected AT's copyright infringement claim. Judge Posner, writing for the court, first concluded that the organization of data in Market Drive was sufficiently original to be copyrightable.[90] Market Drive's unique and complex organization, with 456 fields split among thirty-four tables, showed at least minimal creativity,[91] unlike the simple alphabetical telephone listings in *Feist*.[92] The court nevertheless held that WIREdata was entitled to extract the desired real estate data from Market Drive, since AT's copyright did not extend to the raw data. Judge Posner described several methods for extracting the data without violating AT's copyright. The municipalities could transfer the data from Market Drive into a separate file using tools in either the program itself or in Microsoft Access, a database program run in conjunction with Market Drive. If this process was too time-consuming or expensive for the municipalities, WIREdata could hire its own programmers to perform the extraction.[93] Even if AT modified Market Drive to make extracting the raw data impossible without also copying the database, WIREdata would be entitled to

86. *Id.* at 642-43.

87. *Id.* at 646 ("AT points to the terms of its license agreements with the municipalities, which though ambiguous might be interpreted to forbid the licensees to release the raw data . . . .").

88. WIS. STAT. §§ 19.31 to .39 (2004).

89. *WIREdata*, 350 F.3d at 642.

90. *Id.* at 643.

91. *Id.*

92. *See* Feist Publ'ns, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 362-63 (1991).

93. *WIREdata*, 350 F.3d at 643-44.

make an intermediate copy of Market Drive to access the data, according to *Sega*.[94]

The court rejected AT's argument that its licenses with the municipalities prohibited WIREdata's requested copying. WIREdata was not a party to the licenses and thus was not bound by them. Also, the claim at issue was for copyright violation, not for breach of or interference with contract. Therefore, AT's argument that, under *ProCD*, it could contract beyond the limited rights of copyright was irrelevant to its claim that WIREdata violated its copyright.[95] Furthermore, the court suggested that since the municipalities, and not AT, collected the contested data, AT's attempt to limit access to the data might be copyright misuse.[96]

Because the data at issue was not copyrighted, and because its extraction from Market Drive either would not infringe AT's copyright or would qualify as fair use, the Seventh Circuit reversed the district court's judgment with instructions to vacate the injunction and dismiss the claim. Judge Posner minced no words on the merits of AT's claim: "It would be appalling if [it] succeeded."[97]

B. *Nautical Solutions Mktg., Inc. v. Boats.com*[98]

Boats.com owned and operated a website, Yachtworld.com, that listed yachts for sale.[99] Each listing showed pictures and a description provided by the yacht broker who posted the listing.[100] The descriptions used industry-standard headings such as "electrical," "accommodations," "galley," and "sails and rigging."[101] Yachtworld.com's listings had a distinctive look-and-feel: pictures of the yachts always appeared to the left of the description, the basic facts were shown in bullet-points, and a blue wave appeared on the left side of the screen.[102]

Nautical Solutions ("Nautical") offered a competing website, Yachtbroker.com. Nautical generated listings by using a spider program to make temporary copies of Boats.com's listings. Nautical extracted the descriptions and pictures from the temporary copies, discarded the copies, and

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94. *Id.* at 645 (citing Sega Enters. v. Accolade, Inc., 977 F.2d 1510, 1520-28 (9th Cir. 1992)).

95. *Id.* at 646.

96. *Id.* at 646-47.

97. *Id.* at 642.

98. No. 8:02-cv-760-T-23TGW, 2004 U.S. Dist. LEXIS 6304 (M.D. Fla. Apr. 1, 2004).

99. *Id.* at *2-*3.

100. *Id.* at *5 n.7.

101. *Id.* at *7 n.9.

102. *Id.* at *6.

then used the extracted information to create its own listings.[103] Nautical also offered a "valet service" in which, with a broker's permission, it copied descriptions and pictures from the broker's listings on other websites, such as Yachtworld.com, and pasted this information into Yachtbroker.com.[104] Yachtbroker.com's appearance differed from that of Yachtworld.com: the pictures were to the right of the facts, the facts were in a table, and no blue wave was shown.[105]

Nautical sought a declaratory judgment of noninfringement after Boats.com accused Nautical of violating its copyright in the Yachtworld.com website. The district court found that neither the valet service nor the spider program had infringed Boats.com's copyright and granted Nautical declaratory relief.[106] With regards to the valet service, the court noted that Boats.com did not hold the copyrights in the individual pictures and descriptions; the brokers who created the listings did.[107] Boats.com was not entitled to a copyright over the organization of the descriptions, since its use of industry-standard headings lacked creativity. Boats.com was entitled to a copyright over the website's distinctive look-and-feel, but Nautical had not violated this copyright: Nautical's website had its own unique look-and-feel. The valet service had only copied pictures and descriptions for which Boats.com had no viable copyright claim.[108]

Unlike the valet service, the spider program copied the entire website, with its protected look-and-feel. The court cited *Sega* to justify this copying as allowable intermediate copying, since the spider program only extracted unprotected facts from the copied site.[109] The court performed a cursory, incomplete fair use analysis to justify its holding. It found no evidence of harm to the "potential market value for or value of Yachtworld.com,"[110] and stressed that the "amount and substantiality of the por-

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103. *Id.* at *3-*4.
104. *Id.* at *5.
105. *Id.* at *6.
106. *Id.* at *13.
107. *Id.* at *9.
108. *Id.* at *9-*11.
109. *Id.* at *9.
110. *Id.* at *8. This finding of no market harm ignored the fact that Nautical competed directly with Boats.com. The court seems to have incorrectly placed the burden on Boats.com to show evidence of harm to Yachtworld.com's potential market value. Since fair use is an affirmative defense, the burden should have been on Nautical to show that its copying does not threaten Yachtworld.com's potential market value. *See* Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 590 (1994). The market value of the website is a function of the number of users. Since Boats.com and Nautical compete for users, Nautical most likely cannot meet this burden.

tion used"[111] was minimal, since Nautical's final product was free of infringing material. Having briefly considered only two of the four fair use factors, the court declared the spider program's copying to be fair use.[112]

C. *MyWebGrocer, L.L.C. v. HomeTown Info, Inc.*[113]

MyWebGrocer and its competitor, HomeTown, both designed and operated websites for grocery stores. MyWebGrocer contracted with D'Agostino Supermarkets to develop and maintain D'Agostino's website for two years. In the course of this work, MyWebGrocer created roughly 18,000 product descriptions (for example, "Gerber 1st Foods – Bananas 2.5 oz").[114] D'Agostino informed MyWebGrocer that it would not renew the contract and instead contracted with HomeTown to operate a new website. D'Agostino provided HomeTown with the product descriptions created by MyWebGrocer; HomeTown used the descriptions verbatim in the new site. These descriptions differed from descriptions HomeTown previously had displayed on websites that it operated for other grocery stores. For example, other HomeTown websites described the above bananas as simply "GERB BANANAS."[115]

MyWebGrocer sued HomeTown, alleging that HomeTown had infringed its copyright over the product descriptions. HomeTown counterclaimed, seeking a declaratory judgment that MyWebGrocer's copyright was invalid. The district court denied MyWebGrocer's request for a preliminary injunction, holding that the product descriptions were not creative enough to be copyrighted. MyWebGrocer appealed.[116]

The Second Circuit affirmed the district court's denial of a preliminary injunction, but on different grounds: it rejected the lower court's invalidation of MyWebGrocer's copyright, but held that MyWebGrocer had not proved a likelihood of success on the merits. The court left the issue of whether the product descriptions met copyright's "minimal degree of creativity"[117] test to be decided on remand by the trier of fact. In particular, the court stressed that the descriptions used by HomeTown in its earlier websites differed from MyWebGrocer's descriptions. Even though the facts contained in the product descriptions were not protected, "[a] trier might

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111. *Boats.com*, 2004 U.S. Dist. LEXIS 6304, at *8.
112. *Id.* at *7-*8.
113. 375 F.3d 190 (2d Cir. 2004).
114. *Id.* at 191, 195.
115. *Id.* at 195.
116. *Id.* at 192.
117. *Id.* at 193 (quoting Feist Publ'ns, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 345 (1991)).

conclude that MyWeb[Grocer] made creative choices about what to include or exclude in its product descriptions,"[118] thus allowing for a finding of infringement. However, the court held that this outcome was not sufficiently likely to merit a preliminary injunction.[119]

IV. POSSIBLE STATE LAW CLAIMS IN THE INSTANT CASES

When discussing database protection, the arrangement and selection of archived data must be distinguished from the data itself. Under the *Feist* minimal creativity standard, even short descriptions of grocery items might merit protection as original arrangements of facts. Such generous protection for arrangements of facts may be reassuring to database designers, but it offers no help to those who compile data. Copyright protection also is available when data is selected with a degree of creativity.[120] However, frequently the goal of data compilation is to be comprehensive; by definition, comprehensive data sets lack creativity in their selection.[121] Data gatherers thus often face a free-rider problem, as described in Part II. Second-comers can simply copy their data, free riding off of their hard work.

Data gatherers can try to prevent free-riding through state law doctrines such as licensing, trespass to chattels, and misappropriation, as described in Part I.B. The following sections consider how these doctrines apply to the attempts to protect raw data in the three cases summarized in Part III. Licensing could address the plaintiff's concerns in *MyWebGrocer*, but not in *WIREdata*, where the licensing terms amounted to copyright misuse. Trespass to chattels potentially could apply to the spider program in *Boats.com*. However, none of the cases presents a viable misappropriation claim.

A. Licensing: *MyWebGrocer* and *WIREdata*

Data gatherers can use licensing to restrict copying by database users. Intelligent contracting can allow data gatherers to recoup their development costs, assuming any potential copier is a party to the contract. However, contracts are useless when the copier is a third party. Also, overly aggressive licensing terms can lead to a finding of copyright misuse.

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118. *Id.*

119. *Id.* at 194.

120. *Feist*, 499 U.S. at 350.

121. *See* Jacqueline Lipton, *Balancing Private Rights and Public Policies: Reconceptualizing Property in Databases*, 18 BERKELEY TECH. L.J. 773, 785 (2003).

MyWebGrocer illustrates the need for intelligent contracting. MyWebGrocer developed the disputed product descriptions as part of a two-year contract under which the company created and maintained a website for D'Agostino Supermarkets.[122] Both parties could have foreseen that the contract might not be renewed, leading to a conflict over continued use of the product descriptions. MyWebGrocer could have negotiated for exclusive control of the descriptions in the event of nonrenewal. Alternately, MyWebGrocer could have charged D'Agostino a nonrefundable fee for the development of the product descriptions, in addition to the charge for operating the website. Nonrefundable engineering (NRE) charges are a standard feature in contracts for technical goods and services. Either option would have ensured that MyWebGrocer could recoup its development costs and would have avoided an arcane dispute over whether the product descriptions involved a modicum of creativity.

In *WIREdata*, on the other hand, AT could not have used a properly crafted contract to avoid its conflict with WIREdata, because WIREdata was not a party to AT's contract with the Wisconsin municipalities. Furthermore, AT's attempt to control data that it did not collect and in which it had no legitimate interest probably constituted copyright misuse. Judge Posner suggested this possibility, but declined to "run this hare to the ground,"[123] since the issue of misuse was not relevant to his holding. The issue is easily resolved, however. In *Lasercomb* the Fourth Circuit defined copyright misuse as "the use of the [copyright] to secure an exclusive right or limited monopoly not granted by the [Copyright] Office and which it is contrary to public policy to grant."[124] AT's copyright applied only to the arrangement of the Market Drive database, not to the data stored therein. AT's attempt to prevent disclosure of the data was an attempt to use its copyright on the database "to secure an exclusive right . . . not granted" by copyright law. This attempt was against public policy because, if successful, it would have stifled competition in the market for real estate listing services by restricting access to information needed to create the listings. Thus, AT's license satisfies the *Lasercomb* requirements for misuse.

Even a well-crafted contract without over-reaching terms is only useful for preventing free-riding by the other parties to the contact. In situations involving a lack of privity, parties seeking to protect their data must

122. MyWebGrocer, L.L.C. v. Hometown Info, Inc., 375 F.3d 190, 191 (2d Cir. 2004).

123. Assessment Techs. of Wis., L.L.C. v. WIREdata, Inc., 350 F.3d 640, 647 (7th Cir. 2003).

124. Lasercomb Am., Inc. v. Reynolds, 911 F.2d 970, 977 (4th Cir. 1990) (alterations in original).

turn to tort claims. The following sections discuss two possible claims: trespass to chattels and misappropriation.

B. Trespass to Chattels: *Boats.com*

Trespass to chattels may be a viable claim in cases involving automated online copying, such as *Boats.com*.[125] Whether Boats.com might have had a successful trespass to chattels claim depends on whether the facts of the case are more analogous to those of *eBay* or *Hamidi*.[126] Both Nautical and Bidder's Edge used spider programs to copy data from other websites for use on their own sites. However, it is not clear whether Nautical's copying was of the same magnitude as that of Bidder's Edge.[127] If Nautical constantly crawled the Boats.com website in a manner analogous to the constant crawling of eBay by Bidder's Edge, then Boats.com would have a claim. But if Nautical only crawled the website occasionally, and completed its crawling quickly, then the situation would be more analogous to the occasional e-mails in *Hamidi*, and a trespass claim likely would fail. In the latter case, even similar periodic crawling of the Boats.com site by other potential competitors might not threaten the site's operation, and therefore would not satisfy *eBay*'s requirement for an injunction. Considerable gray area exists between these two possible extremes, for which the result of a trespass to chattels claim would be uncertain.

C. Misappropriation

The narrow five-element definition of misappropriation would prevent misappropriation from applying to the instant cases.[128] In *Boats.com*, the disputed yacht listings were generated by yacht brokers using the Yachtworld.com website, and not by the website itself. Therefore the first element, information gathering by the plaintiff, is absent. Also, the listings do not seem "highly time-sensitive,"[129] in contrast to sports scores and stories on a news wire. Listings do have some time-sensitivity: they are valuable until the yachts in question are sold. While the exact meaning of "highly"

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125. The ruling states without explanation that the district court dismissed a claim under state trespass law. Nautical Solutions Mktg., Inc. v. Boats.com, No. 8:02-cv-760-T-23TGW, 2004 U.S. Dist. LEXIS 6304, at *2 n.1 (M.D. Fla. Apr. 1, 2004).

126. *See supra* Part I.B.2.

127. The record contains no evidence that Nautical's crawling disrupted service on Boats.com's website. However, disruption of service is not required to establish trespass to chattels. *See* eBay, Inc. v. Bidder's Edge, Inc., 100 F. Supp. 2d 1058, 1071 (N.D. Cal. 2000).

128. *See supra* Part I.B.3.

129. Nat'l Basketball Ass'n v. Motorola, Inc., 105 F.3d 841, 852 (2d Cir. 1997).

is not clear, the time frame in *Boats.com* is much longer than in *INS* or *Motorola*. Therefore, the second element probably also is missing.

The *MyWebGrocer* plaintiff would not be any more successful with a misappropriation claim. Descriptions of groceries are even less time-sensitive than yacht listings: their value is constant for as long as the relevant groceries are sold. Further, HomeTown's copying of MyWebGrocer's descriptions is not a threat to the latter's existence, since the copying occurred only after MyWebGrocer's initial contract with the supermarket had expired. The duration of this contract, for which MyWebGrocer bargained freely, should have been sufficient to allow it to recoup its investment. Thus, the second and fifth elements of a misappropriation claim are missing.

A misappropriation claim by AT would be the weakest out of all three cases. AT did not compile the disputed data, the real estate data was not highly time-sensitive, AT was not in direct competition with WIREdata, and WIREdata's use of the property data would not affect the market for AT's database. Thus, all five required elements are missing. This claim would be as "appalling" as AT's copyright claim.

V. DO THESE PLAINTIFFS DESERVE PROTECTION?

The above Part discusses how various legal doctrines apply to the instant cases. A more fundamental question is whether, in light of the economic arguments discussed in Part II, the disputed data deserve protection. The answer in *WIREdata* is clearly no. The tax assessment data that WIREdata sought to copy was collected by subcontractors working for Wisconsin municipalities. Even Tyson and Sherry argue that data collected by government subcontractors should be "made publicly available on a nonexclusive basis."[130] Further, WIREdata would not be free-riding on AT's work, since AT did not compile the data. Finally, WIREdata's and AT's products did not directly compete: AT made databases for storing and analyzing tax data, while WIREdata created real estate listings. Thus, there is no reason to award AT a property right in data stored in the Market Drive database.

Boats.com presents a closer case than *WIREdata*, but ultimately does not demonstrate the need for a property right in data. The websites in *Boats.com* competed directly with each other. However, the data that Nautical copied was compiled by yacht brokers using the Boats.com website, not by Boats.com. Therefore, Nautical did not free-ride off of any data

130. TYSON & SHERRY, *supra* note 62, § 4.2.

collection by Boats.com. Boats.com did have costs related to setting up, operating, and marketing its website. Nautical, however, had similar costs: it had to maintain and market its website in order for people to see the listings it copied. Nautical's copying did not allow it to undercut Boats.com on pricing, and only threatened Boats.com's existence to the extent that any competitor would.

Of the three instant cases, *MyWebGrocer* presents the strongest case for database protection. MyWebGrocer and HomeTown competed directly to operate grocery store websites. MyWebGrocer created the copied product descriptions itself; therefore, HomeTown was free-riding. However, HomeTown only was able to compete after the original two-year contract expired. As discussed above, the contract should have allowed MyWebGrocer to recover its development costs. Therefore, HomeTown's copying should not diminish the willingness of MyWebGrocer or other website operators to offer their services. Instead, the result in this case will encourage these operators to contract more carefully in the future. Thus, this case also does not demonstrate a need for a property right in compiled data.

VI. CONCLUSION

The current lack of protection for data creates a free-rider problem. But the three recent cases evaluated in this Note show that the free-rider problem is not always an issue in database disputes: only in *MyWebGrocer* did the party claiming infringement actually compile the disputed data, and in that case the issue could have been resolved through more intelligent contracting. Instead, these cases illustrate the complexities that can arise in database disputes, and warn against viewing such disputes through a single lens. Any proposed sui generis database protection should be narrowly tailored to provide protection only in cases that threaten to chill database development, thus ensuring that parties such as the plaintiff in *WIREdata* cannot get away with "appalling" claims.

DEFINING THE CONTOURS OF THE DIGITAL MILLENNIUM COPYRIGHT ACT: THE GROWING BODY OF CASE LAW SURROUNDING THE DMCA

By Diane M. Barker

The Digital Millennium Copyright Act (DMCA) went into effect over five years ago, and courts continue to struggle with the task of statutory interpretation. While the constitutionality of the DMCA's anti-circumvention provisions is well established, the parameters of its safe harbor provisions are not as clearly defined. Several recent cases confirm the DMCA's constitutionality, and others define and clarify the roles and obligations of both copyright holders and online service providers in policing infringing works on the Internet. Still more cases have limited the reach of the DMCA to preclude its application outside the area of copyright-protected works.

This Note explores a broad range of recent developments under the DMCA. By way of background, Part I describes the context in which the content industries and online service providers reached the bargain with Congress that resulted in the Digital Millennium Copyright Act. Part II focuses on the anti-circumvention provisions of the DMCA, exploring the most recent developments involving durable goods aftermarkets, the newly announced regulatory exceptions, and the well-settled question of the constitutionality of these provisions. Part III considers the latest cases to interpret the parameters of the safe harbor provisions, and highlights the potential for abuse of cease-and-desist letters. This Note concludes that almost six years under the DMCA have proved both the limited scope of the exceptions and that the prohibitions, though broad, do not extend as far as durable goods aftermarkets and uncopyrighted works.

I. ADOPTION OF THE DIGITAL MILLENNIUM COPYRIGHT ACT

The advent of content in digital format led to an explosion in the quantity of copyrighted material available on the Internet in the 1990s. This explosion led to a commensurate growth in digital piracy in which copyrighted works were copied and distributed over the Internet without the

permission of the copyright holders.[1] The growing concerns of these copyright owners that providing their content in digital format would facilitate infringement led them to seek an expansion of traditional copyright protection.[2] The owners threatened to withhold their products from the market unless Congress afforded them some kind of protection against digital piracy.[3] This strong lobbying by the content industry led Congress to consider expanding existing copyright protection in an effort to encourage the growth of copyrighted content available to the public.[4]

However, the content industry was not alone in its lobbying; online service providers, commonly known as Internet Service Providers (ISPs), also expressed their concerns to Congress that they would be held liable for copyright infringement and digital piracy over the Internet.[5] In an effort to reassure the ISPs and to ensure that the adoption of digital piracy legislation would not hamper the expansion of the Internet, Congress considered adopting a number of safe harbors to shield ISPs from liability. Even with these exceptions, Congress only intended to limit copyright owners' ability to sue ISPs for copyright infringement when the owners' works appeared on the Internet without their consent, not to limit their

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1. *See* 144 CONG. REC. H7074, H7099 (daily ed. Aug. 4, 1998) (statement of Sen. Dingell) ("Piracy of copyrighted works, particularly overseas, has increased dramatically, and copyright owners are desperately in need of additional protection to protect their property from thieves who increasingly prey on their creative ingenuity."); *see also* S. REP. NO. 105-190, at 8 (1998) ("Due to the ease with which digital works can be copied and distributed worldwide virtually instantaneously, copyright owners will hesitate to make their works readily available on the Internet without reasonable assurance that they will be protected against massive piracy.").

2. *See* Peter S. Menell, *Envisioning Copyright Law's Digital Future*, 46 N.Y.L. SCH. L. REV. 63, 134 (2002-2003).

3. *See id. See generally* Pamela Samuelson, *The Copyright Grab*, WIRED NEWS, Jan. 1996, *at* http://www.wired.com/wired/archive/4.01/white.paper_pr.html.

4. *See* S. REP. NO. 105-190, at 8 ("It will facilitate making available quickly and conveniently via the Internet the movies, music, software, and literary works that are the fruit of American creative genius."); *see also* H. REP. NO. 105-511, at 10 (1998) ("When copyrighted material is adequately protected in the digital environment, a plethora of works will be distributed and performed over the Internet.").

5. 144 CONG. REC. S11,887, S11,889 (daily ed. Oct. 8, 1998) (statement of Sen. Hatch) ("The OSPs and ISPs needed more certainty in this area in order to attract the substantial investments necessary to continue the expansion and upgrading of the Internet."); *see also WIPO Copyright Treaties Implementation Act and Online Copyright Liability Limitation Act: Hearing on H.R. 2281 and H.R. 2280 Before the Subcomm. on Courts and Intellectual Prop., House Comm. on the Judiciary*, 104th Cong. (1997) (statement of Roy Neel, President and Chief Executive Officer, United States Telephone Association) ("[W]hile UTSA members are committed to the Internet, the threat of copyright lawsuits is becoming an increasingly salient consideration in offering the service at all.").

ability to sue the person or persons who uploaded their works for direct copyright infringement.[6]

The Clinton Administration made an early effort to address the concerns of both content providers and ISPs by assembling the Information Infrastructure Task Force.[7] A working group formed by the Task Force proposed several changes to the Copyright Act, including outlawing copyright circumvention devices.[8] Both the House and the Senate endeavored to implement the working group's proposals, but bills introduced by each body failed in the 104th Congress.[9]

It was not until after the World Intellectual Property Organization (WIPO) conference in 1996 that Congress again attempted to pass copyright legislation to address digital piracy, this time in an effort to comply with the United States' treaty obligations.[10] After several failed attempts in both the House and the Senate to pass bills incorporating the terms of the WIPO agreement,[11] eventually one succeeded—the Digital Millennium Copyright Act.[12] President Clinton signed the DMCA in 1998.

The DMCA is the single greatest addendum to the Copyright Act since its passage in 1976. The Act added six new sections and two new chapters to the Copyright Act.[13] Congress designed the new chapter twelve to protect content providers. Chapter twelve contains the so-called anti-circumvention provisions and anti-trafficking provisions which prohibit

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6. *See* 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 12B.01[C][1] (2004).

7. *See* S. REP. NO. 105-190, at 2.

8. INFO. INFRASTRUCTURE TASK FORCE, U.S. DEP'T OF COMMERCE, INTELLECTUAL PROPERTY RIGHTS AND THE NATIONAL INFORMATION INFRASTRUCTURE: THE REPORT OF THE WORKING GROUP ON INTELLECTUAL PROPERTY RIGHTS (1995) [hereinafter WHITE PAPER], *available at* http://www.uspto.gov/web/offices/com/doc/ipnii/ipnii.pdf.

9. *See* S. 1284, 104th Cong. (1995); H.R. 2441, 104th Cong. (1995).

10. The two treaties that emerged from the conference, the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty, both required that participating countries "provide adequate legal protection and effective legal remedies against the circumvention of effective technological measures" used to protect copyrighted works. WIPO Copyright Treaty art. 11, Dec. 20, 1996, *available at* http://www.wipo.int/clea/docs/en/wo/wo033en.htm; WIPO Performances and Phonograms Treaty art. 18, Dec. 20, 1996, *available at* http://www.wipo.int/clea/docs/en/wo/wo034en.htm.

11. H.R. 2180, 105th Cong. (1997) (addressing ISP liability); H.R. 3048, 105th Cong. (1997) (embodying the terms of the WIPO treaties). Congress failed to enact either bill.

12. Pub. L. No. 105-304, 112 Stat. 2860 (1998) (codified in scattered sections of 17 U.S.C.)

13. The Act added chapters twelve and thirteen to the Copyright Act. Chapter thirteen addresses vessel hull design protection—a topic not covered in this Note.

the circumvention of technological measures that protect a copyrighted work and the trafficking in devices designed for such circumvention.[14] Additions to chapter five of the Copyright Act contain safe harbor provisions that Congress designed to shield ISPs.[15] This Note explores recent developments under the DMCA: Part II focuses on the anti-circumvention provisions of chapter twelve, and Part III treats the safe harbor provisions of chapter five.

II. THE ANTI-CIRCUMVENTION PROVISIONS

The anti-circumvention provisions are arguably the most important part of the DMCA. Their length belies their significance—these provisions impose both civil liability and criminal sanctions on violators.[16] Even though the anti-circumvention provisions do not constitute the lengthiest section of the DMCA, this section may be the most complicated.

A. Background

Congress adopted the anti-circumvention provisions of the DMCA to placate the content industries.[17] Congress tailored the statute to the needs of copyright holders and content providers who release their works in encrypted digital format. As a result, Congress limited the anti-circumvention provisions to copyright-protected works that are effectively protected by technological measures.

The anti-circumvention measures consist of three liability provisions. Section 1201(a)(1) proscribes the act of circumventing technological measures that control access to a copyrighted work,[18] section 1201(a)(2) prohibits the trafficking in devices for the purpose of circumventing technological measures that control access to a copyrighted work,[19] and sec-

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14. 17 U.S.C. § 1201 (2000).
15. *Id.* § 512.
16. *Id.* § 1204.
17. *See supra* text accompanying notes 2-5.
18. "No person shall circumvent a technological measure that effectively controls access to a work protected under this title." 17 U.S.C. § 1201(a)(1)(A).
19. No person shall manufacture, import, offer to the public, provide, or otherwise traffic in any technology, product, service, device, component, or part thereof, that—
    (A) is primarily designed or produced for the purpose of circumventing a technological measure that effectively controls access to a work protected under this title;
    (B) has only limited commercially significant purpose or use other than to circumvent a technological measure that effectively controls access to a work protected under this title; or

tion 1201(b) bans the trafficking in or marketing of anti-circumvention devices that target the use of copyrighted works.[20] The statute enumerates several exceptions and limitations to these anti-circumvention provisions, which range from a limited exemption allowing nonprofit libraries, archives, and educational institutions to circumvent a technological measure for the purposes of determining whether to add the copyrighted work to their collection,[21] to slightly broader exemptions for reverse engineering[22] and encryption research.[23]

Arguably, the statute also offers protection for the enterprising content provider with a penchant for public domain material. Commentators have pointed out that public domain material intermingled with original work and sealed with a technological measure would qualify for protection under the statute, even though copyright law only allows for the protection of the original aspects of the work in the absence of a protective technological measure.[24] Thus, it is possible under the statute to effectively create a new copyright where none existed before.

B. Developments

1. Durable Goods Aftermarkets

Congress enacted the DMCA to protect the products of the content industries. In keeping with this intent, courts have shied away from extending the protections of the DMCA beyond the scope originally envisioned by Congress in the few cases that have raised this issue.[25] As the following

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> (C) is marketed by that person or another acting in concert with that person with that person's knowledge for use in circumventing a technological measure that effectively controls access to a work protected under this title.

Id. § 1201(a)(2).

20. *Id.* § 1201(b) (providing similar prohibitions against trafficking in technology that is "primarily designed or produced for the purpose of circumventing protection afforded by a technological measure that effectively protects a right of a copyright owner under this title in a work or a portion thereof").

21. *Id.* § 1201(d).

22. *Id.* § 1201(f).

23. *Id.* § 1021(g).

24. *See e.g.*, 3 NIMMER & NIMMER, *supra* note 6, § 12A.06[B][1].

25. *See e.g.*, Lexmark Int'l, Inc. v. Static Control Components, Inc., 387 F.3d 522 (6th Cir. 2004); Chamberlain Group, Inc. v. Skylink Techs., Inc., 381 F.3d 1178 (Fed. Cir. 2004) (holding that defendant's universal transmitter, which allowed users access to plaintiff's encrypted software embedded in its garage door openers, did not violate the anti-circumvention provisions of the DMCA), *petition for cert. filed*, 73 U.S.L.W. 3465 (2005). *See generally* Daniel C. Higgs, Note, Lexmark International, Inc. v. Static Control Components, Inc. & Chamberlain Group, Inc. v. Skylink Technologies, Inc.: *The*

case shows, attempts by durable goods manufacturers to extend the protections of the DMCA to cover their products have failed.

The Court of Appeals for the Sixth Circuit recently vacated a preliminary injunction against a microchip manufacturer sued under the anti-circumvention and anti-trafficking prohibitions.[26] Printer manufacturer Lexmark sought to enjoin microchip manufacturer Static Control Components (SCC) from distributing chips that mimicked Lexmark's copyrighted "Toner Loading Program."[27] The SCC chips enabled third-party, refurbished toner cartridges to engage with Lexmark's copyrighted "Printer Engine Program" and function with Lexmark printers.[28] Based on SCC's wholesale copying of the Toner Loading Program, the district court held that Lexmark had established a likelihood of success on its copyright infringement and DMCA claims.[29] The Sixth Circuit reversed, holding that the Toner Loading Program was not copyrightable and that it did not function as an access control mechanism to the Printer Engine Program.[30] The court reasoned that although the Toner Loading Program controlled one route of access, the Printer Engine Program was otherwise accessible.[31] Indeed, one need only purchase a Lexmark printer and the literal code of the Printer Engine Program would be freely available on the printer memory.[32] It followed that the Toner Loading Program did not function as an access control mechanism under the DMCA. The court relied heavily on the "effectively controls access" language of the statute to preclude a finding of infringement where the work is otherwise readily accessible.[33]

This case demonstrates several important prerequisites to liability under the DMCA. As a threshold issue, the work that is protected by technological measures must qualify for copyright protection. Liability can turn on whether the court finds a work protectable at all—even the most effective access restrictions will not impart copyright protection to an otherwise unprotected work. Secondly, there must be some type of security device in place to prevent unauthorized copying. The decision in *Lexmark* turned

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DMCA and Durable Aftermarket Goods, 19 BERKELEY TECH. L.J. 59 (2004) (discussing whether the DMCA's anti-circumvention provisions were intended to be applied to aftermarket goods and concluding that such an extension would be troubling).

26. Lexmark Int'l., Inc. v. Static Control Components, Inc., 387 F.3d 522 (6th Cir. 2004).

27. *Id.* at 528-29.

28. *Id.* at 529, 530-31.

29. *Id.*

30. *Id.* at 549-50.

31. *Id.* at 546-47.

32. *Id.* at 546.

33. *Id.* at 546-47.

not on the degree of protection, but on the lack thereof. Because Lexmark had left one avenue to copying its Printer Engine Program wide open, the court found that SCC had no liability under the DMCA. This case illustrates the manifest unwillingness of the courts to extend the protection of the statute's anti-circumvention provisions to regulate consumer goods.

2. *Rulemaking/Regulatory Exceptions*

Not completely insensitive to the rights of users, Congress incorporated a fail-safe mechanism into the DMCA for accommodating legitimate users of copyrighted works that would be adversely affected by the anti-circumvention provisions.[34] The anti-circumvention ban of § 1201 includes a provision directing the Librarian of Congress, in conjunction with the Register of Copyrights, to create additional exemptions from the ban on circumventing access controls.[35] This authority does not, however, extend to creating exemptions from the anti-trafficking prohibitions. The Librarian determines which actions to exempt from anti-circumvention liability on a three-year cycle. This schedule allows her to discard obsolete exceptions and to implement new exceptions which have developed in the intervening period. The practical effect is that from one cycle to the next, users of a particular class of works cannot be certain that their exemption will carry over to the next cycle. The resulting uncertainty led many researchers and other qualified users to abandon their activities at the threshold of the last rulemaking proceeding for fear of liability.[36]

Section 1201(a)(1)(C) provides the factors the Librarian should consider when making her determination:

(i) The availability for use of copyrighted works;

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34. According to the Commerce Committee report, the rulemaking proceeding is designed to "monitor developments in the marketplace for copyrighted materials, and allow the enforceability of the prohibition against the act of circumvention to be selectively waived, for limited time periods, if necessary to prevent a diminution in the availability to individual users of a particular category of copyrighted materials." H.R. REP. NO. 105-551, pt. 2, at 36 (1998).

35. 17 U.S.C. § 1201(d) (2000).This ongoing rulemaking is a novel regulatory activity in the area of Copyright Law. *See* Menell, *supra* note 2, at 197 ("Copyright law has entered a new phase in which the government will play a more central and ongoing role in the implementation of copyright protection.").

36. *See* ELEC. FRONTIER FOUND., UNINTENDED CONSEQUENCES: FIVE YEARS UNDER THE DMCA (Sep. 24, 2003) (giving several examples of this phenomenon, including the reluctance of prominent Dutch cryptographer Niels Ferguson to publish his findings on security flaws in an Intel video encryption system because of fear of liability, as well as Prof. Fred Cohen's move to de-publish his evidence-gathering software from his website for fear of the same), *at* http://www.eff.org/IP/DMCA/unintended_consequences.pdf.

(ii) The availability for use of works for nonprofit, archival, preservation, and educational purposes;

(iii) The impact that the prohibition on circumvention of technological measures applied to copyrighted works has on criticism, comment, news reporting, teaching, scholarship, or research;

(iv) The effect of circumvention of technological measures on the market for or value of copyrighted works; and

(v) Such other factors as the Librarian considers appropriate.[37]

The day before the prohibitions outlined in the DMCA took effect in 2000, the Librarian of Congress published the results of the initial rulemaking proceeding.[38] These first exemptions included "compilations consisting of lists of websites blocked by filtering software" and "[l]iterary works, including computer programs and databases, protected by access control mechanisms that fail to permit access because of malfunction, damage or obsoleteness."[39] Upon the expiration of the two original exemptions, the Librarian of Congress approved four additional classes of works for exemption on October 31, 2003.[40] She based these exemptions on a lengthy recommendation by the Register of Copyrights.[41] The four new exemptions are as follows:

1) Compilations consisting of lists of Internet locations blocked by commercially marketed filtering software applications that are intended to prevent access to domains, websites, or portions of websites, but not including lists of Internet locations blocked by software applications that operate exclusively to prevent receipt of e-mail.

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37. 17 U.S.C. § 1201(a)(1)(c).

38. Exemption to the Prohibition on Circumvention of Copyright Protection Systems for Access Control Technologies, 65 Fed. Reg. 64556, 64561 (2000).

39. *Id.*

40. Exemption to Prohibition on Circumvention of Copyright Protection Systems for Access Control Technologies, 68 Fed. Reg. 62,011 (2003).

41. Memorandum from Marybeth Peters, Register of Copyrights, to James H. Billington, Librarian of Congress, Recommendation of the Register of Copyrights in RM 2002-4; Rulemaking on Exemptions from Prohibition on Circumvention of Copyright Protection Systems for Access Control Technologies (Oct. 27, 2003) [hereinafter Recommendation to Register of Copyrights], http://www.copyright.gov/1201/docs/registers-recommendation.pdf.

2) Computer programs protected by dongles[42] that prevent access due to malfunction or damage and which are obsolete.

3) Computer programs and video games distributed in formats that have become obsolete and which require the original media or hardware as a condition of access.

4) Literary works distributed in ebook format when all existing ebook editions of the work . . . contain access controls that prevent the enabling of the ebook's read-aloud function and that prevent the enabling of screen readers to render the text into a "specialized format."[43]

In addition to recommending the four classes of works for exemption, the Register of Copyrights considered and rejected a number of proposed classes, including a broad exception for fair use.[44] In total, the Register rejected twenty-four proposed classes. In fact, the Librarian's exemptions are so narrow as to have very little practical effect. The overly limited nature of the exemptions has led some scholars to observe that they severely restrict fair use.[45]

3. *Constitutionality*

Another recent case makes it clear that the constitutionality of the anti-circumvention provisions of the DMCA is a well-settled issue. Because the courts have demonstrated their unwillingness to overturn the statute on constitutional grounds such as free speech, fair use, or the scope of Congressional powers, it is unlikely to be a successful defense to liability under the DMCA.

Recently, marketers and retailers of DVD-ripping software raised several constitutional challenges to the DMCA to no avail.[46] 321 Studios filed a complaint seeking two forms of declaratory relief for its software, DVD Copy Plus and DVD-X COPY.[47] Both programs allow a user to copy video content from original DVDs.[48] DVD Copy Plus allows a user to record a portion of the DVD content onto a recordable CD, whereas DVD-X COPY creates an identical copy of the original DVD onto recordable

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42. "A software protection device which must be plugged into a computer to enable the protected software to be used on it." OXFORD ENGLISH DICTIONARY (2d ed. 1989).

43. Exemption to Prohibition Against Circumvention, 37 C.F.R. § 201.40 (2004).

44. Recommendation to Register of Copyrights, *supra* note 41, at 82.

45. *See* David Nimmer, *A Riff on Fair Use in the Digital Millennium Copyright Act*, 148 U. PA. L. REV. 673 (2000); Samuelson, *supra* note 3.

46. 321 Studios v. MGM Studios, Inc., 307 F. Supp. 2d 1085 (N.D. Cal. 2004).

47. *Id.* at 1089.

48. *Id.* at 1089-90.

DVD media.[49] In order to access the DVD content, both programs employ some method of decryption to bypass the Contents Scramble System (CSS) that has become the industry standard for DVD access control.[50] In relevant part, 321 Studios sought a declaration that its software did not violate the DMCA or, in the alternative, that the anti-circumvention provisions of the DMCA were constitutionally invalid.[51] The court relied heavily on previous anti-circumvention decisions in *Corley*[52] and *Elcom*[53] to strike down 321 Studios' several constitutional challenges.

321 Studios first disputed that the DMCA impermissibly regulated speech in the form of computer code in violation of the First Amendment. Relying on *Corley*, the court found that the functional aspects of computer code regulated by the DMCA did not rise to the level of content-based restrictions prohibited by the First Amendment.[54] Similarly, the court dismissed 321 Studios' second argument that the DMCA unconstitutionally restricts the fair use rights of users. The court reasoned, again drawing heavily on the *Corley* decision, that while users are entitled to make back-up copies of their lawfully purchased DVDs, fair use does not entitle them to a perfect copy.[55] Finally, the court relied on the reasoning in *Elcom* to dismiss 321 Studios' argument that the DMCA exceeded the scope of Congressional powers.[56]

The *321 Studios* court did not stray far from the conclusions of its predecessors *Reimerdes*,[57] *Corley*, and *Elcom* in adjudicating 321 Studios' constitutional challenges. The extent to which the court relied on *Corley* and *Elcom* suggests that the court found the constitutionality of the statute

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49. *Id.*

50. *Id.*

51. *Id.*

52. Universal City Studios, Inc. v. Corley, 273 F.3d 429, 458-59 (2d Cir. 2001) (holding that the DMCA does not unconstitutionally constrain fair use).

53. United States v. Elcom Ltd., 203 F. Supp 2d 1111 (N.D. Cal. 2002) (holding that the DMCA was not unconstitutionally vague; that the DMCA did not violate free speech under the First Amendment because it is tailored to achieve the government's legitimate and protected interests; that the limited impairment of users' fair use rights did not render the DMCA unconstitutionally overbroad; that the DMCA is not unconstitutionally vague under the First Amendment; and that Congress did not exceed its authority under the Commerce Clause, the Intellectual Property Clause, or the Necessary and Proper Clause to enact the DMCA).

54. *Id.* at 1099-101.

55. *Id.* at 1101-02

56. *Id.* at 1103-05.

57. Universal City Studios, Inc. v. Reimerdes, 111 F. Supp. 2d 294 (S.D.N.Y. 2000) (upholding the constitutionality of the DMCA and enjoining defendants from posting the decryption code of CSS on the Internet or linking to websites that posted the code).

well established. As a result, potential defendants under the anti-circumvention provisions of the DMCA can no longer hope to escape liability by persuading a court that the Act is unconstitutional. Instead, they would be better served by working within the exemptions provided in the statute itself, such as the exemptions for reverse engineering and encryption research.

III. THE SAFE HARBOR PROVISIONS

This Part describes the structure and function of the safe harbor provisions of the DMCA. Section A describes the provisions in detail. Section B focuses on the element of notice required by the safe harbor provisions. Section C clarifies the importance of qualifying for threshold eligibility before an ISP may assert any of the safe harbor provisions. Section D demonstrates that while the safe harbor provisions arguably provide the most effective escape from liability for ISPs, they are not the ISPs' exclusive recourse. Finally, Section E addresses concerns that copyright holders will abuse the notice system of the safe harbor provisions by demanding that ISPs remove material that is not in fact copyright protected or otherwise subject to the DMCA.

A. Background

Another statutory exemption to liability under the DMCA, in addition to the regulatory exceptions promulgated by the Librarian of Congress, is the so-called "safe harbor" provision for ISPs. As part of the compromise leading to the DMCA, ISPs received immunity from the copyright-infringing activities of their subscribers. Sections 512(a)-(d) provide protection from liability for: (a) transitory digital network communications;[58] (b) system caching;[59] (c) information residing on systems or networks at the direction of users;[60] and (d) information location tools.[61] To raise any of these safe harbor defenses, an ISP must meet certain threshold requirements.[62] Depending on which safe harbor the ISP seeks to establish, the statute imposes different conduct obligations on both the copyright holder and the ISP. For instance, the storage safe harbor in § 512(c) requires notice by the copyright holder and "take down" by the ISP, yet the conduit safe harbor in § 512(a) requires neither.

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58. 17 U.S.C. § 512(a) (2000).
59. *Id.* § 512(b).
60. *Id.* § 512(c).
61. *Id.* § 512(d).
62. *Id.* § 512(i).

B. Notice Requirements

Under the DCMA, a successful claim for secondary copyright infringement depends on effective notice of the allegedly infringing activity by the copyright holder. Without such notice, an ISP can more easily demonstrate that it lacks "actual knowledge" of infringing materials required for safe harbor under § 512(a), (b), and (c). Adequate notice requires that a copyright holder provide an ISP with: its contact information and personal signature (or the signature of its representative); identification of the alleged infringing work; the location of the alleged infringing work; a statement of good faith belief that the alleged infringing work is unauthorized; and a statement that all information in the notification is accurate.[63] In addition, the court in *Hendrickson v. Amazon.com, Inc.* held that notice from a copyright holder is not viable for an indefinite period of time.[64] Instead, the notice only applies to items infringing the copyrighted work at the time the copyright holder sends the notice.[65] The notice will not be adequate as to future infringing works. Once effective notice is given, ISPs must meet increasing obligations in order to avoid liability.

In *Hendrickson*, the plaintiff owned the copyright to a film which he had not yet released in DVD format.[66] Nevertheless, Hendrickson found that he was able to purchase the film on DVD from a third-party seller on Amazon's website.[67] Hendrickson thus brought suit against Amazon.com (Amazon) for both direct and indirect copyright infringement. The court dismissed the direct infringement claim for lack of sufficient evidence and focused on the merits of the vicarious infringement claim.[68] In order to qualify for the storage safe harbor in § 512(c), Amazon had to demonstrate that (1) it lacked actual knowledge of the infringing material; (2) it did not receive a financial benefit from the infringing activity; and (3) once notified by the copyright holder, it acted quickly to remove the material.[69]

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63. *Id.* § 512(c)(3)(A)(i)-(vi).

64. 298 F. Supp. 2d 914, 917 (C.D. Cal. 2003).

65. The court reasoned that "[b]ecause the language of the statute is present tense, it clearly indicates that Congress intended for the notice to make the service provider aware of the infringing activity that is occurring at the time it receives the notice." *Id.*

66. *Id.* at 915.

67. *Id.* at 916.

68. In granting summary judgment for Amazon on the direct infringement claim, the court reasoned that an auto-generated e-mail from Amazon after the purchase and webpages displaying the item were insufficient to establish that Amazon was the direct seller of the infringing material. *Id.* at 915.

69. Section 512(c)(1) requires that a service provider:

(A) (i) does not have actual knowledge that the material or an activity using the material on the system or network is infringing;

Primarily due to the inadequacy of Hendrickson's notice to Amazon, the court held that Amazon was able to satisfy all three elements of § 512(c). The court found that Amazon lacked actual knowledge under the first element because Hendrickson's initial notice was inadequate with respect to the DVD he purchased from the third-party seller nine months later.[70] The second element was more problematic for Amazon because it received a financial benefit from the third-party seller. The court found, however, that Amazon had neither the right nor ability to control the activity of third-party sellers, thus satisfying the second element.[71] Finally, also because of Hendrickson's lengthy delay after providing notice, the court held that the third element did not apply and that Amazon qualified for the safe harbor defense of the DMCA.[72] The time lapse between Hendrickson's initial notice and his purchase of the infringing DVD was simply too great to trigger Amazon's take down duties under the statute. Ultimately, Amazon owed the success of their safe harbor defense to Hendrickson's inadequate notice.

The *Hendrickson* case represents an important clarification of the roles of both copyright holders and ISPs in responding to the availability of infringing works on the Internet. Copyright holders cannot expect their duty to end and ISPs' liability to begin once they send a single notice of infringing works. While the court's holding did not provide an outside limit on the viability of a copyright holder's notice, it suggests at the very least that nine months is too long. In this respect, the court aptly reasoned that Congress did not intend for ISPs' to monitor their websites indefinitely. The copyright holder must share some of the burden in policing the Internet for infringing works.

(ii) in the absence of such actual knowledge, is not aware of facts or circumstances from which infringing activity is apparent; or

(iii) upon obtaining such knowledge or awareness, acts expeditiously to remove, or disable access to, the material;

(B) does not receive a financial benefit directly attributable to the infringing activity, in a case in which the service provider has the right and ability to control such activity; and

(C) upon notification of claimed infringement as described in paragraph (3), responds expeditiously to remove, or disable access to, the material that is claimed to be infringing or to be the subject of infringing activity.

17 U.S.C. § 512(c)(1) (2000).

70. *Hendrickson*, 298 F. Supp. at 917-18.

71. *Id.* at 918.

72. *Id.* at 917-18 (stating that the delay was nine months).

C. Threshold Eligibility

Another recent case, *Ellison v. Robertson*, demonstrates the importance of meeting threshold requirements under § 512(i) before an ISP can qualify for any of the four safe harbor limitations of liability under § 512(a)-(d).[73] In this case, Harlan Ellison, author of several novels and short stories, sued America Online (AOL) for vicarious and contributory copyright infringement after an Internet user posted digital copies of Ellison's copyrighted works on a USENET news group which, according to standard USENET protocol, were ultimately forwarded to AOL's server.[74] The district court granted summary judgment for AOL, having found that AOL qualified for safe harbor protection as an ISP. However, AOL had changed its contact e-mail address for reporting copyright abuses but did not register the change with the U.S. Copyright Office until several months later.[75] AOL had also failed to configure its old e-mail address for reporting abuses to allow messages to be either forwarded to the new address or returned to the sender.[76] The Ninth Circuit held that AOL's poor notification procedures could lead a jury to believe that AOL had not rea-

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73. *See* Ellison v. Robertson, 357 F.3d 1072 (9th Cir. 2004). Section 512(i) provides the following:

> Conditions for eligibility.
>
> (1) Accommodation of technology. The limitations on liability established by this section shall apply to a service provider only if the service provider—
>
> (A) has adopted and reasonably implemented, and informs subscribers and account holders of the service provider's system or network of, a policy that provides for the termination in appropriate circumstances of subscribers and account holders of the service provider's system or network who are repeat infringers; and
>
> (B) accommodates and does not interfere with standard technical measures.
>
> (2) Definition. As used in this subsection, the term "standard technical measures" means technical measures that are used by copyright owners to identify or protect copyrighted works and—
>
> (A) have been developed pursuant to a broad consensus of copyright owners and service providers in an open, fair, voluntary, multi-industry standards process;
>
> (B) are available to any person on reasonable and nondiscriminatory terms; and
>
> (C) do not impose substantial costs on service providers or substantial burdens on their systems or networks.

17 U.S.C. § 512(i).

74. *Ellison*, 357 F.3d at 1074-75.

75. *Id.* at 1077.

76. *Id.*

sonably implemented a policy against repeat infringers, as required by § 512(i)(A).[77]

The ineffectiveness of notice in *Ellison* turned not on the actions of the copyright holder but rather on the actions of the ISP. AOL's poor notification procedures led the court to hold that there were triable issues of material fact regarding AOL's threshold eligibility for safe harbor under § 512(i). This case demonstrates the cost at which safe harbor protection comes to ISPs—they must meet their obligations under the statute in order to receive immunity from liability. This includes enacting reasonable policies against repeat infringers.

D. The Safe Harbor Is Not the Exclusive Defense to Liability for Copyright Infringement

Failure to meet safe harbor requirements does not preclude ISPs from raising other affirmative defenses to copyright infringement claims. The statute itself provides that other defenses are not affected by the failure of an ISP to qualify for safe harbor protection.[78] The court in *CoStar Group, Inc. v. LoopNet, Inc.* recently affirmed that failure to satisfy safe harbor requirements does not preclude an ISP from raising other infringement defenses.[79] In *CoStar*, subscribers to a website administered by LoopNet posted CoStar's copyrighted photographs of commercial real estate. CoStar sued LoopNet for direct copyright infringement.[80] Although LoopNet had a cursory inspection procedure in place to check for infringing photographs, the court found that this process did not rise to the level of volitional conduct required to find liability for direct copyright infringement.[81] LoopNet's inability to qualify for safe harbor under § 512 notwithstanding, the court held that it was not liable for direct copyright infringement under a traditional copyright infringement analysis.[82]

While the § 512 safe harbor is arguably the most important shelter from liability for ISPs, the *LoopNet* case emphasized that it is not the exclusive reprieve from liability. The safe harbor provisions do not displace traditional defenses to copyright infringement claims. Rather, both tradi-

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77. *Id.* at 1080.

78. "Other defenses not affected. The failure of a service provider's conduct to qualify for limitation of liability under this section shall not bear adversely upon the consideration of a defense by the service provider that the service provider's conduct is not infringing under this title or any other defense." 17 U.S.C. § 512(l).

79. 373 F.3d 544 (4th Cir. 2004).

80. *Id.* at 546.

81. *Id.* at 555-56.

82. *Id.* at 556.

tional defenses and the statutory exemptions are available to ISPs to defend infringement lawsuits.

E. Cease-and-Desist Letters

In order to curb the misuse of the DMCA outside its express boundaries, courts have shown a willingness to award damages where persons misrepresent that their works are subject to protection under the Act. Under § 512(f) of the safe harbor provisions, alleged infringers and ISPs can recover damages where persons knowingly and materially misrepresent either that their works are copyrighted or that their copyrighted works have been infringed.[83]

In *Online Policy Group v. Diebold*, the court awarded monetary damages for the abuse of cease-and-desist letters.[84] Diebold, an electronic voting machine manufacturer, sent cease-and-desist letters to several ISPs after an e-mail archive acknowledging problems with the machines became available on the Internet.[85] Diebold advised the ISPs in these letters that if they removed or disabled access to the e-mail archive, they would be shielded from a copyright infringement suit.[86] However, because the court found that Diebold deliberately sought to suppress publication of content that it knew was not subject to copyright protection, the court found the company liable under § 512(f) of the DMCA for damages.[87]

In this case, the users who posted the archive and the ISP had both the time and the resources to call Diebold's bluff. However, the real danger is situations where the fear of liability causes users to buckle under demands of false copyright holders. While the *Diebold* decision shows the willing-

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83. Section 512(f) provides the following:

> (f) Misrepresentations. Any person who knowingly materially misrepresents under this section—
>
> (1) that material or activity is infringing, or
>
> (2) that material or activity was removed or disabled by mistake or misidentification, shall be liable for any damages, including costs and attorneys' fees, incurred by the alleged infringer, by any copyright owner or copyright owner's authorized licensee, or by a service provider, who is injured by such misrepresentation, as the result of the service provider relying upon such misrepresentation in removing or disabling access to the material or activity claimed to be infringing, or in replacing the removed material or ceasing to disable access to it.

17 U.S.C. § 512 (f).

84. 337 F. Supp. 2d 1195 (N.D. Cal. 2004).

85. *Id.* at 1197.

86. *Id.* at 1198.

87. *Id.* at 1204-05.

ness of courts to sanction this kind of behavior, the ease with which the DMCA can be invoked to further improper ends is unsettling—especially considering that not every case in which copyright holders wield the DMCA to manage content will be litigated. Of real concern is where content is withheld from the public simply because it is adverse to the alleged copyright holder and the ISP is concerned about liability.

IV. CONCLUSION

While case law surrounding the DMCA continues to develop, some areas at least are relatively certain. The constitutionality of the Act is one example. For the prospective anti-circumvention defendant, challenging the statute itself is not going to be a successful strategy for evading liability. Those accused of violating the Act's anti-circumvention provisions will be more successful by conforming within one of the Act's enumerated exceptions, or by asserting affirmative defenses, such as fair use or copyright misuse.

Recent decisions under the anti-circumvention provisions also suggest a willingness of courts to limit the Act's reach outside the arena of traditionally copyright-protected works. These courts have struck down efforts by durable goods manufacturers to invoke the DMCA to protect consumer goods.

In addition, courts have shown a readiness to sanction misuses of the ISP safe harbor provisions of the DMCA, such as the abuse of cease-and-desist letters. More general decisions involving the safe harbor also indicate that immunity from liability comes at a cost to the ISPs, who must adhere to the conduct outlined in the statute in order to avail themselves of the Act's protection. Both content providers and ISPs will have to work within the confines of the DMCA to effectuate the ostensible purposes of the Act: policing the Internet to remove pirated works while fostering the Internet's ongoing development.

ADDITIONAL DEVELOPMENTS—COPYRIGHT

IMS HEALTH GMBH & CO. OHG V. NDC HEALTH GMBH & CO. KG

2004 E.C.R. C-418/01, 4 C.M.L.R. 28

The European Court of Justice (ECJ) applied a strict interpretation of the criteria for compulsory licensing of intellectual property under Article 82, an antitrust provision, of the European Community Treaty. The ECJ also articulated a three-part market effects test for when compulsory licensing is required.

IMS Health GmbH & Co. OHG ("IMS") brought a copyright infringement action in German national court against Pharma Intranet Information AG ("PII") and NDC Health GmbH & Co. KG ("NDC"), who acquired PII, for offering data services in a format to which IMS owned the copyright. After the national courts granted and affirmed interlocutory orders barring the defendants from using data structures similar to IMS's copyrighted format, NDC filed a complaint with the European Commission alleging that IMS's refusal to license the data format constituted an antitrust violation. The commission issued an interim decision ordering IMS to license its data format to the competitors, but the order was later withdrawn when the Commission determined that the competitors did not need a license to compete with IMS. At the same time, the German court that was adjudicating the copyright dispute requested a preliminary ruling from the ECJ on the requirements for compulsory licensing under Article 82.

In making its decision, the ECJ sought to harmonize past ECJ decisions. The ECJ viewed the German court's referral as asking essentially two questions: (1) whether the refusal to license the intellectual property (IP) in the case constituted an abuse of a dominant position within the meaning of Article 82, and (2) what factors are relevant in the determination of whether an IP is "indispensable" to market entry. On the latter question, the ECJ held that a court must consider whether there are other alternatives and whether technical, legal, or economic obstacles impair the viability of those alternatives, assuming a similar level of output. In this assessment, a court must consider customer participation in the development of the original IP and the likelihood of future purchases of the alternative product or service.

As for the first question, the ECJ answered that a refusal to license IP is an antitrust violation only under "exceptional circumstances." The circumstances are deemed exceptional when access to the IP is indispensable for carrying out a particular business and three additional conditions are met: (1) the refusal to license bars the emergence of a new product—one that is not offered by the IP owner and for which there is potential consumer demand; (2) no objective justifications exist for the refusal; and (3) the refusal eliminates all competition in the relevant market. National courts must assess these conditions on a case-by-case basis, considering potential or even hypothetical markets as relevant to the question. The Court reiterated the rule that the market analysis compels a court to identify an upstream market (composed of the original product or service) and a downstream or secondary market (one in which the original product or service is used to make another product or supply another service) and to find that the upstream product or service is indispensable to the downstream product or service.

The ECJ remanded the case to the national court for a judgment in accordance with its answers and a determination of costs.

PERFECT 10 V. VISA INTERNATIONAL SERVICE ASS'N

No. C 04-0371 JW, 2004 U.S. Dist. LEXIS 15895 (N.D. Cal. Aug. 5, 2004)

The district court dismissed the plaintiff's claims that credit card companies that provided financial services to websites that allegedly infringed its copyrights and trademarks were liable for contributory and vicarious infringement, where the plaintiff's complaint did not adequately allege the elements of these claims.

Plaintiff Perfect 10 provides adult entertainment services, including a magazine and website displaying nude models. Perfect 10 owns copyrights in most of its images, many of which are labeled with the registered trademark "Perfect 10." The defendant financial institutions provide credit card transactional services to various websites and other entities. Perfect 10 requested that defendants stop providing credit card processing services to websites that allegedly infringed their copyrights and trademarks. Defendants did not comply, and Perfect 10 sued.

The court granted the defendants' motion to dismiss for failure to state a claim because the plaintiff did not plead facts which supported its claims of contributory and vicarious copyright infringement. As to the contributory infringement claim, while defendants did not dispute knowledge of the infringing activity, the court held that they did not materially contribute to the infringing activity. The court reasoned that the defendants' provision of content-neutral credit card processing services did not bear a direct relationship to the infringing acts. Distinguishing between a material contribution to the functioning and to the infringing activities of said websites, the court found that while the latter qualifies as contributory infringement, the former does not. On the vicarious copyright infringement claim, the court found that while defendants might have received a direct financial benefit from the infringing activity, the claim must be dismissed because defendants did not have the right and ability to control the conduct of the infringers.

The court also granted defendants' motion to dismiss the plaintiff's claims for contributory and vicarious trademark infringement, its state trademark claim, and its claims for right of publicity, unfair competition, and false advertising. Claims of libel and intentional interference with economic relations were time-barred by statute.

PRACTICEWORKS, INC. V. PROFESSIONAL SOFTWARE SOLUTIONS OF ILLINOIS, INC.

No. JFM-02-1205, 2004 U.S. Dist. LEXIS 11645 (D. Md. June 23, 2004)

The court ruled that a reseller violated the Copyright Act by loading a software product into its computers' random access memory (RAM) to provide technical support and services to third-party customers after termination of the reseller's contract with the software owners.

PracticeWorks, a provider of information management technology for dental health practitioners, holds copyrights for a software product called SoftDent® Dental Management System. It granted Professional Software Solutions of Illinois, Inc. ("PSSI") exclusive rights to resell the software within parts of Illinois and Ohio. In addition to exclusive resale rights, the relevant contracts allowed PSSI to provide local software support and service to end-users. The contracts stated that upon their termination, PSSI was to return to PracticeWorks "any and all materials regarding the [software] in any form whatsoever . . . ." PracticeWorks later terminated the contract and sued for a declaration regarding the termination. PSSI returned some copies of the software and other materials, but retained a few copies in order to continue providing technical support and service for its customers.

The court held that PSSI violated the Copyright Act in continuing to use the software for technical support because this activity required the software to be loaded into RAM, and loading the software into RAM constituted copying of the software. Following termination of the resale and support agreements between PracticeWorks and PSSI, such copying violated the exclusive rights of copyright ownership. PSSI argued that viewing the software on its computers fell within an exception to the Copyright Act codified at 17 U.S.C. § 117(c), covering computer maintenance and repair. The court held that this exception applied only to cases of loading software in order to repair the machine onto which the program is loaded. Thus, the exception did not apply to repairs of the software itself, nor did it cover repair or maintenance of a third party's machine.

The court also held that PSSI violated its contractual obligations by retaining copies of the software after PracticeWorks terminated their resale agreements. PSSI argued that the contracts with PracticeWorks did not restrict the use of copies of the software obtained as end-users. The court responded that the contracts unambiguously implied that PSSI could act only as dealers, not as both dealers and end-users. Any copies of the software that PSSI used to provide services to customers were subject to the contracts. The court also brushed aside PSSI's overly literal reading of the contract requiring return of materials "regarding the [software]" as not applying to the actual software itself.

KNORR-BREMSE SYSTEME FUER NUTZFAHRZEUGE GMBH V. DANA CORP.: A STEP IN THE RIGHT DIRECTION FOR WILLFUL INFRINGEMENT

By Carol Johns

The law has traditionally levied punitive damages against wrongdoers who act in bad faith or with willful intent.[1] These damages serve a dual role of punishing blameworthy conduct and deterring undesirable behavior before it happens.[2] Patent law provides for punitive damages under the doctrine of willful infringement. While the Patent Act does not expressly address willfulness or intent, § 284 provides the statutory basis for an award of up to treble damages for infringement.[3]

The doctrine of willful infringement came of age in response to perceived underenforcement that allowed competitors to copy patented designs in "flagrant disregard" of the owners' property rights.[4] Congress was concerned that, in the absence of a secure monopoly on their technologies, inventors would hesitate to share their ingenuity with the public, thus undermining the Patent Act's incentive to disclose.[5] The courts interpreted and addressed this concern by awarding enhanced damages in cases where an infringer acted with willful intent.[6]

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1. *See, e.g.*, Kolstad v. Ada, 527 U.S. 526, 535 (1999) (finding that willful intent is required for an award of punitive damages under the Civil Rights Act); BMW of N. Am. v. Gore, 517 U.S. 559, 568 (1996) ("Punitive damages may properly be imposed to further a State's legitimate interests in punishing unlawful conduct and deterring its repetition."). The level of intent required to trigger such measures has been described by the Supreme Court as that which is "not merely negligent." McLaughlin v. Richland Shoe Co., 486 U.S. 128, 133 (1988).

2. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 908(1) (1979).

3. 35 U.S.C. § 284 (2000).

4. *See* Knorr-Bremse Sys. Fuer Nutzfahrzeuge Gmbh v. Dana Corp., 383 F.3d 1337, 1343 (Fed. Cir. 2004) (en banc) [hereinafter *Knorr-Bremse IV*]. The Senate Report accompanying the Patent Act of 1836 described the issuance of questionably-valid patents and subsequent disrespect for patent rights. The 1836 Act addressed overissuance by requiring examination of patent applications, instead of mere registration, and included a discretionary treble damages clause without describing its application. S. Rep. No. 24-239 (1836), *reprinted in* 9 DONALD S. CHISUM, CHISUM ON PATENTS app. 12 (2004).

5. S. Rep. No. 24-239, *reprinted in* 9 CHISUM, *supra* note 4, app. 12.

6. *See, e.g.*, Read Corp. v. Portec, Inc., 970 F.2d 816, 826-27 (Fed. Cir. 1992); Bott v. Four Star Corp., 807 F.2d 1567, 1572, 1574-75 (Fed. Cir. 1986); Matthew D. Powers

Due to the lack of explicit statutory guidance in § 284, the factors involved in finding willfulness and in determining damages emerged from common law.[7] The Federal Circuit has repeatedly instructed courts to look to the "totality of the circumstances" in determining willfulness.[8] However, as the doctrine evolved, the duty to obtain an opinion of counsel before initiating any possible infringing activity gained prominence over other factors.[9] With its 1986 opinion in *Kloster Speedsteel AB v. Crucible Inc.*, the Federal Circuit elevated the advice of counsel defense above other evidence of good faith, stating that an accused infringer's failure to obtain advice of counsel or to submit the advice to the court would lead to a presumption of bad faith.[10]

Kloster-Speedsteel's "adverse inference" has since encouraged undesirable conduct on the part of patentees, their competitors, and attorneys. For example, the adverse inference discourages innovators from reading patents,[11] encourages patentees to harass competitors,[12] and inhibits communication between innovators and their attorneys.[13] Numerous commentators have criticized the modern willfulness doctrine, contending that willfulness charges do not effectively deter direct copying or punish truly

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& Steven C. Carlson, *The Evolution and Impact of the Doctrine of Willful Patent Infringement*, 51 SYRACUSE L. REV. 53, 77-82 (2001) (providing a history of willful infringement doctrine).

7. *See, e.g.*, *Read*, 970 F.2d at 826-27; Gustafson, Inc. v. Intersystems Indus. Prods., Inc., 897 F.2d 508, 510 (Fed. Cir. 1990); Rolls-Royce Ltd. v. GTE Valeron Corp., 800 F.2d 1101, 1110 (Fed. Cir. 1986).

8. Rite-Hite Corp. v. Kelley Co., Inc., 819 F.2d 1120, 1125-26 (Fed. Cir. 1987); *Rolls-Royce*, 800 F.2d at 1110.

9. *See* Underwater Devices, Inc. v. Morrison-Knudsen Co., 717 F.2d 1380, 1389-90 (Fed. Cir. 1983).

10. Kloster Speedsteel AB v. Crucible Inc., 793 F.2d 1565, 1579-80 (Fed. Cir. 1986) ("[Defendant]'s silence on the subject, in alleged reliance on the attorney-client privilege, would warrant the conclusion that it either obtained no advice of counsel or did so and was advised that its importation and sale of the accused products would be an infringement of valid U.S. patents.").

11. NAT'L ACAD. OF SCIS., A PATENT SYSTEM FOR THE 21ST CENTURY 119 (Stephen A. Merrill et al. eds., 2004) [hereinafter NAS STUDY]; Mark A. Lemley & Ragesh K. Tangri, *Ending Patent Law's Willfulness Game*, 18 BERKELEY TECH. L.J. 1085, 1100-01 (2003).

12. Lemley & Tangri, *supra* note 11, at 1093-94.

13. *See, e.g.*, Upjohn Co. v. United States, 449 U.S. 383, 389 (1981) ("[The] purpose [of the privilege] is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice."); Sharper Image Corp. v. Honeywell Int'l, Inc., 222 F.R.D. 621, 632 (N.D. Cal. 2004) (discussing the pressure to waive attorney-client privilege); Lemley & Tangri, *supra* note 11, at 1092-93.

culpable behavior and that the doctrine creates unhealthy incentives for industry as well as patent lawyers.[14] In a recent report on patent reform, a National Academy of Sciences board remarked that "the shield [of willful infringement] seems to have morphed into a sword."[15]

After nearly two decades under the adverse inference rule, an *en banc* Federal Circuit addressed the issue in *Knorr-Bremse Systeme Fuer Nutzfahrzeuge Gmbh v. Dana Corp.* ("*Knorr-Bremse IV*").[16] The court reversed its own precedent and overturned the adverse inference created by an accused infringer's failure to obtain and produce advice of counsel.[17]

Knorr-Bremse IV alleviates some problems created by the adverse inference, but avoids the remaining defects in the willfulness doctrine. For example, although the duty of due care to avoid infringement remains intact, the Federal Circuit did not instruct defendants on how to demonstrate "due care" in the absence of an exculpatory legal opinion. The decision also fails to provide disincentives for unfounded claims of willfulness. Finally, the other factors in the "totality of the circumstances" test are too amorphous to guide competitors or provide certainty regarding freedom to operate. Thus, it is unclear whether the *Knorr-Bremse IV* decision will change the behavior of attorneys or clients on either side of patent infringement suits.

Part I of this Note introduces willful infringement and the evolution of the adverse inference. Part II describes the *Knorr-Bremse IV* decision. Part III discusses the problems with the willfulness doctrine in the years leading up to the case and analyzes the possible effects of the decision. Finally, Part IV presents proposals to reform the willfulness standard.[18] It also argues that, while *Knorr-Bremse IV* signaled a step in the right direc-

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14. *See generally* Brief for Amici Curiae Public Knowledge, *Knorr-Bremse IV*, 383 F.3d 1337 (Fed. Cir. 2004) (Nos. 01-1357, 01-1376, 02-1221, 00-1256) [hereinafter Public Knowledge Brief], *available at* 2003 WL 23208464; FED. TRADE COMM'N, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY ch. 5, at 28-31 (2003) [hereinafter FTC REPORT], *available at* http://www.ftc.gov/os/2003/10/innovationrpt.pdf; NAS STUDY, *supra* note 11, at 118-20; Lemley & Tangri, *supra* note 11; Powers & Carlson, *supra* note 6.

15. NAS STUDY, *supra* note 11, at 118.

16. 383 F.3d 1337 (Fed. Cir. 2004) (en banc).

17. *Id.* at 1344.

18. Public Knowledge Brief, *supra* note 14, at 9; FTC REPORT, *supra* note 14, ch. 5, at 28-31; NAS STUDY, *supra* note 11, at 118-20; Lemley & Tangri, *supra* note 11; Powers & Carlson, *supra* note 6; Thomas F. Cotter, An Economic Analysis of Enhanced Damages and Attorney's Fees for Willful Patent Infringement 25-28 (unpublished manuscript, on file with author).

tion, additional steps would more effectively reverse the harmful incentives created by the doctrine and further the goals of the Patent Act.

I. LEGAL BACKGROUND: WILLFULNESS DOCTRINE AND THE ADVICE OF COUNSEL DEFENSE

A. Willful Infringement

Willfulness is a judicially-created doctrine that goes beyond the remedial regime enunciated by the Patent Act. A patent does not bestow the patentee with an affirmative right to use or market his invention. Instead, the inventor may seek an injunction and compensatory damages from anyone that practices his invention without permission.[19] An infringer need not be aware of a patent to be found liable,[20] but the patent holder may not seek damages until the accused is made aware of the patent.[21] Thus, patent law is a remedial system and infringement is a strict liability offense.[22]

Section 284 of the modern Patent Act provides for infringement damages "adequate to compensate for the infringement, but in no event less than a reasonable royalty . . . together with interest and costs as fixed by the court. . . . [T]he court may increase the damages up to three times the amount found or assessed."[23] A patent holder may also attempt to seek compensation for attorney's fees, even if he is unable to show that he suffered measurable damages.[24]

1. Historical Background of the Willfulness Doctrine

While much of the Patent Act of 1836 was aimed at Patent Office reform, inclusion of the discretionary treble damages clause demonstrated

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19. 35 U.S.C. §§ 154(a)(2), 283-284 (2000) (describing the patent term of twenty years from filing and the remedies available to the patentee). For a summary of the early history of treble damages for willful infringement, see Powers & Carlson, *supra* note 6, at 58-75.

20. *See* 35 U.S.C. § 271(a); Powers & Carlson, *supra* note 6, at 56-57.

21. 35 U.S.C. § 287(a). The patentee can constructively give notice by affixing his patent number to the invention or its packaging. Notice may also take the form of a complaint letter from the patentee. *Id.*

22. *See id.* § 271(a); Powers & Carlson, *supra* note 6, at 56-57 ("[I]nfringement is a strict liability tort.").

23. 35 U.S.C. § 284.

24. *Id.* § 285 (authorizing the court to award attorney's fees to the prevailing party in exceptional cases). The Federal Circuit has held that "[b]ad faith litigation, willful infringement, or inequitable conduct are among the circumstances that may render a case 'exceptional' for purposes of § 285." Knorr-Bremse Sys. Fuer Nutzfahrzeuge Gmbh v. Dana Corp., 133 F. Supp. 2d 843, 864 (E.D. Va. 2001) [hereinafter *Knorr-Bremse II*] (quoting Mahurkar v. C.R. Bard, Inc., 79 F.3d 1572, 1580 (Fed. Cir. 1996)).

early congressional recognition of willful infringement.[25] The Senate Report that accompanied the bill noted widespread copying, where the culprit would build the claimed invention from an issued patent and then patent an identical or trivially-modified version for himself.[26] The Report commented that patentees faced difficulty and expense in trying to enforce their rights and that, due to limited record-keeping capabilities, the Patent Office was unable to effectively access the prior art to determine novelty of these copy-cat patents.[27]

Eighteen years after its passage, the Supreme Court, in *Seymour v. McCormick*,[28] stated that the Act left "the power to inflict vindictive or punitive damages . . . to the discretion and judgment of the court within the limit of trebling the actual damages."[29] The Court distinguished discretionary treble damage awards from actual damages, where the latter was to be determined by the trier of fact without regard for intent. In the wake of *Seymour*, courts generally imposed enhanced damages only where there was evidence of deliberate copying or other bad faith behavior.[30]

2. *Modern Cases*

The Federal Circuit, after its formation in 1982, developed willfulness into a doctrine that posed a formidable threat to accused infringers. In *Underwater Devices, Inc. v. Morrison-Knudsen Co.*, the nascent court ruled that once a potential infringer discovers a patent, he has an affirmative duty of due care to avoid infringement.[31] He may become aware of a patent (i) by receiving notice from the patentee, either in a cease-and-desist letter or a licensing offer; (ii) from the U.S. Patent and Trademark Office (PTO), perhaps during prosecution of his own patent; or (iii) independently, such as while researching his field of interest.[32]

The Federal Circuit emphasized the importance of an opinion letter to prove due care, but noted that it would not exonerate the client if he relied

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25. Powers & Carlson, *supra* note 6, at 64-66.

26. S. Rep. No. 24-239 (1836), *reprinted in* 9 CHISUM, *supra* note 4, app. 12 at 12-4.

27. One can imagine that modern information accessibility and cataloguing ameliorate these problems to a large extent.

28. 57 U.S. 480 (1854).

29. *Id.* at 489.

30. *See, e.g.*, Powers & Carlson, *supra* note 6, at 68-70.

31. 717 F.3d 1380, 1389-90 (Fed. Cir. 1983) ("Where, as here, a potential infringer has actual notice of another's patent rights, he has an affirmative duty to exercise due care to determine whether or not he is infringing. Such an affirmative duty includes, *inter alia*, the duty to seek and obtain competent legal advice from counsel *before* the initiation of any possible infringing activity." (citations omitted)).

32. Lemley & Tangri, *supra* note 11, at 1090.

on it unjustifiably.[33] Thus, not only must the accused show that he relied on the opinion, but he must also satisfy the more objective inquiry of whether he was reasonable to do so.[34]

The accused infringer in *Underwater Devices* refused a license from the patentee, based on the advice of in-house counsel to "refuse to even discuss . . . royalties" because patents are held "invalid in approximately 80% of the cases."[35] The court noted the defendant's disregard for the patent right in finding willful infringement.[36] Disrespect for patent validity, rightful or not, provided the original motivation for the willful infringement doctrine.

The cases following *Underwater Devices* further defined the duty of due care. In 1986, in *Bott v. Four Star Corp.*, the Federal Circuit provided a nonexclusive list to help the trier of fact decide whether infringement was willful.[37] The list included:

> (1) whether the infringer deliberately copied the ideas or design of another;
>
> (2) whether the infringer, when he knew of the other's patent protection, investigated the scope of the patent and formed a good-faith belief that it was invalid or that it was not infringed, and
>
> (3) the infringer's behavior as a party to the litigation.[38]

The second factor provided the basis for the advice of counsel defense that has subsequently become so central. Similar to *Underwater Devices*, the court in *Bott* accorded substantial weight to this defense, deciding that the defendant had not acted in good faith, and noting that it did not seek independent counsel to determine infringement. Moreover, defendant's in-house attorney only imparted an oral opinion "consist[ing] merely of conclusory statements without supporting reasons."[39]

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33. *Underwater Devices*, 717 F.2d at 1390.

34. *Id.* The court suggested that a competent opinion would be independently rendered, directed toward infringement and validity of the patent at issue, and based on probative sources. *Id.*

35. *Id.* at 1385.

36. *Id.* at 1390 ("Had [the memo] contained within its four corners a patent validity analysis, properly and explicitly predicated on a review of the file histories of the patents at issue, and an infringement analysis that, *inter alia*, compared and contrasted the potentially infringing method or apparatus with the patented inventions, the opinion may have contained sufficient internal indicia of creditability . . . .").

37. 807 F.2d 1567, 1572 (Fed. Cir. 1986).

38. *Id.*

39. *Id.*

Bott and *Underwater Devices* provided guidance for the trier of fact to determine willfulness. Yet § 284 leaves the decision of whether, and by how much, to enhance damages to district court judges, who had little guidance on this issue until the Federal Circuit's discussion in *Read Corp. v. Portec, Inc.*[40] Continuing from the *Bott* factors, *Read* added:

> (4) Defendant's size and financial condition.
> (5) Closeness of the case.
> (6) Duration of defendant's misconduct.
> (7) Remedial action by the defendant.
> (8) Defendant's motivation for harm.
> (9) Whether defendant attempted to conceal its misconduct.[41]

While *Bott* spoke to the willfulness determination and *Read* to the amount of damages, courts and juries have since used all nine factors in deciding both questions.[42] However, the list is not exclusive and the "totality of the circumstances" should be examined for willfulness and setting damages.[43]

B. The Advice of Counsel Defense

Despite the totality of the circumstances test, courts tended to favor the second *Bott* factor, considering an attorney's opinion of non-infringement or unenforceability particularly strong evidence against willful infringement.[44] The Federal Circuit formalized this defense in subsequent decisions to create a presumption of bad faith in the absence of such an opinion.

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40. 970 F.2d 816 (Fed. Cir. 1987).

41. *Id.* at 826-27 (citations omitted).

42. *Knorr-Bremse IV*, 383 F.3d 1337, 1346 (Fed. Cir. 2004) (en banc); Sharper Image Corp. v. Honeywell Int'l Inc., 222 F.R.D. 621, 629-30 (N.D. Cal. 2004). The judge and jury play "curiously blended" roles in willful infringement. A "jury determination of this 'fact' question is only advisory [and] a judge is not required to enhance damages." *Sharper Image*, 222 F.R.D. at 629 n.15.

43. *See, e.g.*, *Knorr-Bremse IV*, 383 F.3d at 1346; Gustafson, Inc. v. Intersystems Indus. Prods., Inc., 897 F.2d 508, 510-11 (Fed. Cir. 1990) (finding that the actor's willful intent "must be inferred from all the circumstances"); Rite-Hite Corp. v. Kelley Co., 819 F.2d 1120, 1125-26 (Fed. Cir. 1987); Rolls-Royce Ltd. v. GTE Valeron Corp., 800 F.2d 1101, 1110 (Fed. Cir. 1986) ("In respect of willfulness, there cannot be hard and fast *per se* rules."); Underwater Devices, Inc. v. Morrison-Knudsen Co., 717 F.2d 1380, 1390 (Fed. Cir. 1983).

44. *See, e.g.*, Comark Communications, Inc. v. Harris Corp., 156 F.3d 1182, 1190-91 (Fed. Cir. 1998).

1. *The Adverse Inference Before* Knorr-Bremse IV

With *Kloster Speedsteel v. Crucible Inc.* in 1986,[45] the Federal Circuit elevated advice of counsel above the other *Bott* factors. This holding permitted courts to infer that an accused infringer had acted in bad faith if he did not commission a legal opinion. From this, a court could presume (1) that a defendant either knew that he was infringing and did not want to commit such an opinion to paper or that (2) he was acting with willful ignorance. The court further held that where the accused obtained an opinion but refused to waive the attorney-client privilege, courts could negatively infer that the opinion was incriminating.

Kloster Speedsteel thus signaled the era of the adverse inference. Under the rule, a party that becomes aware of a patent must decide whether to spend resources investigating and securing legal counsel or to proceed and risk enhanced damages.[46] Moreover, accused infringers are not necessarily shielded from a willfulness claim once they seek an exculpatory legal opinion.[47] The defendant must show that he reasonably relied on the opinion[48] and that it was competently rendered.[49] A claim of good faith may be undermined if the accused produces an opinion from an attorney who is not conversant with patent law, who is in-house or otherwise not independent,[50] or who does not render an opinion based on ascertainable facts.[51] Such an analysis relies on the jury's more objective determination of whether the accused was reasonable to rely on the opinion[52] and its more subjective analysis of whether the accused acted in good faith based on the specific circumstances.[53]

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45. 793 F.2d 1565, 1579-80 (Fed. Cir. 1986); *see also* Fromson v. Western Litho Plate & Supply Co., 853 F.2d 1568, 1572-73 (Fed. Cir. 1988) (quoting *Kloster Speedsteel* and finding willful infringement where the defendant did not turn over its opinion of counsel).

46. *See, e.g.*, *Sharper Image*, 222 F.R.D. at 632.

47. *Kloster Speedsteel*, 793 F.2d at 1579; *see also* SRI Int'l v. Advanced Tech. Lab., 127 F.3d 1462, 1465-67 (Fed. Cir. 1997).

48. *Sharper Image*, 222 F.R.D. at 632.

49. *Comark Communications*, 156 F.3d at 1191; Read Corp. v. Portec, Inc., 970 F.2d 816, 829 (Fed. Cir. 1992).

50. Underwater Devices Inc. v. Morrison-Knudsun Co., 717 F.2d 1380, 1390 (Fed. Cir. 1983).

51. Johns Hopkins Univ. v. Cellpro, Inc., 152 F.3d 1342, 1364 (Fed. Cir. 1998).

52. *Sharper Image*, 222 F.R.D. at 632.

53. *Underwater Devices*, 717 F.2d at 1390.

2. *Advice of Counsel as Evidence of Good Faith*

If a defendant chooses to rely on his attorney's opinion to show good faith, the court considers his attorney-client privilege waived and requires production of the once-confidential advice to examine its reliability.[54] The waiver extends beyond the opinion letter, as courts have compelled additional communications and work product from the attorney.[55] Understandably, this broad effect of producing counsel's opinion has been the source of considerable controversy.[56]

The attorney-client privilege is supported by years of jurisprudence, and is nicely summarized by then-Justice Rehnquist in *Upjohn Co. v. United States*.[57] The privilege is intended "to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice."[58] Clients will only be willing to fully disclose information to their attorneys if they do not fear its revelation.[59] *Kloster Speedsteel* and its progeny suggest that the possibility of willful infringement presents a special exception to the policy: The patentee's need to inquire into the defendant's intent outweighs the accused infringer's right to confidential communications with his attorney. Regardless of the accuracy of that statement, the cost of the adverse inference is high, and accused infringers often decide to waive their privileges in order to avoid the adverse inference.[60]

3. *The Scope of the Waiver*

In practice, once a defendant waives his attorney-client privilege, there is wide variation in what a court may require him to produce. Courts have hesitated to compel attorney work product not communicated to the client

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54. *Sharper Image*, 222 F.R.D. at 625 n.4. This assumption is designed to prevent defendants from using legal advice to defend against a claim of bad intent and then refusing to allow discovery of the content of the advice.

55. *See id.* (summarizing situations where attorney work product has been compelled).

56. Critics generally cite FED. R. CIV. P. 26(b)(3), which details work product immunity and protects materials generated in preparation for litigation in the absence of "substantial need" on the part of the plaintiff.

57. 449 U.S. 383 (1981).

58. *Id.* at 389.

59. *Id.*

60. *See, e.g.*, William F. Lee & Lawrence P. Cogswell, III, *Understanding and Addressing the Unfair Dilemma Created by the Doctrine of Willful Patent Infringement*, 41 HOUS. L. REV. 393, 439-49 (2004); Lemley & Tangri, *supra* note 11, at 1096-97; Powers & Carlson, *supra* note 6, at 86-91.

because it may not truly reflect the party's intent.[61] However, the waiver has been stretched to include uncommunicated work product,[62] especially when investigating whether an attorney provided a non-reproducible verbal opinion to the client to avoid damaging, written evidence.[63]

Subject matter may also determine what material a court demands. The court may require the defendant to present only those opinions that cover the patent at issue.[64] Alternatively, the court may request opinions on related patents.[65] Further, if the defendant does not claim invalidity, the court might only compel opinions that address infringement.[66]

The scope of the waiver may also vary according to time.[67] The court may compel opinions commissioned before the defendant began the allegedly infringing behavior, extend the waiver to opinions sought after the defendant had notice of the patent at issue, or reach to compel opinions rendered after the patentee served the defendant with an infringement complaint.[68] "Infringement is a continuing tort" and the court may look for evidence of the defendant's intent over time, even if it appears he originally infringed innocently.[69]

A party accused of infringement will frequently retain separate firms to render the infringement opinion and to litigate the suit in order to avoid disclosing communications with his preferred litigation counsel that could put him at a competitive disadvantage with his accuser in the marketplace or in court.[70] Occasionally however, courts require material from both the opinion counsel and the attorney representing the accused in the infringement suit—for instance, where continuing infringing activity is an issue.[71] This expansive view of waiving the attorney-client privilege has been criticized. In *Sharper Image Corp. v. Honeywell International, Inc.*, the

61. Electro-Scientific Indus., Inc. v. Gen. Scanning, Inc., 175 F.R.D. 539, 544-547 (N.D. Cal. 1997) (allowing the work product to be entered under a protective order); Thorn EMI N. Am., Inc. v. Micron Tech., Inc., 837 F. Supp. 616, 620-22 (D. Del. 1993).

62. Sharper Image Corp. v. Honeywell Int'l, Inc., 222 F.R.D. 621, 641 (N.D. Cal. 2004).

63. *Electro-Scientific*, 175 F.R.D. at 544-47 (discussing the particular relevance of the attorney's opinion in this case).

64. *Sharper Image*, 222 F.R.D. at 637-39.

65. *Id.* at 639 (suggesting that opinions on related patents might be compelled where the patentee could show that confidentiality would result in unfair disadvantage).

66. *Id.* at 637-38.

67. Lemley & Tangri, *supra* note 11, at 1094-96.

68. *Id.*

69. Pall Corp. v. Micron Separations, Inc., 66 F.3d 1211, 1221-22 (Fed. Cir. 1995).

70. Lemley & Tangri, *supra* note 11, at 1105-06; Powers & Carlson, *supra* note 6, at 91-93.

71. *See* Lemley & Tangri, *supra* note 11, at 1098-99, 1107.

district court stressed the right of the accused to have confidential litigation counsel, noting that revealing materials from litigation counsel would put the defendant at a distinct competitive disadvantage, for example, in negotiating a settlement with a powerful plaintiff.[72]

In summary, prior to *Knorr-Bremse IV*, a party accused of willfulness, and either without a favorable opinion of counsel or willingness to waive privilege on the opinion, was subject to automatic disadvantage and dealt a "virtual death blow."[73]

II. *KNORR-BREMSE IV*

A number of stakeholders have criticized modern willfulness doctrine and the chilling effect of the adverse inference in the years leading up to the *Knorr-Bremse* cases. Thus, conditions were ripe for the Federal Circuit to address whether an accused infringer's failure to secure a legal opinion and his reliance on the attorney-client privilege should give rise to a negative inference.

A. Background

Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH ("Knorr-Bremse"), a German corporation, designs and sells brakes for heavy commercial vehicles. Knorr-Bremse owns U.S. Patent No. 5,927,445 ("the '445 patent") entitled "Disk Brakes for Vehicles Having Insertable Actuator."[74] Haldex Brake Products AB is a Swedish company that designs air brakes in cooperation with its American subsidiary, Haldex Brake Products Corp. (collectively "Haldex"). Haldex made the prototype for its Mark II model brake in 1996, and agreed to collaborate with Dana Corporation ("Dana"), another American company, to sell Mark II brakes in the United States.[75] Beginning in 1997, Haldex sent a number of the brakes to Dana from Sweden, free of charge, for initial testing.[76]

In 1998, Knorr-Bremse orally notified Dana of its pending U.S. patent and of patent disputes that had arisen with Haldex in Europe. In 1999,

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72. Sharper Image Corp. v. Honeywell Int'l Inc., 222 F.R.D. 621, 643-44 (N.D. Cal. 2004).

73. Lee & Cogswell, *supra* note 60, at 419.

74. The '445 patent issued on July 27, 1999, stemming from a PCT application filed February 1, 1996 in Germany. U.S. Patent No. 5,927,445 (issued July 27, 1999).

75. *Knorr-Bremse II*, 133 F. Supp. 2d 843, 849-50 (E.D. Va. 2001).

76. *Id.* The collaborators installed the Mark II brakes on both Dana trucks and those of potential customers for free, and kept performance records. They also advertised the brakes in trade shows and publications during 1997-2000. *Knorr-Bremse IV*, 383 F.3d 1337, 1341 (Fed. Cir. 2004) (en banc).

shortly after the '445 patent issued, Knorr-Bremse notified Dana in writing, and again noted the European patent disputes with Haldex.[77]

In May 2000, Knorr-Bremse commenced an infringement suit against all three entities, who denied infringement and counterclaimed invalidity based on obviousness and indefiniteness. During discovery, the defendants presented the Mark III as a good-faith attempt to design around the patentee's brake and moved for summary judgment of non-infringement in September 2000.[78] After a Markman hearing, the district court held that the Mark II literally infringed the '445 patent. The court granted defendants' motion against damages, as the patentee could not demonstrate harm from the testing of Mark II brakes on Dana trucks.[79] At trial, the court also held that the Mark III literally infringed the '445 patent and that the claims were valid and nonobvious.[80]

As to the issue of willfulness, the court noted that Knorr-Bremse discussed both the German and U.S. versions of the '445 patent with Haldex in 1999. Subsequently, Haldex obtained a copy of the '445 patent and contacted European and American counsel on the issue of infringement. However, defendants continued to display, promote, and test their Mark II brakes after receiving notice.[81] In spite of evidence that Knorr-Bremse orally notified Dana of the '445 patent in 1998, the district court allowed that Dana was not aware of it until Knorr-Bremse filed the infringement suit in May 2000.[82] However, Dana did not obtain a legal opinion on infringement or investigate the '445 patent at that time, opting instead to rely on Haldex to handle the matter. Dana continued to test and promote the Mark II brakes, even after the company was charged with infringement.[83]

The court relied on the adverse inference to find willful infringement, as Haldex did not turn over the opinion of its U.S. attorney for discovery and Dana did not retain counsel.[84] Moreover, additional *Read* factors weighed against the defendants. They did not have a substantial defense to infringement, given the lack of convincing evidence of obviousness[85] or

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77. *Knorr-Bremse IV*, 383 F.3d at 1341.

78. *Knorr-Bremse II*, 133 F. Supp. 2d. at 849-50, 857.

79. Knorr-Bremse Sys. Fuer Nutzfahrzeuge Gmbh v. Dana Corp., 133 F. Supp. 2d 833, 842 (E.D. Va. 2001) [hereinafter *Knorr-Bremse I*].

80. *Knorr-Bremse II*, 133 F. Supp. 2d at 859-62.

81. *See Knorr-Bremse IV*, 383 F.3d at 1341.

82. *Knorr-Bremse II*, 133 F. Supp. 2d at 857.

83. *Id.* at 857-58.

84. *Id.* at 862-63.

85. *Id.* at 856 ("Significantly, defendants offered no expert testimony or persuasive lay testimony concerning (i) the level of ordinary skill in the art at the time of the inven-

indefiniteness; they did not discontinue their allegedly-infringing behavior or take remedial action upon learning of the '445 patent; and finally, defendants continued their activities even after the Mark II was found to literally infringe.[86] Despite the finding of willfulness, the court could not require enhanced damages, because Knorr-Bremse did not suffer measurable damages. But in light of the defendants' willful behavior, the court awarded attorney's fees to Knorr-Bremse in accord with § 285.[87]

The Federal Circuit sua sponte granted *en banc* review,[88] and requested *amicus* briefs on three questions:

> 1. When the attorney-client privilege and/or work product privilege is invoked by a defendant in an infringement suit, is it appropriate for the trier of fact to draw an adverse inference with respect to willful infringement?
>
> 2. When the defendant has not obtained legal advice, is it appropriate to draw an adverse inference with respect to willful infringement?
>
> . . . .
>
> 4. Should the existence of a substantial defense to infringement be sufficient to defeat liability for willful infringement even if no legal advice has been secured?[89]

Hence, the court not only indicated that it would reconsider the adverse inference, but signaled a possible safe harbor for defendants in willfulness cases.

B. The *En Banc* Decision

The Federal Circuit released its opinion in September 2004, after input from not only the parties, but many other groups as well. Industry, trade groups, and academics submitted twenty-four briefs, resoundingly in favor of the defendant-appellant and critical of the adverse inference. The Federal Circuit agreed and eliminated the adverse inference from the willfulness inquiry.

Judge Newman's opinion stated that a party accused of willful infringement: (1) does not draw an adverse inference in claiming attorney-

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tion, (ii) the scope and content of the prior art, and (iii) the differences between the prior art and the claims at issue.").

86. *Id.* at 863.

87. *Id.* at 864.

88. Knorr-Bremse Sys. Fuer Nutzfahrzeuge Gmbh v. Dana Corp., 344 F.3d 1336 (Fed. Cir. 2003) [hereinafter *Knorr-Bremse III*].

89. *Id.* at 1336-37.

client or work product privilege to protect a legal opinion; (2) does not draw an adverse inference by not obtaining an infringement opinion; but nonetheless (3) may be held liable for willful infringement even if he had a substantial defense to infringement in the absence of a legal opinion of invalidity or non-infringement.

Through *Knorr-Bremse IV*, the Federal Circuit overturned the adverse inference advanced in *Kloster Speedsteel*, and returned to the totality of the circumstances standard by stating that "the trier of fact [is] to accord each factor the weight warranted by its strength in the particular case."[90] Citing *Rolls-Royce*,[91] the court rejected application of a per se rule, and opted for a balance of factors such as those enumerated in *Bott* and *Read*.[92] The majority explicitly declined to address the issue of whether the jury should be told if a defendant commissioned an opinion of counsel when the defendant invokes attorney-client privilege.[93]

Judge Dyk filed a separate opinion, concurring-in-part and dissenting on the issue of a potential infringer's affirmative duty of due care.[94] His opinion stated that patent law diverges from other aspects of law where violating a duty of due care is akin to negligence, and he argued that a finding of willfulness, with its punitive consequences, should be reserved for truly culpable behavior.[95] Finally, he noted that the due care standard does not benefit the patent system, given that the patentee is compensated for infringement damages regardless of the offender's intent, and because the outcome of infringement cases is so difficult to predict.[96]

By removing the adverse inference, *Knorr-Bremse IV* reduced the negative connotation of not invoking the advice of counsel defense that had grown for the last twenty years.[97] While *Knorr-Bremse IV* will be wel-

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90. *Knorr-Bremse IV*, 383 F.3d 1337, 1347 (Fed. Cir. 2004).

91. *Id.* at 1346; Rolls Royce, Ltd. v. GTE Valeron Corp., 800 F.2d 1101, 1110 (Fed. Cir. 1986).

92. *Knorr-Bremse IV*, 383 F.3d at 1346. The court remanded the issue of whether defendants should be liable for willful infringement in this particular case. The court also dismissed defendants' assertion that attorney's fees are punitive in the absence of damages, noting that attorney's fees are compensatory and well within the discretion of the district court on remand. *Id.* at 1347.

93. *Id.* at 1346.

94. *Id.* at 1348 (Dyk, J., concurring-in-part and dissenting-in-part).

95. *Id.* at 1348-52 (Dyk, J., concurring-in-part and dissenting-in-part) (citing recent Supreme Court cases, State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408 (2003), and BMW of N. Am., Inc. v. Gore, 517 U.S. 559 (1996), which limit punitive damages in the interest of due process).

96. *Id.* at 1351-52 (Dyk, J., concurring-in-part and dissenting-in-part).

97. *Id.* at 1344-45.

comed by practitioners, the Federal Circuit declined to supply defendants with a safe harbor by holding that a substantial defense to infringement would not necessarily preclude a finding of willfulness.[98] Moreover, *Knorr-Bremse IV* left some troubling aspects of the willfulness doctrine untouched.

III. DISCUSSION

Knorr-Bremse IV developed in the midst of broad-based efforts to reform the patent system.[99] Willful infringement is among the least popular patent doctrines,[100] criticized as an ineffective deterrent for deliberate infringement,[101] inaccurate punishment for truly malicious actors,[102] and the motivation for evasive, undesirable behavior on the part of competitors and their patent attorneys.[103] Even though *Knorr-Bremse IV* removed the adverse inference, it is unlikely to alleviate these criticisms to any great extent.

A. Problems with the Willfulness Doctrine Prior to *Knorr-Bremse IV*

1. Deterrence

One of the rationales for rewarding enhanced damages for willfulness has been deterrence of intentional violation of patent rights, based on the concern that those rights are underenforced.[104] Presumably, the specter of an increased penalty will encourage potential infringers to exercise due care and prevent blatant copying of competitors' patents. However, of the nine willfulness factors listed in *Read*,[105] only "deliberate copying" guides the economically-cautious innovator in knowing how to circumvent en-

98. *Id.* at 1347.

99. *See generally* FTC REPORT, *supra* note 14, ch. 5, at 28-31; NAS STUDY, *supra* note 11, 118-20.

100. FTC REPORT, *supra* note 14, ch. 5, at 29.

101. *See* Powers & Carlson, *supra* note 6, at 100-01.

102. *Id.* at 95-96.

103. *Knorr-Bremse IV*, 383 F.3d at 1351 (Dyk, J., concurring-in-part and dissenting-in-part). *See generally* Lemley & Tangri, *supra* note 11.

104. Cotter, *supra* note 18, at 21-23. The underenforcement concern that motivated the Patent Act of 1836 and the subsequent willfulness doctrine was largely based on search limitations at the early Patent Office. *See, e.g.*, Powers & Carlson, *supra* note 6, at 100-01. Hence, the majority in *Knorr-Bremse IV* noted that "the 'conceptual underpinnings' of this precedent . . . have significantly diminished in force." 383 F.3d at 1344 (citation omitted); *see also id.* at 1352 (Dyk, J., concurring-in-part and dissenting-in-part).

105. Read Corp. v. Portec, Inc., 970 F.2d 816, 826-27 (Fed. Cir. 1992).

hanced damages. The other factors are not easily defined or instructive to a party that wants to steer clear of the risk, and focus instead on punishing culpable behavior *ex post facto*.[106] For example, where the accused is not made aware of the patent, the determination of "whether the defendant attempted to conceal his conduct" would not apply or help the accused know how to avoid liability. Thus, the nine willfulness factors may not effectively avert the undesirable behavior that the doctrine was designed to prevent.

2. *Punishment*

Penalizing culpable behavior is another rationale for the doctrine. However, willful infringement, especially with the adverse inference, does not serve as fair punishment because it does not necessarily address an infringer's actual intent.[107] The Federal Circuit has acknowledged the difficulty in distinguishing good faith efforts to design around a patent (which is encouraged by the Patent Act) from willful infringement.[108] A naïve innovator may not realize he must procure advice of counsel to avoid an unmerited presumption about his intent. Additionally, where one commissions an opinion, he may want to keep it from his competitors, not to hide unfavorable information, but to hold back confidential or strategic business information. Furthermore, a blameless innovator may face financial ruin simply by sharing the field with a patentee that uses notice letters to harass competition.[109] Finally, once a defendant waives attorney-client privilege, the court may examine attorney work product that the client never saw or acted on. Thus, the willfulness doctrine as it stands may improperly penalize or harass blameless parties.

3. *Innovation*

The willfulness doctrine also undermines the incentives to innovation that animate the patent system. Inventors are discouraged from fully educating themselves about the state of the art for fear that awareness of a

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106. Cotter, *supra* note 18, at 25-28, 44-46 (showing that in many cases, enhanced damages are efficient only where they actually deter infringement).

107. *See, e.g.*, Gustafson, Inc. v. Intersystems Indus. Prods., Inc., 897 F.2d 508, 511 (Fed. Cir. 1990) ("[P]atentees are authorized to sue 'innocent' manufacturers immediately after their patents issue and without warning. To hold such patentees entitled to increased damages or attorney's fees on the ground of willful infringement, however, would be to reward use of the patent system as a form of ambush.").

108. Powers & Carlson, *supra* note 6, at 95-97 (citing WMS Gaming, Inc. v. Int'l Game Tech., 184 F.3d 1339, 1354-55 (Fed. Cir. 1999)).

109. Lemley & Tangri, *supra* note 11, at 1091-93, 1103.

patent will be used against them. Thus, the very reason for requiring disclosure is subverted, and technology cannot progress at an optimal rate.[110]

Settlement and licensing negotiations are also upset by willfulness because of defendants' desire to avoid revealing confidential or damaging information. The harm is two-fold. First, the competitive balance is skewed because patentees can force defendants to make financial outlays with very little basis. Second, in trying to minimize revelations and time spent in litigation, defendants likely leave potentially-invalid patents unchallenged.

Furthermore, the willfulness doctrine wastes both innovative and judicial resources. Inventive enterprises redirect money from development to legal efforts. Since patentees risk nothing in pleading willfulness, it is almost always asserted, requiring defendants to spend more time and money to defend against the claim.[111] Furthermore, evidence showing willfulness tends to prejudice juries toward a finding of infringement, whether knowingly or not. Indeed, this effect can be so strong that courts occasionally allow bifurcated trials.[112]

4. *Loss of Privilege*

The adverse inference undermines the honest and open communications between a lawyer and his client that benefit both the legal effort and society. Faced with a potentially broad waiver of confidentiality, a client might be less than candid with his attorney for fear of having to disclose damaging information to his competitor. Where parties counter this concern by commissioning separate firms for litigation and for rendering an infringement opinion, neither the client nor his legal representatives can base their decisions on the most accurate, complete information.[113] Finally, attorneys are aware that clients require an exculpatory opinion, and thus may hedge their appraisal of potential infringement.[114] This behavior

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110. 35 U.S.C. § 112 ¶ 1 (2000) (requiring both a written description of the invention and an enabling disclosure); Lemley & Tangri, *supra* note 11, at 1100-02.

111. Kimberly Moore, *Judges, Juries, and Patent Cases—An Empirical Peek Inside the Black Box*, 99 MICH. L. REV. 365, 393-94, tbl.5 (2000). Juries decided on the issue of willfulness in 45% of infringement cases between 1983 and 1999. This is a large percentage, considering the strong incentive for willfulness defendants to settle. *Id.* at 390.

112. Lemley & Tangri, *supra* note 11, at 1107-08.

113. Brief for Amici Curiae Association of Patent Law Firms at 7-8, *Knorr-Bremse IV*, 383 F.3d 1337 (Fed. Cir. 2004) (Nos. 01-1357, 01-1376, 02-1221, 02-1256) (discussing conflict of interest walls that may be required between firms serving the same client), *available at* 2003 WL 23200560.

114. Lemley & Tangri, *supra* note 11, at 1092-93. An attorney may also hedge by offering a verbal warning instead of a written opinion. *Id.* at 1103-05; Posting of Greg

is harmful in two respects. First, a client may infringe thinking that his attorney has cleared him, and secondly, the credibility of a judicial system that depends on suspect opinion letters is compromised.

B. Implications of *Knorr-Bremse IV*

Knorr-Bremse IV helps to restore the patent system's goals of promoting disclosure and innovation by deemphasizing the advice of counsel factor. In particular, removal of the adverse inference will reduce instances of unfair punishment, aid innovation by reducing the resources spent on opinions and clarifying freedom to operate, and help restore the attorney-client relationship, thereby reducing undesirable, evasive behavior.

The finder of fact will no longer be able to presume malicious intent based on an accused infringer's failure to consult counsel or claim privilege. Thus, the ruling may lead to a more just allotment of punitive damages. *Knorr-Bremse IV* may also give inventors more room to read patents and proceed from a disclosure that the PTO has already found to be inventive and enabled.[115] If a potential infringer becomes aware of a patent on his own, he is now more empowered to make a good faith assessment of whether he should seek legal advice,[116] leaving him with more time and money for innovation.

Knorr-Bremse IV also harmonizes the patent system with other aspects of the law by restoring the attorney-client and work product privileges.[117] The majority pointed out that the Federal Circuit had never explicitly held that the attorney-client privilege did not apply in a patent case, but admitted that the adverse inference "distort[ed] the attorney-client relationship."[118] In light of the ruling, clients are more apt to commission opinions from their usual counsel, which can render more valid and honest ad-

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Aharonian, patnews@ns1.patenting-art.com (Sept. 15, 2004) (copy on file with author) (arguing that uncertainty with claim language interpretation allows for a wide range of infringement opinions and quoting two practitioners about the cottage industry of favorable opinion writers), *at* patents@world.std.com.

115. An unscientific survey on the Internet Patent News listserv asked readers whether a party could safely keep an updated database of its competitor's patents. While past results have been evenly split between yes, no, and maybe, the results after *Knorr-Bremse IV* were 50% yes, 50% maybe. Posting of Greg Aharonian, patnews@ns1.patenting-art.com (Nov. 24, 2004) (copy on file with author), *at* patents@world.std.com.

116. Knorr-Bremse*: The Federal Circuit Overrules Its Precedent and Reshapes Willfulness*, Morrison & Foerster LLP, *available at* http://www.mofo.com/news/general.cfm?MCatID=&concentrationID=25&ID=1324&Type=5 (last visited Sept. 14, 2004) ("One result of *Knorr-Bremse* may be a greater receptivity to noninfringement and invalidity analyses by technical personnel.").

117. *See Knorr-Bremse IV*, 383 F.3d 1337, 1344-45 (Fed. Cir. 2004) (en banc).

118. *Id.* at 1344.

vice.[119] Hopefully, this result will benefit the legal profession by preventing clients from infringing on the basis of an inaccurate opinion.

C. Issues Remaining After *Knorr-Bremse IV*

Time will tell just how safe competitors are from the adverse inference in light of *Knorr-Bremse IV*. The court left much of willfulness doctrine, and its resulting uncertainty, intact.[120]

The Federal Circuit addressed deterrence and underenforcement concerns by holding that a substantial defense to infringement, such as a good faith belief of invalidity, would not preclude a finding of willfulness. While this ruling certainly discourages deliberate infringement,[121] it does not tackle the assertion that many patents *are* invalid.[122] Hence, competitors are improperly excluded from areas covered by invalid patents. Because accurately determining patent validity is quite complicated, the holding suggests that defendants face an uphill battle in demonstrating good faith without a convincing legal opinion.

Despite Judge Dyk's dissent, the duty of due care to avoid infringement stands.[123] While defendants will no longer be punished for a presumed intent, the court did not clarify how an accused party could demonstrate lack of intent—that is, good faith. For example, courts may accept an institutional policy for addressing potential infringement issues as evidence that the accused was exercising due care. However, the Federal Circuit has looked skeptically at in-house procedures in the past,[124] thus com-

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119. Knorr-Bremse: *The Federal Circuit Changes the Law on Opinion of Counsel*, Foley & Lardner LLP, *available at* http://www.foley.com/publications/pub_detail.aspx?pubid=2396 (last visited Feb. 17, 2005) ("[After Knorr-Bremse], accused infringers may be able to choose to have their opinion counsel serve as litigation counsel if they so desire.").

120. *See Knorr-Bremse IV*, 383 F.3d at 1352 (Dyk, J., concurring-in-part and dissenting-in-part); *see, e.g.*, Walter C. Linder & William L. Roberts, *Do You Want My Opinion?*, Faegre & Benson LLP, *available at* http://www.faegre.com/articles/article_1428.aspx (last visited Feb. 17, 2005) ("Like the court's decision in the *Festo* case on the doctrine of equivalents, it may take further court actions in the coming years to determine the full effects of the *Knorr-Bremse* case.").

121. The court may be attempting to prevent potential infringers from proceeding with the assertion that most patents are invalid anyway. *See, e.g.*, Underwater Devices, Inc. v. Morrison-Knudsen Co., 717 F.2d 1380, 1385 (Fed. Cir. 1983).

122. FTC REPORT, *supra* note 14, Executive Summary, at 5-14; John R. Allison & Mark A. Lemley, *Empirical Evidence on the Validity of Litigated Patents*, 26 AIPLA Q.J. 185 (1998). This issue will be revisited in the next part.

123. *Knorr-Bremse IV*, 383 F.3d at 1344.

124. *See* Bott v. Four Star Corp., 807 F.2d 1567, 1572 (Fed. Cir. 1986); *Underwater Devices*, 717 F.2d at 1390. In addition, while a defendant might be just as protective of an

panies should use caution in drafting such plans. Even after *Knorr-Bremse IV*, defendants are left with a difficult decision: Should they trust the reversal of the adverse inference, decline to turn over infringement opinions, and try to prove good faith some other way, or should they take their chances in asserting the defense and waiving privilege? Until the Federal Circuit revisits the issue to address the scope of material made accessible under the waiver or until more cases provide reassurance that the adverse inference is dead, defendants will likely remain cautious and commission infringement opinions.

Though *Knorr-Bremse IV* helped level the playing field for willfulness charges, it stopped short of requiring any evidentiary basis for claiming willfulness, so patent holders still do not risk much in seeking enhanced damages. The number of willfulness cases and the load on the judiciary is thus unlikely to drop. Further, and perversely, removing the inference might actually make cases more time-consuming.

Finally, the Federal Circuit specifically set aside the question of whether to inform the jury if the defendant commissioned an infringement opinion.[125] In light of the main holding, the presence or absence of an infringement opinion should be only one factor in determining willfulness. However, an opinion of non-infringement or invalidity is still powerful evidence to a jury.[126] If a court informs a jury that defendants have chosen to rely on privilege, for whatever reason, the jury might perceive that probative evidence is being "hidden" from them and hold some prejudice against the concealing party. Policy justifications exist on both sides of this question. Informing the jury of the presence or absence of a protected opinion provides them with more information to decide based on the totality of the circumstances, while withholding the information saves accused infringers from undue prejudice.

IV. RECOMMENDATIONS FOR ADDITIONAL REFORM OF THE WILLFUL INFRINGEMENT DOCTRINE

The *Knorr-Bremse* holding provides a step in the right direction for promoting innovation and disclosure, reducing the amount of resources wasted on legal opinions and litigation, and restoring client privileges. However, it fails to create a predictable standard for competitors in assess-

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infringement determination from an in-house non-lawyer as one from an attorney, he would be unable to claim privilege.

125. *Knorr-Bremse IV*, 393 F.3d at 1346-47.

126. Lemley & Tangri, *supra* note 11, at 1091-92.

ing their freedom to operate. Thus, current efforts by policy makers and practitioners to reform the doctrine should continue.

A. Improvement Objectives

Harmonizing the doctrine of willful infringement with policies within and outside of patent law will assist parties on all sides to make informed decisions. Successful reform will seek to achieve the following goals:

> (1) Promote innovation[127] by:
>
> (a) directing resources away from litigation;
>
> (b) encouraging inventors to read patents so society can benefit from the public disclosure;[128]
>
> (c) encouraging competition by leveling the balance of negotiating power between parties;[129]
>
> (d) setting a predictable, uniform standard for willfulness so that parties can make informed, strategic decisions;[130]
>
> (2) Preserving the rationale behind the willfulness doctrine by deterring deliberate infringement and properly penalizing egregious conduct; and
>
> (3) Restoring the attorney-client and work product privileges,[131] thereby improving the quality of opinions and diminishing evasive behaviors.

B. Proposed Changes

A growing list of proposed reforms seeks to address these goals. More drastic proposals include a bright line rule to reduce the number of willfulness claims and a plan to limit the intent inquiry to the moment that infringement begins. Others seek more subtle fixes for the doctrine as it stands.

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127. *See* U.S. CONST. art. I, § 8, cl. 8; FTC REPORT, *supra* note 14, Executive Summary, at 16.

128. *See* Brenner v. Manson, 383 U.S. 519, 533-34 (1965); FTC REPORT, *supra* note 14, ch. 5, at 28-31 (noting that the subsequent increase in validity challenges will improve patent quality and the public's ability to rely on patents).

129. FTC REPORT, *supra* note 14, ch. 5, at 30, 32.

130. Recent Federal Circuit decisions have sought to establish more clear-cut guidelines in patent law. *See, e.g.*, Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., 535 U.S. 722, 730-31 (2002); Markman v. Westview Inst., 517 U.S. 370, 390 (1996) (describing that Congress's reason for creating the Federal Circuit was that "increased uniformity would 'strengthen the United States patent system in such a way as to foster technological growth and industrial innovation'") (citation omitted).

131. *See* Upjohn Co. v. United States, 449 U.S. 383, 389 (1981).

1. *Bright Line Rule*

The Federal Trade Commission (FTC) and others have suggested a formalized alternative to the totality of the circumstances analysis.[132] Under this proposal, a patentee could not assert willful infringement until he gave sufficient written notice to provide the accused with standing to challenge the patent.[133] Accordingly, accused parties would only be liable for punitive damages if they continued the offending activity after receiving such notice. This proposal would reduce the number of willfulness claims, restore competitive balance, more fairly punish culpable behavior, and reduce the need for privileged evidence.

Where patentees risk declaratory judgment of invalidity, they will more honestly assess whether their claims will withstand the challenge. Patentees may still claim willfulness after a trial for infringement in order to benefit from juries' sympathetic perception of patent holders. Nevertheless, this proposal would weed out more meritless claims of willfulness and lighten the load for the judiciary. Not only would patentees act based on the strength of their patents, but potential infringers would as well. Allowing competitors to challenge patents that they believe to be invalid will invigorate the patent system.[134] This in turn, will expose weaker patents, generally leaving the stronger ones in the field. As a result, the bright line rule would deter deliberate infringement based on lack of respect for patent quality.[135]

A predictable trigger for willful infringement charges will also allow parties to plan strategically without second-guessing how a jury will view their behavior. Competing parties will be able to direct resources away from the "opinion of counsel" budget to other areas. Further, because the defendants will be on more equal footing in potential litigation, settlement and licensing negotiations will proceed with more objective, value-based motivations.

Under this proposal, enhanced damages would still be available for patentees where the accused continued the offending activity after receiv-

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132. Public Knowledge Brief, *supra* note 14; FTC REPORT, *supra* note 14, ch. 5, at 28-31.

133. To request declaratory judgment of invalidity or non-infringement, an accused party must have a reasonable apprehension that his accuser will initiate suit on infringement. FTC REPORT, *supra* note 14, ch. 5, at 31.

134. In response to complaints about patent quality, the *FTC Report* suggests a post-issue review period to allow competitors to challenge patents. *See* FTC REPORT *supra* note 14, ch. 5, at 17-23.

135. *See id.* ch. 5, at 31.

ing notice. Thus, the deterrent effect, if legitimate,[136] would be preserved, and punishment would be reserved for more culpable behavior. Holders of questionable patents, however, could no longer harass their competitors with impunity.

This plan would reduce the need to access privileged evidence of intent, as the defendant's conduct would be more probative. Where the accused continued to act without challenging his accuser, the willfulness determination could truly rely on the totality of the circumstances, as there would be no question that the defendant was on notice.

The standard arguments against formalism (making rigid guidelines)[137] do not apply to willful infringement. For example, fewer willfulness charges will likely not increase the number of patents filed, increase the examination standards, or decrease certainty,[138] because the willfulness factors are not as nebulous or technical as those involved in claim construction or the doctrine of equivalents.[139] Courts will be provided with an easy to apply notice-or-no-notice standard and competitors will be better able to avoid unwarranted charges.

While this willfulness standard poses a large burden on a patentee to police his claims, the underenforcement concern is offset by the fact that the patentee will at least be compensated for infringement damages,[140] regardless of whether he can show bad faith by the defendant. In addition, patentees in the Internet age are better able to police their own patents and determine their validity than they were when the doctrine arose. Thus, the burden would be allocated more fairly, as patentees are currently better equipped to prove willfulness than defendants are to prove their good faith.

2. *Initial Intent Proposal*

A second proposal suggests that willful infringement should only be available where the patentee can provide evidence of deliberate copy-

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136. *See* Powers & Carlson, *supra* note 6, at 100-01 (asserting that threat of an injunction and litigation costs are much more effective deterrents to infringement than the threat of enhanced damages).

137. *See generally* John R. Thomas, *Formalism at the Federal Circuit*, 52 AM. U. L. REV. 771 (2003).

138. Public Knowledge Brief, *supra* note 14, at 9-11. While the number of patent validity challenges might increase, the effect would likely be small because asserted patents would likely be strong enough to persuade defendants to negotiate.

139. Thomas, *supra* note 137.

140. 35 U.S.C. § 284 (2000). Moreover, patentees would be more accountable for providing constructive notice on their products, and processes where possible, in accordance with § 287(a).

ing.[141] Such a system would restore the pre-1980s standard for willfulness damages.[142] The relevant inquiry would be the defendant's intent when he began the infringing activity.[143] This approach provides the advantages of reducing the number of claims, deterring and punishing deliberate copying, simplifying the analysis, and reducing the amount of evidence required. However, opinion letters would likely remain the most probative evidence of early intent, for example, to show that a defendant proceeded even after receiving an unfavorable opinion. Therefore, privilege would still be an issue. In addition, this plan does little to reduce a patentee's incentive to harass competitors.

Under this system, patentees could claim willfulness where they provided clear, corroborated evidence that the accused copied from their patent. While advice of counsel would remain quite relevant, juries would only consider evidence of the defendant's initial intent, so the inquiry into his legal materials would be more limited. Reducing the time required would also cut down on court costs. This proposal has the further advantage of punishing truly culpable behavior while sparing parties that began infringing unknowingly.[144]

This proposal has a few disadvantages. Patentees may not be able to access satisfactory evidence of copying, even if it exists. Also, courts would still likely compel privileged material from defendants relying on an advice of counsel defense. Finally, innovators would still have some incentive to avoid reading patents because their awareness might be used to show copying. However, plaintiffs in clear cases of willful infringement would not be harmed and, because the scope of the inquiry would be limited, defendants would suffer less collateral damage to their businesses from the trial.

3. *Less Drastic Plans*

Additional proposals are more modest. For example, some have proposed tinkering with the scope of material available to the court where the defendant waives his privilege.[145] This proposal recognizes the importance of the advice of counsel defense and seeks to reduce the damage to defen-

141. Public Knowledge Brief, *supra* note 14, at 9-1; Lemley & Tangri, *supra* note 11, at 1116-22; Cotter, *supra* note 18.

142. *See* Powers & Carlson, *supra* note 6, at 68 (describing the standard as limited to cases of conscious and deliberate infringement).

143. Lemley & Tangri, *supra* note 11, at 1118-19.

144. *Id.*

145. *See generally* David O. Taylor, *Wasting Resources: Reinventing the Scope of Waiver Resulting from the Advice-of-Counsel Defense to a Charge of Willful Patent Infringement*, 12 TEX. INTELL. PROP. L.J. 319 (2004).

dants that use it. However, it does little to address undesirable behavior by any of the involved parties. Another suggestion is to increase damage awards where infringement is hard to detect and there is a higher risk of underenforcement.[146] This proposal has the advantage of punishing and deterring egregious behavior with more consistency. However, as courts already have discretion to set the award within statutory limits, it does little to impose real change in an unpopular doctrine.

V. CONCLUSION

By reversing the adverse inference, *Knorr-Bremse* helps to restore the attorney-client privilege to parties accused of willful infringement and eliminate a presumption of intent that has posed a serious obstacle to competitors' freedom to operate. Unfortunately, the decision does not address additional problems with the willfulness doctrine. Although *Knorr-Bremse* represents an important step, a more predictable standard for willfulness would restore freedom to operate for competitors, more effectively deter and punish undesirable behavior, and promote innovation, all in line with the aims of the Patent Act. In light of the patentee's ever-expanding ability to monitor the competition, there is less risk of patent underenforcment. Potential infringers, on the other hand, are faced with patent validity issues that are increasingly complex. Therefore, the balance of equities has shifted to favor a more limited willful infringement doctrine.[147]

146. Lemley & Tangri, *supra* note 11, at 1111-25; Cotter, *supra* note 18.

147. *See Knorr-Bremse IV*, 383 F.3d 1337, 1352 (Fed. Cir. 2004) (Dyk, J., concurring-in-part and dissenting-in-part).

SCHERING CORP. V. GENEVA PHARMACEUTICALS, INC.: CLARIFICATION OF THE INHERENT ANTICIPATION DOCTRINE AND ITS IMPLICATIONS

By Cynthia Chen

An invention must be new at the time of discovery to be patentable.[1] A patent fails the § 102 novelty requirement[2] if the invention is anticipated by prior art.[3] To demonstrate invalidity by anticipation, a single prior art reference must disclose "each and every limitation of the claimed invention."[4] Under the doctrine of inherency, a patent is invalid based on anticipation even if a prior art reference failed to expressively disclose a feature of the claimed invention, as long as the missing feature is a "deliberate or a necessary consequence of what was intended."[5] On the other hand, inherent anticipation requires certainty—a prior accidental achievement of a product or process does not constitute inherent anticipation, since a true accident gives the public no assurance that others can achieve the same result at a later time.[6]

In *Schering Corp. v. Geneva Pharmaceuticals, Inc.*, the Federal Circuit resolved a long-standing debate in the doctrine of inherent anticipation—whether recognition of an inherent feature in the prior art is required.[7] The court invalidated an allergy medicine patent claim on the ground that a prior drug patent inherently anticipated all of that drug's metabolites.[8] The court held that inherent anticipation does not require that the inherent feature be appreciated at the time of the earlier patent, as long as the disclosure is a "necessar[y] and inevitabl[e]" consequence of the earlier invention.[9]

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1. *See* 2 JOHN GLADSTONE MILLS III ET AL., PATENT LAW FUNDAMENTALS § 10.1 (2d ed., rev. 2004).

2. *See* 35 U.S.C. § 102 (2000).

3. *See* 2 MILLS ET AL., *supra* note 1, §§ 10.2, 10.6.

4. Schering Corp. v. Geneva Pharms., Inc., 339 F.3d 1373, 1377 (Fed. Cir.), *review en banc denied*, 348 F.3d 992 (Fed. Cir. 2003).

5. 1 DONALD S. CHISUM, CHISUM ON PATENTS § 3.03 (2004); *see also* Atlas Powder Co. v. Ireco Inc., 190 F.3d 1342, 1347 (Fed. Cir. 1999).

6. *See* 1 CHISUM, *supra* note 5, § 3.03.

7. 339 F.3d at 1377.

8. *Id.* at 1380. A metabolite is the compound formed by the body upon ingestion of a drug. *Id.*

9. *Id.* at 1378-80.

The *Schering* decision represents an effort by the Federal Circuit to balance two conflicting goals of the patent system: to stimulate inventive efforts by giving inventors exclusive rights for a limited period and to allow the public at large to derive benefits from the advances in technology.[10] While the decision arguably might create some challenges in biotechnology and pharmaceutical patents, it articulates a bright-line rule for future inherency cases and ensures that an invention passes to the pubic domain upon the expiration of the patent term. To minimize any potential negative impact on pharmaceutical innovations, the court also provided guidance on future patent protection on metabolites of known drugs.[11]

Part I of this Note examines the historical development and evolution of the inherency doctrine, from the Supreme Court's earlier emphasis on rewarding inventive efforts, to the conflicting decisions by the Federal Circuit before *Schering*. Part II provides a summary of *Schering*. Part III.A analyzes the underlying policy considerations of the inherency doctrine; Part III.B discusses the fairness of the *Schering* outcome; Part III.C discusses the implications of *Schering* on pharmaceutical drug innovations and argues that the chilling effects of *Schering* on metabolite research will be minimal; and finally, Part III.D argues that the "necessary and inevitable" test promulgated by *Schering* should be strictly applied in inherency analysis, and that invalidity should only be found in cases where there is an absolute certainty of inherent features.

I. BACKGROUND

The patent system represents a carefully crafted bargain that promotes both innovation and public disclosure of new and useful technologies, in return for a limited monopoly.[12] While one goal of patent law is to give a reasonable reward to inventors in order to stimulate innovative efforts, the main objective is "to promote the Progress of Science and useful Arts."[13] The Supreme Court ruled that this could be best achieved "by giving the public at large a right to make, construct, use, and vend the thing invented, at as early a period as possible; having a due regard to the rights of the inventor."[14]

10. Pfaff v. Wells Elecs., Inc., 525 U.S. 55, 63 (1998).
11. *Schering*, 339 F.3d at 1381.
12. *See, e.g.*, *Pfaff*, 525 U.S. at 63.
13. U.S. CONST. art. I, § 8, cl. 8; Pennock v. Dialogue, 27 U.S. (2 Pet.) 1, 19 (1829).
14. *Pennock*, 27 U.S. (2 Pet.) at 19.

The novelty requirement lies at the heart of the patent system and assures that knowledge already in the public domain "remain[s] there for the free use of the public."[15] Granting a monopoly in existing public information serves no socially useful purpose and in fact injures the public.[16] A patent fails to meet the novelty requirement if the same invention is anticipated by prior art, that is, if a single prior art reference discloses "each and every element of the claimed invention."[17]

Inherent anticipation can be established if a prior art reference functions in accordance with all the limitations of a claimed invention.[18] Thus, a prior art reference can anticipate a later invention without expressly disclosing every limitation, as long as the missing descriptive matter is inevitably present.[19] However, inherent anticipation requires absolute certainty, and "may not be established by probabilities or possibilities."[20] "The mere fact that a certain thing *may* result from a given set of circumstances is not sufficient."[21]

A. *Tilghman* and *Eible Process*: Accidental, Unintended Results Do Not Anticipate

The Supreme Court established in *Tilghman v. Proctor* that an accidental, unintended, and unappreciated production of a product or process does not constitute anticipation.[22] In *Tilghman*, the patentee claimed a process of treating fats and oils by separating them into fatty acids and glycerine through the action of water at a high temperature and pressure.[23] Two of the prior art references the accused infringer cited were (1) the use of animal fat in a steam engine to lubricate the piston,[24] and (2) the purification of fats and oils in preparation for soap-making.[25] Despite

15. Aronson v. Quick Point Pencil Co., 440 U.S. 257, 262 (1979). Section 102(a) of the Patent Act precludes patenting an invention that is previously in use or described in a printed publication. *See* 35 U.S.C. § 102 (2000).

16. Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 148 (1989).

17. *See* 2 MILLS ET AL., *supra* note 1, § 10.6.

18. *See id.* § 10.5.

19. Cont'l Can Co. USA v. Monsanto Co., 948 F.2d 1264, 1268 (Fed. Cir. 1991).

20. *Id.* at 1269 (quoting Hansgirg v. Kemmer, 102 F.2d 212, 214 (C.C.P.A. 1939)).

21. *Id.*

22. 102 U.S. 707, 711-72 (1881).

23. *Id.* at 708-09.

24. Mitchell v. Tilghman, 86 U.S. (19 Wall.) 287, 314-15 (1873). A scientific article published thirty years before Tilghman's invention made the observation that Perkins used animal fat in a steam engine to lubricate the piston and diminish friction. *Id.* The *Tilghman v. Proctor* case involved the same patent as in the *Mitchell v. Tilghman* case, and in fact, overruled *Mitchell* as to the validity of the patent. *Tilghman*, 102 U.S. at 708.

25. *Tilghman*, 102 U.S. at 711.

the possible production of fatty acids in these processes, the Supreme Court held that Tilghman's invention was not anticipated.[26] The Court found that the cited prior users never fully understood the process by which fatty acids were generated, and therefore, the "accidental[] and unwitting[]" formation of fatty acid was of "no consequence."[27] The Court emphasized the importance of subjective appreciation in the anticipation analysis, stating that:

> If the acids were accidentally and unwittingly produced, whilst the operators were in pursuit of other and different results, without exciting attention and without its even being known what was done or how it had been done, it would be absurd to say that this was an anticipation of Tilghman's discovery.[28]

Similarly, in *Eibel Process Co. v. Minnesota & Ontario Paper Co.*, the Supreme Court held that "accidental results, not intended and not appreciated, do not constitute anticipation."[29] In this case, Eibel's patent claimed an improved paper-making machine, by elevating the pitch of the paper-making wire by several degrees.[30] The challenger relied on prior machines that introduced some pitch for drainage purposes.[31] The Court found that the existence of any high pitch in prior machines was "under unusual conditions" because the pitch needed for drainage was usually small.[32] Therefore, inherent anticipation could not be established.[33] Citing *Tilghman*, the Court held that to serve the purpose of the patent system, courts should first "look[] into the art to find what the real merit of the alleged discovery or invention is and whether it has advanced the art substantially," and if so, courts should construe the patent to "secure to the inventor the reward he deserves."[34]

The Supreme Court in *Tilghman* and *Eibel Process* apparently disregarded accidental achievements in anticipation analysis.[35] The holdings are consistent with one goal of patent law—to stimulate inventive

26. *Id.* at 711-12.
27. *Id.* at 711, 731.
28. *Id.* at 711-712.
29. 261 U.S. 45, 66 (1923).
30. *Id.* at 52, 58.
31. *Id.* at 58.
32. *Id.*
33. *Id.* at 66.
34. *Id.* at 63.
35. *See* 1 CHISUM, *supra* note 5, § 3.03[2].

efforts and public disclosure by giving inventors reasonable rewards.[36] In cases where the existence of a product or a process is either accidental or unappreciated, the public gains no new or useful knowledge from the prior user, nor has the prior user truly engaged in any innovative activity. Therefore, the Court found it "absurd" that unappreciated, accidental results would prevent an inventor from claiming a conscious and deliberate discovery she had made.[37]

A number of lower court decisions soon followed *Tilghman* and *Eibel Process*. In *Pittsburgh Iron & Steel Foundries Co. v. Seaman-Sleeth Co.*, the Third Circuit held that the prior production of an alloy "was not known to those who produced it" and not "recognized as a new product," therefore the alloy was "without value as an anticipation."[38] In *Munising Paper Co. v. American Sulphite Pulp Co.*, the Sixth Circuit held that the "prior accidental production of the same thing, when the character and function were not recognized until the invention of the later patent, does not effect anticipation."[39] Finally, in *Toch v. Zibell Damp Resisting Paint Co.*, the Second Circuit similarly stated that novelty was not defeated if the prior user had no knowledge of the results.[40] These decisions generally followed the Supreme Court's rationale in *Tilghman* that exclusive rights to inventions are granted to reward genuine innovative efforts and, that in exchange for granting patent rights, the public benefits from the knowledge of how to make and use the invention.[41]

B. Recognition of the Inherent Feature in the Prior Art: Two Lines of Federal Circuit Cases

While the *Tilghman* decision is generally interpreted as holding that accidents do not anticipate later inventions, the scope of *Tilghman* depends on how courts construe the meaning of "accident."[42] An earlier accidental achievement of a product may have been either (1) sporadic or unusual or (2) a consistent and necessary consequence of what was

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36. *See* Pfaff v. Wells Elecs., Inc., 525 U.S. 55, 63 (1998); *Eibel Process*, 261 U.S. at 63.

37. *See* Tilghman v. Proctor, 102 U.S. 707, 712 (1881).

38. 248 F. 705, 709 (3d Cir. 1918).

39. 228 F. 700, 703 (6th Cir. 1915).

40. 233 F. 993, 995 (2d Cir. 1916) (stating that "novelty is not negatived by a prior accidental production of the same thing when the operator does not recognize the means by which the accidental result is accomplished, and no knowledge of them, or of the method of their employment, is derived from the prior use by any one").

41. *See Pfaff*, 525 U.S. at 63-64.

42. *See* 1 CHISUM, *supra* note 5, § 3.03[2].

intended but nevertheless unappreciated.[43] Until the *Schering* decision in 2003, the Federal Circuit had oscillated on the issue of whether a person of ordinary skill in the art must recognize the inherent feature of a prior art reference.[44] Some decisions required recognition of the inherent feature, while others held the opposite.[45]

1. *The* Atlas Powder *Line of Cases: Recognition in the Prior Art Is Not Required for Inherent Anticipation*

In *Atlas Powder Co. v. IRECO Inc.*, the Federal Circuit held that "[i]nherency is not necessarily coterminous with the knowledge of those of ordinary skill in the art," and that insufficient understanding "does not defeat a showing of inherency."[46] In *Atlas Powder*, the patents claimed composite explosives made from a particular blasting composition.[47] The claimed explosives were identical to the blasting compositions of two prior art references.[48] However, the prior art references did not explicitly include a "sufficient aeration entrapped" limitation.[49] Nevertheless, a calculation of the percentage of the water-in-oil emulsion showed that air was inevitably trapped in the prior art explosives.[50] Based on this calculation, the court concluded that the patents were anticipated even though entrapped air was not recognized as an ingredient in the prior art.[51]

A similar holding can be found in *Titanium Metals Corp. v. Banner*, in which inherent anticipation was established even though a critical property of a claimed alloy was not disclosed in the prior reference.[52] The Federal Circuit found that although the alloy's "good corrosion resistance in hot brine environments" was an unappreciated property, the newly discovered characteristic did not "render the old composition patentably new."[53] Therefore, the *Atlas Powder* and *Titanium Metals* decisions took the position that even though the inherent structure, composition, or function was unknown or unappreciated in the prior art, insufficient understanding

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43. *See id.*
44. *See id.* § 3.03[2][c].
45. *See id.*
46. 190 F.3d 1342, 1347, 1349 (Fed. Cir. 1999).
47. *Id.* at 1343-46.
48. *Id.* at 1345.
49. *Id.*
50. *Id.* at 1348-49.
51. *Id.* at 1347-48.
52. 788 F.2d 775, 781 (Fed. Cir. 1985). The prior art reference disclosed the same alloy composition without discussing its "good corrosion resistan[t]" property. *Id.*
53. *Id.* at 782; *see Atlas Powder*, 190 F.3d at 1347 (interpreting *Titanium Metals*).

of the inherent feature should not defeat a finding of anticipation.[54] The decisions reflect the policy consideration that the public should remain "free to make, use, or sell prior art compositions or processes, regardless of whether or not they understand their complete makeup or the underlying scientific principles which allow them to operate."[55]

Cases following the reasoning of *Titanium Metals* and *Atlas Powder* include *In re Cruciferous Sprout Litigation*[56] and *MEHL/Biophile International Corp. v. Milgraum*.[57] In *Cruciferous*, the inventors recognized that certain sprouts and food products were rich in glucosinolates, which could reduce the risk of cancer.[58] The prior art included the same sprouts but did not recognize the existence of glucosinolates.[59] In finding the patent invalid, the court emphasized that since the patent owner merely discovered some inherent, unappreciated properties of the sprout products, the novelty requirement was not met.[60] Similarly, in *MEHL/Biophile*, the court held that a method claim of "hair depilation" was anticipated by a prior article teaching the "alignment of the laser light over a hair follicle."[61] The fact that the article's authors did not appreciate the results (that is, hair removal) was "of no importance."[62]

2. *The* Continental Can *Line of Cases: An Inherent Feature in the Prior Art Must Be Recognized by Persons of Ordinary Skill for Anticipation*

Another line of inherency cases followed *Continental Can Co. USA v. Monsanto Co.*,[63] which some courts had read to suggest that an inherent feature must be recognized by a person of ordinary skill in the art within the prior art time frame.[64] The patent at issue in *Continental Can* claimed a

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54. *See Altas Powers*, 190 F.3d at 1347.

55. *Id.* at 1348.

56. 301 F.3d 1343 (Fed. Cir. 2002), *cert. denied sub nom.*, Brassica Prot. Prods. LLC v. Sunrise Farms, 538 U.S. 907 (2003).

57. 192 F.3d 1362 (Fed. Cir. 1999).

58. 301 F.3d at 1345-47.

59. *Id.* at 1346.

60. *Id.* at 1350-51.

61. 192 F.3d at 1364, 1366.

62. *Id.* at 1366.

63. 948 F.2d 1264, 1268 (Fed. Cir. 1991).

64. *See, e.g.*, Toro v. Deere & Co., 355 F.3d 1313, 1320-21 (Fed. Cir. 2004) (commenting on the confusion over the interpretation of *Continental Can*); Elan Pharms., Inc. v. Mayo Found. for Med. Educ. & Research, 304 F.3d 1221, 1228 (Fed. Cir. 2002), *vacated en banc*, 314 F.3d 1299 (Fed. Cir. 2002) (holding that to prove inherency "it must be shown that the undisclosed information was known to be present in the subject matter of the reference").

plastic bottle with hollow support ribs.[65] The prior art reference disclosed a bottle with support ribs but did not state that the ribs were "hollow"; nevertheless, the competitor provided expert testimony suggesting that the manufacturing process inherently produced hollow ribs.[66] Holding that it was improper to find invalidity based on the inherency doctrine, the Federal Circuit established a two-prong test for inherent anticipation: first, "evidence must make clear that the missing descriptive matter is necessarily present in the thing described in the reference," and second, the undisclosed feature must be "recognized by persons of ordinary skill."[67]

Continental Can was followed by *Crown Operations International, LTD v. Solutia Inc.*[68] and *Rosco, Inc. v. Mirror Lite Co.*[69] In *Crown*, the challenger argued that if a prior art reference disclosed the same structure as the patent, then the resulting property (in this case, "two percent solar control reflectance") was inherent.[70] The court declined to adopt the challenger's approach and held that inherency could not be established if the "two percent" limitation was unrecognized in the prior art.[71] Similarly, in *Rosco*, the panel held that the inherency question was not based on whether a prior art process inherently resulted in a claimed invention, but whether one of skilled in the art would read the prior art as inherently disclosing the invention.[72]

3. EMI Group *and Distinguishing* Atlas Powder *and* Continental Can*: Law of Nature Versus Undisclosed Physical Structure*

In *EMI Group North America, Inc. v. Cypress Semiconductor Corp.*,[73] the Federal Circuit articulated a distinction between *Atlas Powder* and *Continental Can*.[74] The patent in dispute in *EMI Group* claimed a metallic fuse for semiconductor chips that could be blown in a vapor-induced

65. 948 F.2d at 1266.
66. *Id.* at 1266-68.
67. *Id.* at 1268; *see, e.g.*, AstraZeneca AB v. Mut. Pharm. Co., 278 F. Supp. 2d 491, 514 (E.D. Pa. 2003), *aff'd-in-part, rev'd-in-part, and remanded*, 384 F.3d 1333 (Fed. Cir. 2004) (stating that "certain Federal Circuit cases have referred to inherency as a two-prong determination"); Steven C. Carlson, *Inherent Anticipation*, 40 IDEA 297, 300-01 (2000) (stating that *Continental Can* established a two-prong test to determine inherency).
68. 289 F.3d 1367 (Fed. Cir. 2002).
69. 304 F.3d 1373 (Fed. Cir. 2002).
70. 289 F.3d at 1377.
71. *Id.* at 1378.
72. 304 F.3d at 1381.
73. 268 F.3d 1342 (Fed. Cir. 2001).
74. *Id.* at 1350-51.

step.[75] The prior art fuses had the same structure but did not include "vapor-induced explosion" in the claims.[76] The court found that the "vapor-induced explosion" was a "scientific explanation" on how the prior art fuses had functioned, and such theoretical explanation was inherent.[77] To reconcile *Continental Can* and *Atlas Powder*, the court stated that the requirement that persons of ordinary skill recognize the missing descriptive matter "may be sensible for claims that recite limitations of structure, compositions of matter, and method steps" to ensure that the undisclosed feature necessarily existed in the prior art.[78] In contrast, "[t]heoretical mechanisms or rules of natural law that are recited in a claim" were not patentable themselves and did "not need to be recognized by one of ordinary skill in the art for a finding of inherency."[79] The panel gave a hypothetical example to illustrate the point: people had been using fires for thousand of years without knowing that oxygen was necessary for fire, and the first person to discover the oxygen could not patent "a method of making fire with oxygen."[80]

Although *EMI Group*, to some extent, harmonized the apparent conflicts between *Continental Can* and *Atlas Powder*, the panel did not explicitly endorse the view that recognition should be required where an inherent feature is a physical structure or a method step.[81] Instead, the panel merely stated that the recognition requirement "*may* be sensible" in *Continental Can* type of scenarios, while stopping short of ruling that future inherent anticipation cases should be decided on the physical structure versus law of nature dichotomy.[82] The tension between *Continental Can* and *Atlas Powder* was not fully resolved by *EMI Group* and caused significant confusion regarding what was the correct test for inherent anticipation analysis.[83]

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75. *Id.* at 1344-48.

76. *Id.* at 1350.

77. *Id.* at 1349-50.

78. *Id.* at 1350-51.

79. *Id.* at 1351.

80. *Id.* The apparent tension between *Atlas Powder* and *Continental Can* was also noted by Judge Pfaelzer in *ICN Pharmaceuticals, Inc. v. Geneva Pharmaceuticals Technology Corp.*, 272 F. Supp. 2d 1028 (C.D. Cal. 2003). Following *EMI Group*, Judge Pfaelzer held that the inherent feature in *ICN* appeared to be related to a law of nature, thereby distinguishable from *Continental Can*. *ICN Pharms.*, 272 F. Supp. 2d at 1051-52.

81. *See EMI Group*, 268 F.3d at 1350-51.

82. *See id.* (emphasis added).

83. *See, e.g.*, Toro v. Deere & Co., 355 F.3d 1313, 1320-21 (commenting on the confusion over the interpretation of *Continental Can*).

II. CASE SUMMARY

The Federal Circuit resolved the conflicting interpretations of *Atlas Powder* and *Continental Can* in *Schering*, taking the position that one of ordinary skill in the art is not required to recognize an inherent feature in the prior art reference.[84] The court held that inherency does not depend on whether the subject matter was recognized in prior art, but on whether it was an "accidental" result "under unusual conditions," or a "natural result flowing from the explicit disclosure of the prior art."[85]

A. Facts and Procedural History

Plaintiff Schering Corporation ("Schering") is a pharmaceutical company and the owner of U.S. Patent Nos. 4,282,233 ("the '233 patent") and 4,659,716 ("the '716 patent"), both covering antihistamine drugs.[86] Antihistamines inhibit the histamines that cause allergic symptoms.[87] The '233 patent covers the antihistamine loratadine, the active component of Claritin®.[88] The '716 patent, which is more recent, covers a natural metabolite of loratadine called descarboethoxyloratadine (DCL).[89] A metabolite is a compound formed in a person's body upon ingestion of a pharmaceutical drug.[90] The parties did not dispute the fact that the '233 patent expired in December 2002 and constituted "prior art" to the '716 patent under 35 U.S.C. § 102(b).[91]

The defendants are pharmaceutical companies who sought to manufacture a generic version of Claritin as soon as the '233 patent expired.[92] After reviewing the FDA-approved drugs and related patents, the defendants challenged the validity of the '716 patent, and Schering filed suit for infringement.[93] Both parties brought summary judgment motions.[94]

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84. Schering Corp. v. Geneva Pharms., Inc., 339 F.3d 1373, 1378-79 (Fed. Cir.), *review en banc denied*, 348 F.3d 992 (Fed. Cir. 2003).

85. *Id.* at 1378-79.

86. *Id.* at 1375; *see* U.S. Patent No. 4,659,716 (issued Apr. 21, 1987); U.S. Patent No. 4,282,233 (issued Aug. 4, 1981).

87. 339 F.3d at 1375.

88. *Id.*

89. *Id.*

90. *Id.*

91. Schering Corp. v. Geneva Pharms., Inc., 275 F. Supp. 2d 534, 536 (D.N.J. 2002).

92. *Id.* at 536.

93. *Id.* at 536-37.

94. *Id.* at 535.

The parties agreed that both claims 1 and 3 of the '716 patent cover DCL regardless of its method of production, including metabolic conversion of loratadine into DCL in the human body.[95] It was also undisputed that as of February 15, 1984, the date on which Schering's '716 application was filed, one of ordinary skill in the art would not have recognized that administration of loratadine to humans necessarily resulted in the metabolic production of DCL.[96] Shortly thereafter, starting in 1985, research and clinical studies consistently characterized DCL as the "active circulating metabolite" or "primary metabolite" of loratadine in humans.[97]

The district court found claims 1 and 3 of the '716 patent invalid because the '233 patent inherently anticipated the claims.[98] The court found that there was no genuine issue of material fact that the consumption of loratadine by humans necessarily resulted in the natural production of DCL.[99] Although the natural and inevitable production of DCL upon human ingestion of loratadine was not fully appreciated by persons of ordinary skill in the field until after 1984, the process was nevertheless an "'inherent characteristic or functioning' of the use of loratadine."[100] Schering appealed from the finding of invalidity.

B. The Federal Circuit's Analysis

The Federal Circuit affirmed the district court's summary judgment of invalidity.[101] The court clarified the previous misinterpretation of *Continental Can* and held that inherency does not require recognition in prior art references.[102] In distinguishing *Schering* from *Tilghman* and *Eibel Process*, the court held that inherency is established as long as the claimed invention is a "natural result" flowing from the prior art disclosure.[103] In contrast, if the subject matter is an "accidental" result "under unusual circumstances," novelty is not defeated by the accidents.[104]

The Federal Circuit addressed four issues in *Schering*. First, the court unambiguously resolved the conflict between the two lines of Federal Circuit cases discussed in Part I, and rejected the notion that inherent

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95. *Id.* at 537.
96. *Id.* at 538.
97. *Id.* at 537-38.
98. *Id.* at 539.
99. *Id.* at 541.
100. *Id.* at 542.
101. Schering Corp. v. Geneva Pharms., Inc., 339 F.3d 1373, 1378-79 (Fed. Cir.), *review en banc denied*, 348 F.3d 992 (Fed. Cir. 2003).
102. *Id.* at 1377-78.
103. *Id.* at 1378-79.
104. *Id.*

anticipation required recognition in the prior art.[105] The court noted that *Continental Can* had been misinterpreted—*Continental Can* only allows parties to resort to "the opinions of skilled artisans" to determine whether an inherent feature exists.[106] The court further stated that in *Continental Can*, the summary judgment on anticipation was vacated not because "past recognition of the inherent feature" was required, but because there were conflicting expert testimonies as to whether the feature was inherent.[107] In contrast, summary judgment on invalidity in *Schering* was proper because undisputed evidence supported the conclusion that DCL was formed "necessarily and inevitably" when loratadine was ingested.[108] In ruling so, the court also distinguished *Schering* from other "accidental anticipation" cases such as *Eibel Process* and *Tilghman*.[109] Unlike the DCL patent in *Schering*, the disputed inventions in *Eibel Process* and *Tilghman* were either unintended, accidental results or formed under unusual circumstances, and thus did not constitute anticipation.[110]

Second, the court acknowledged that *Schering* was a case of first impression because the prior art supplied no express description of "any part of the claimed subject matter," whereas in previous cases, the prior art reference contained an incomplete description and inherency supplied the missing aspect.[111] However, the court saw no reason to limit the doctrine of inherency to gap-filling situations.[112] Because inherency places subject matter in the public domain, "the extent of the inherent disclosure does not limit its anticipatory effect."[113] Therefore, inherency should operate to anticipate entire inventions as well as limitations within an invention.[114]

Third, the court held that an anticipatory reference need "only enable subject matter that falls within the scope of the claims at issue, nothing more."[115] Since the '716 patent claims DCL in any form, to qualify as an enabling reference, the '233 patent need only describe how to make DCL

105. *Id.* at 1377.
106. *Id.* at 1377-78.
107. *Id.*
108. *Id.*
109. *Id.* at 1378.
110. *Id.*
111. *Id.* at 1379.
112. *Id.*
113. *Id.*
114. *Id.* at 1380.
115. *Id.* at 1381.

in any form, including a natural metabolite in a patient's body.[116] Therefore, the '233 patent provides an enabling disclosure.[117]

Finally, the court provided guidance on patenting metabolites of known drugs in the future. The panel advised that "[w]ith proper claiming, patent protection is available for metabolites of known drugs."[118] Three examples of such claiming were given. First, a metabolite could be claimed in its pure and isolated form.[119] Second, the court suggested a claim to a metabolite in a pharmaceutical composition, such as a claim directed to a metabolite coupled to a pharmaceutical carrier.[120] Schering's patent included such claims, and the court noted that those claims were not anticipated.[121] Third, the court suggested including method claims directed to the utilization or administration of the metabolites or the corresponding pharmaceutical composition.[122] Again, Schering's '716 patent included claims like this and such claims were not anticipated by the '233 patent.[123]

C. The Denial of *En Banc* Review

Dissenting opinions in the Federal Circuit's denial of *en banc* review raised issues as to whether *Schering* violates one of the established requirements for anticipation.[124] Judge Newman's dissent questioned whether the loratadine patent satisfied the enablement requirement for inherent anticipation of DCL.[125] Since the '233 patent did not mention DCL, Judge Newman found no precedent supporting the position that a product whose existence was previously unknown and was not in the prior art is unpatentable on the ground that it "existed undiscovered."[126] Judge Lourie's dissent pointed out that an enabling disclosure was clearly necessary for anticipation.[127] Judge Lourie argued that since the '233 patent did not identify or even mention any metabolite of loratadine, it was "hardly an enabling disclosure."[128] Judge Lourie found the *Schering*

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116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.*
121. *Id.*
122. *Id.*
123. *Id.*
124. *See* Schering Corp. v. Geneva Pharms., Inc., 348 F.3d 992 (Fed. Cir. 2003), *denying en banc review to* 339 F.3d 1373 (Fed. Cir. 2003).
125. *Id.* at 993-94 (Newman, J., dissenting).
126. *Id.* at 993 (Newman, J., dissenting).
127. *Id.* at 995-96 (Lourie, J., dissenting).
128. *Id.* (Lourie, J., dissenting).

decision "extraordinary" because it "effectively preclud[ed] virtually all patents on human metabolites of drugs."[129]

III. DISCUSSION

Patents are awarded as incentives for innovations that "promote the Progress of Science and useful Arts."[130] Without upfront investments, many inventions would not be developed.[131] Therefore, patent law gives inventors a limited period of exclusivity to recover their investments.[132] Upon the expiration of the patent term, the invention enters the public domain, and the public can freely make and use the invention.[133] Any attempt to extend the term of the monopoly after a patent expires runs counter to the policy and purpose of the patent laws.[134]

A. *Tilghman* Versus *Schering*: Incentives for Knowledge Accumulation or Protecting Public Domain Subject Matters?

The Supreme Court in *Tilghman* and *Eible Process* suggested that only deliberate, intended efforts constitute prior use.[135] The Court took a Lockean position that ownership is derived from labor: when a person mixes his labor with his creations, he enjoys the natural right of intellectual property.[136] The holdings are consistent with an important goal of the patent system—the accumulation of public knowledge.[137] In exchange for granting patent rights to the inventor who made the actual discovery of the inherent feature, the public gains new and useful knowledge.[138] The rationale of the "accidental anticipation" exception was summarized by the Third Circuit in *Edison Electric Light Co. v. Novelty Incandescent Lamp Co.*: an accidental achievement entitles "no

129. *Id.* at 995 (Lourie, J., dissenting).

130. *See* U.S. CONST. art. I, § 8, cl. 8; Pennock v. Dialogue, 27 U.S. (2 Pet.) 1, 19 (1829).

131. *See generally* Katherine J. Strandburg, *What Does The Public Get?: Experimental Use and the Patent Bargain*, 2004 WIS. L. REV. 81, 90-91.

132. *See id.*

133. *See Pennock*, 27 U.S. (2 Pet.) at 19.

134. Brulotte v. Thys Co., 379 U.S. 29, 31 (1964).

135. *See* 1 CHISUM, *supra* note 5, § 3.03[2].

136. *See* ROBERT P. MERGES ET AL., INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 2-5 (3d ed. 2003). *See generally* Edwin C. Hettinger, *Justifying Intellectual Property*, 18 PHIL. & PUB. AFF. 31, 36-45 (1989) (discussing labor, natural intellectual property rights, and the Lockean provisos); Justin Hughes, *The Philosophy of Intellectual Property*, 77 GEO. L.J. 287, 296-330 (1988) (discussing Locke's property theory).

137. *See Pennock*, 27 U.S. (2 Pet.) at 19.

138. *See id.*

consideration" because it "[*gives*] *nothing to the world*, standing in the way of discovery, indeed, instead of promoting it."[139] By granting patent rights to those who discovered the previously unrecognized information, the rule rewards deliberate inventive activities and provides incentives to study existing products or processes. On the other hand, an incentive-orientated rule might injure the rights of prior users. If the steam engine cited in *Tilghman* had indeed produced fatty acids thirty years before Tilghman's invention, would it be fair for Tilghman to enjoin such use just because he was the first to discover how the fatty acids were actually produced?

In addition, the Court in *Tilghman* essentially promulgated a highly questionable, "subjective appreciation" test—whether the prior user (the operator) herself had understood the invention.[140] A subjective appreciation test would lead to great controversies and uncertainties. The patentability of many inventions would depend on the mental states and credibility of prior users. So even if we were to adopt a rule that requires prior appreciation, at minimum, the test should be objective, as the Federal Circuit in *Continental Can* articulated: the undisclosed feature should be "recognized by *persons of ordinary skill*."[141]

Schering, on the other hand, reflected the Federal Circuit's desire to strictly enforce the essence of the § 102 novelty requirement: non-removal of public domain subject matters.[142] Instead of harmonizing *Atlas Powder* and *Continental Can* on the "physical structure versus law of nature" distinction (as suggested in *EMI Group*), the court took a bright-line position that inherent anticipation does not require appreciation or recognition in prior art, as long as the disclosure is a "necessary and inevitable" consequence of the prior disclosures.[143] The outcome of *Schering* is consistent with the notion that after the expiration of a patent monopoly, the "discoveries embodied in them shall become a part of the public stock of knowledge."[144] When Schering's loratidine patent expired in 2002, it became public knowledge and other pharmaceutical companies should be free to make generic versions of Claritin. Had the Federal Circuit decided otherwise and held Schering's DCL claim valid, all

139. 167 F. 977, 980 (3d Cir. 1909) (emphasis added).

140. Tilghman v. Proctor, 102 U.S. 707, 711-12 (1881).

141. Cont'l Can Co. USA v. Monsanto Co., 948 F.2d 1264, 1268 (Fed. Cir. 1991) (emphasis added).

142. *See* 35 U.S.C. § 102(a) (2000).

143. Schering Corp. v. Geneva Pharms., 339 F.3d 1373, 1378-80 (Fed. Cir.), *review en banc denied*, 348 F.3d 992 (Fed. Cir. 2003).

144. *See* Beidler v. United States, 253 U.S. 447, 453 (1920).

generic versions of Claritin would have inevitably infringed the DCL patent since (1) all patients taking generic loratidine will naturally produce DCL in their bodies as a metabolite, and (2) Schering's DCL claim is broad enough to encompass DCL in all forms, including metabolites produced in human bodies.[145] This would have effectively taken the expired loratidine patent out of the public domain and extended the patent term of loratidine until the DCL patent expires. If such practices were allowed, a patentee could potentially identify a series of metabolites of a known drug (for example, A is metabolized into B, then B into C, then C into D, and so on), and then strategically stagger the patent filings of A, B, C, and D, thereby significantly increasing the patent term of the original compound. From this point of view, *Schering* correctly prevented "unjustified timewise extension of the right to exclude granted by a patent no matter how the extension is brought about."[146]

Although the Federal Circuit distinguished *Schering* from *Tilghman* on "accidental" versus "inevitable" grounds,[147] the underlying policy considerations of *Tilghman*—incentives for knowledge accumulation and rewarding ingenuity—were not addressed by the *Schering* court. From this point of view, the two cases are not in complete harmony with each other. The incentive goal and the nonremoval-of-existing-subject-matter goal obviously clashed in *Schering*: denying patent protection on DCL discourages Schering scientists from disclosing a valuable discovery to the public, while granting patent protection on DCL allows Schering to take the expired loratidine patent out of public domain. A fair interpretation of *Schering* is that when the two goals cannot both be served, the need to protect public knowledge trumps the need to encourage beneficial discoveries and disclosures.

B. Is *Schering* Unfair to Those Who Discovered the Inherent Information?

Although the *Schering* outcome may seem harsh to those who discovered an inherent feature of the prior art, it is important to note that not all discoveries enjoy equal rewards in the patent system. Courts have traditionally barred patent protection on certain categories of discoveries based on public policy.

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145. *See, e.g.*, Hoechst-Roussel Pharms., Inc. v. Lehman, 109 F.3d 756 (Fed. Cir. 1997) (holding that a person may infringe a claim to a metabolite if the person ingests a compound that metabolizes into the claimed metabolite).

146. Eli Lilly & Co. v. Barr Labs., Inc., 251 F.3d 955, 968 (Fed. Cir. 2001).

147. *Schering*, 339 F.3d at 1378.

A classical example is that the discoverer of a new use of an old substance cannot obtain a product patent on the old substance, but only a process patent on the new use.[148] This rule holds true even if no use was previously known for the substance.[149] In *In re Hafner*, an old product (a resin) would have been useless without Hafner's discovery of how to use it;[150] nevertheless, the discovery of a new use did not make the resin patentable even when the prior art did not teach any use of the resin.[151] Some commentators have argued that the "new use patent" rule failed to produce optimal levels of either (1) research into new products or (2) research into new uses for old products because incentives were too great for the former and too weak for the latter.[152] Nevertheless, courts have firmly established the "new use patent" rule,[153] favoring the policy consideration of protecting public domain knowledge over the need to provide optimal incentives for research.[154] One can make a similar argument that after *Schering*, research on second-generation metabolite drugs will be discouraged because patent protection for metabolites is not as broad as the protection for original drugs. However, before a complete solution is found that optimally balances the incentives and the scope of property rights given to pioneering drugs and second-generation improvements, the *Schering* rule at least prevents patentees from manipulating the system to unfairly extend the terms of patent monopolies.

Courts have also traditionally limited patent protection on natural substances.[155] *General Electric Co. v. DeForest Radio Co.* highlights the judiciary reluctance to grant patents on naturally-occurring substances, regardless of the economic value of the discovery.[156] In *DeForest*, the patentee converted tungsten, a naturally-existing yet very brittle material, into "an entirely new metal" that was highly valuable for incandescent

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148. *See* ROBERT PATRICK MERGES & JOHN FITZGERALD DUFFY, PATENT LAW AND POLICY: CASES AND MATERIALS 392-97 (3d ed. 2002).

149. *See In re* Hafner, 410 F.2d 1403 (C.C.P.A. 1969).

150. *Id.* at 1404-06.

151. *Id.*

152. *See* MERGES & DUFFY, *supra* note 148, at 393.

153. *See, e.g.*, Ansonia Brass & Copper Co. v. Elec. Supply Co., 144 U.S. 11, 17 (1892) (holding that "it is no new invention to use an old machine for a new purpose"); *In re* Schreiber, 128 F.3d 1473, 1477 (Fed. Cir. 1997) (holding that "recitation of a new intended use for an old product does not make a claim to that old product patentable").

154. *See* MERGES & DUFFY, *supra* note 148, at 392-97.

155. *See id.* at 97.

156. 28 F.2d 641, 642 (3d Cir. 1928).

electric lamps.[157] The Third Circuit acknowledged that there was little doubt that the discovery led to a "tremendous" technological advance.[158] Nevertheless, the court invalidated the product patent on pure tungsten because pure tungsten "existed in nature and doubtless has existed there for centuries."[159] To some extent, one can argue that the discovery of DCL in *Schering* is similar to the discovery of pure tungsten in *DeForest*. DCL was naturally produced by patients who took Claritin. Although DCL was identified several years after Claritin was marketed, no one can deny that DCL existed as early as the time when the first Claritin pills became available.

Many additional examples can be found in which a discovery, albeit highly valuable and clearly enriching the public knowledge, is denied patent protection.[160] Although sometimes it seems unfair that the patent system rewards some discoverers' labor and investments but not others', the ultimate goal of patents is to promote advances in science and art.[161] Therefore, patent protection should be denied if granting a patent will unreasonably stifle competition, extend monopolies, or remove existing knowledge from public use.

C. Implications of *Schering* for the Pharmaceutical Industry

If a metabolite of a drug indeed works better than the original compound,[162] would *Schering*'s bright-line rule discourage companies like Schering from future metabolite research because they could no longer secure patent protection on inherent subject matter? Or, would other pharmaceutical companies step in so that metabolites would be discovered sooner rather than later because that subject matter is in the public domain? Although the full effect of *Schering* is hard to predict, a reality check of the pharmaceutical industry indicates that *Schering* is unlikely to have any significant impact on metabolite research.

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157. *Id.*

158. *Id.* at 644.

159. *Id.* at 643.

160. *See* Parker v. Flook, 437 U.S. 584, 589 (1978) (holding that a "principle" or "fundamental truth" is unpatentable); Gottschalk v. Benson, 409 U.S. 63, 67 (1972) (holding that prohibited categories include phenomena of nature, mental processes, and abstract intellectual concepts). *See generally* MERGES & DUFFY, *supra* note 148, at 77-128 (discussing the bar to patenting "laws of nature, physical phenomena, and abstract ideas").

161. *See* U.S. CONST. art. I, § 8, cl. 8.

162. In fact, Schering-Plough regards DCL, marketed as Clarinex®, as a "new and improved version" of Claritin®. *See, e.g.*, Rita Rubin, *Claritin to Go OTC Next Spring, Clarinex to Replace It*, USA TODAY, Apr. 23, 2002, at D11, *available at* http://www.usatoday.com/news/health/drugs/2002-04-23-claritin.htm.

1. *Patenting Metabolites of Known Drugs in the Future*

It should be clear that the invalidity of a metabolite patent based on inherency requires a dual footing.[163] First, the prior art compound must necessarily produce the metabolite.[164] Second, the claim must be sufficiently broad to encompass the naturally-produced form of the metabolite.[165] In fact, in an effort to encourage future research on drug products, the *Schering* court went out of its way to provide guidance on obtaining valid metabolite patents.[166]

Most importantly, a metabolite could be claimed in its pure and isolated form.[167] The allowance of purified metabolite claims echoes the "product of nature" doctrine established in *Parke-Davis v. E.K. Mulford Co.*,[168] in which purified adrenaline extracted from adrenal glands was held patentable.[169] Judge Hand concluded in *Parke-Davis* that purified adrenaline did not exist in nature, and was "for every practical purpose a new thing commercially and therapeutically."[170]

The same rule applies to artificial compounds as well. In *Kuehmsted v. Farbenfabriken of Elberfeld Co.*, the Seventh Circuit held that aspirin purified from a mixture was patentable, even if aspirin was previously known to exist in that mixture.[171] Thus, it is more accurate to say that the *Schering* court did not invalidate all metabolite patents, but instead would only allow a narrower scope of patent protection on metabolites and treat metabolites of known drugs as if they were natural products or previously-existing, unpurified compounds.

The valid metabolite claims suggested by the *Schering* court could all be explained on enablement grounds. An enabling disclosure is necessary for inherent anticipation.[172] While naturally-produced DCL within the human body was enabled by the earlier loratidine patent (merely by taking Claritin pills), the purified form of DCL or the method of administration were clearly unanticipated since DCL was not even discovered when the

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163. Schering Corp. v. Geneva Pharms, Inc., 339 F.3d 1373, 1376, 1379-80 (Fed. Cir.), *review en banc denied*, 348 F.3d 992 (Fed. Cir. 2003).

164. *Id.* at 1380.

165. *Id.* at 1376, 1380.

166. *Id.* at 1381.

167. *Id.*

168. 189 F. 95, 102-04 (S.D.N.Y. 1911).

169. *Id.* at 103.

170. *Id.*

171. 179 F. 701, 704-05 (7th Cir. 1910).

172. Schering Corp. v. Geneva Pharms, Inc., 339 F.3d 1373, 1376, 1379-80 (Fed. Cir.), *review en banc denied*, 348 F.3d 992 (Fed. Cir. 2003).

loratidine patent was filed. Therefore, although the Federal Circuit dropped the recognition requirement in *Schering*, most metabolite patent claims that require deliberate human intervention (such as purification steps or method of administration) will not be invalidated by inherency.[173] Thus, as a result of the enablement requirement of inherency, metabolite drugs will still enjoy a wide range of patent protection; in most cases, only the naturally-produced forms found in the human body cannot be protected.

2. *Potential Impact on Research Incentives for Metabolites of Existing Pharmaceutical Drugs*

Considering that it takes on average twelve to fifteen years to discover and develop a new medicine,[174] including approximately eight and a half years to obtain the Food and Drug Administration (FDA) approval,[175] it is still advantageous for a brand-name drug company to engage in metabolite research. The FDA approval process for new drugs involves three clinical trial phases and a period of FDA review.[176] On average, brand-name manufacturers spend $400 million to $500 million on each drug that survives the approval process.[177] In contrast, second-generation metabolite drugs are significantly cheaper to bring to the market since the FDA approval process is shorter and the patentee has already accumulated large amounts of research and clinical trial data from the original pioneer drug.[178] A 2002 National Institute for Health Care Management ("NIHCM") study shows that from 1989 to 2000, highly innovative drugs

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173. In addition, merely naming a compound in a prior art reference, without more, does not satisfy the enablement requirement of an anticipatory reference under 35 U.S.C. § 102. *See In re* Wiggins, 488 F.2d 538, 543 (C.C.P.A. 1973) (holding that a list of compounds by name "constituted nothing more than speculation about their potential or theoretical existence" because naming a compound alone was not enough to enable one skilled in the art to make the compound).

174. PHARM. RESEARCH & MFRS. OF AM., WHY DO PRESCRIPTION DRUGS COST SO MUCH . . . AND OTHER QUESTIONS ABOUT YOUR MEDICINES 2-3 (2000), *at* http://www.phrma.org/publications/publications/brochure/questions/questions.pdf.

175. Jaclyn L. Miller, *Drug Price Competition and Patent Term Restoration Act: The Elimination of Competition Between Drug Manufacturers*, 5 DEPAUL J. HEALTH CARE L. 91, 96-98 (2002).

176. *Id.* at 92-98.

177. *Id.* at 98, 103. The entry barrier for a new drug is incredibly high. Brand-name companies once stated that every year, scientists screen more than 126,000 chemicals for potential drug development, while only sixteen will ever make it through the regulatory process and eventually appear in the pharmacy. *Id.* at 103.

178. *See, e.g.*, Martha Slud, *New Tricks for Old Drugs? Pharmaceutical Makers Study How to Extend the Life of Blockbuster Drugs*, CNNMONEY.COM, Nov. 8, 2000, *at* http://money.cnn.com/2000/11/08/companies/olddrugs.

comprised only 15 percent of the pharmaceutical drugs approved by the FDA, while the vast majority of approved drugs were in fact modified versions of existing drugs.[179] Therefore, despite the weaker patent protection on metabolite drugs, companies still have a strong incentive to engage in second-generation drug research. In fact, Schering's Clarinex® (with DCL as the active ingredient) accounted for $600 million in sales in 2002.[180]

Nevertheless, some commentators argued that after *Schering* metabolite patents may no longer have significant value.[181] For example, one commentator stated:

> [A]ssume a pioneer company is developing compound A, a compound that is metabolized in the body to form active compound B. . . . [The *Schering*] outcome raises the real risk that a competitor could design a novel, non-obvious parent compound, for example compound C, that is also metabolized to form active compound B; this could be done even during the patent term of compound A. Before *Schering*, such design around activity could have been prevented by the filing of patents covering active metabolites.[182]

This scenario will probably be extremely rare for several reasons. First, with the Research and Development (R&D) data accumulated from compound A and metabolite B, the brand-name company is in a better position to identify and market the hypothetical compound C than its competitors. Second, competitors might be reluctant to risk R&D resources searching for compound C because a prolonged and expensive lawsuit is almost inevitable. Finally, identifying a "novel, non-obvious" compound C might not be as easy as it appears in the above example. Some minor changes in chemical structure could significantly change the pharmaceutical property of a drug. For example, although D-Amino Acids and L-Amino Acids are almost identical,[183] the human body can only utilize L-Amino Acids. Making a "non-obvious" modification from B to C

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179. *Pricey Copycat Drugs Bring Big Profits, Not New Cures*, USA TODAY, May 31, 2002, at A11, *available at* http://www.usatoday.com/usatonline/20020531/4156073s.htm.

180. Zeke Ashton, *Schering-Plough's Tough Row*, Motley Fool, Sept. 12, 2003, *at* http://www.fool.com/news/commentary/2003/commentary030912za.htm.

181. *Schering Corp. v. Geneva Pharm. et al.*, Mayer, Brown, Rowe & Maw LLP, *at* http://www.ipcounsel.com/recent/schering_v_geneva.html (last visited Mar. 8, 2005).

182. *Id.*

183. D-Amino Acid and L-Amino Acid are identical in atom composition, but are mirror-images of each other, just like left and right hands. *See generally* LUBERT STRYER, BIOCHEMISTRY 18-23 (4th ed. 1995).

might render C poorly absorbable, or more toxic, or with a shorter effective time. Treasure hunting for a hypothetical compound C could turn out to be expensive and futile, with resources spent on compounds that never make a profit. Competitors might be better off simply waiting for the compound A patent to expire.[184] Taking all these risk factors into consideration, *Schering* is unlikely to significantly reduce the value of metabolite patents.

D. The "Necessary and Inevitable Consequence" Test Should Be Strictly Applied in Determining Inherent Anticipation

Although *Schering* has clarified the confusion over the recognition requirement in prior art references and provides clear guidance for future cases, the bright-line rule it promulgates runs the risk of unfairly depriving inventors of their property rights for valuable discoveries. Therefore, the "necessary and inevitable consequence" test should be strictly applied in determining whether a patent claim is inherently anticipated by prior art.

1. Distinguishing Between "Scientific Explanation" and "Structures or Method Steps"

The Federal Circuit in *EMI Group* articulated an interesting distinction between (1) a structure, compositions of matter, and method steps and (2) theoretical mechanisms or rules of natural law, and suggested that these two categories of inherency cases might be treated differently.[185] Although the *Schering* court ignored this distinction, categorizing inherent features into these two groups may sometimes help courts determine whether the challenged claims satisfy the "necessary and inevitable" test laid out in *Schering*.

When the undisclosed or unrecognized feature is method steps or a structural component of a machine, there is a significant risk that people skilled in the art will not be able to achieve the same result each time. They might miss some steps or fail to utilize the structural component,

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184. The Hatch-Waxman Act, codified in relevant part at 21 U.S.C. § 355 and 35 U.S.C. § 271(e), has made the FDA approval process easier for generic drugs by creating the Abbreviated New Drug Application (ANDA). Generic drug companies only need to prove that their drug is a bioequivalent to the corresponding brand-name drug, and the active ingredient, dosage form, strength, and route of administration are the same as the FDA-approved brand-name drug. Thus, the approval process is much cheaper, shorter, and less in depth compared with the FDA process of a new chemical. *See* 21 U.S.C. § 355(j) (2000). *See generally* Miller, *supra* note 175, at 98-102.

185. EMI Group N. Am., Inc. v. Cypress Semiconductor Corp., 268 F.3d 1342, 1350-51 (Fed. Cir. 2001).

rendering the results unpredictable. *Tilghman*,[186] *Eibel Process*,[187] and *Continental Can*[188] all fall into this category. In *Tilghman*, the claimed invention was a process patent that produced glycerin and fatty acids.[189] Without recognizing the necessary steps and conditions of the process, it would be impossible to consistently reproduce the result. Similarly in *Eibel Process*, a high-pitched wire was necessary for the improved paper-making machine.[190] Without recognizing the required pitch for the wire, the public would not have been able to derive the benefit of the invention. Finally, in *Continental Can*, an indispensable feature of the invention was the "hollow" support ribs, which rendered the bottles flexible and impact-resistant.[191] With this category of cases, because the unrecognized features could easily be missed by others, the prior art reference should be carefully scrutinized to ensure that it indeed "necessarily and inevitably" anticipates the disputed claims. Recognition of the inherent feature might as well be required in most cases in order to pass the "necessary and inevitable" test.

On the other hand, if a claim merely recites a scientific explanation, a theoretical mechanism, or an unrecognized advantage of a prior art, inherency is usually established. *Titanium Metals*[192] and *Cruciferous*,[193] discussed in Part I, are examples of this category of cases. As early as 1916, the Second Circuit already made a distinction between unappreciated scientific theories and unappreciated processes in *Tilghman*, and held that failing to recognize scientific principles did not "vitiate the patent."[194] Similarly, in *EMI Group*, inherency was established because "vapor-induced explosion" was a scientific explanation of how the prior

186. Tilghman v. Proctor, 102 U.S. 707 (1881).

187. Eibel Process Co. v. Minnesota & Ontario Paper Co., 261 U.S. 45 (1923).

188. Cont'l Can Co. USA v. Monsanto Co., 948 F.2d 1264 (Fed. Cir. 1991).

189. 102 U.S. at 708-09.

190. 261 U.S. at 52, 58.

191. 948 F.2d at 1266.

192. Titanium Metals Corp. v. Banner, 778 F.2d 775 (Fed. Cir. 1985).

193. *In re* Cruciferous Sprout Litig., 301 F.3d 1343 (Fed. Cir. 2002), *cert. denied sub nom.*, Brassica Prot. Prods. LLC v. Sunrise Farms, 538 U.S. 907 (2003).

194. Toch v. Zibell Damp Resisting Paint Co., 233 F. 993, 995, 997 (2d. Cir. 1916). The Second Circuit followed *Tilghman*'s ruling, stating that "novelty is not negatived by a prior accidental production of the same thing when the operator does not recognize the means by which the accidental result is accomplished, and no knowledge of them, or of the method of their employment, is derived from the prior use by any one." *Id.* at 995. But, the court distinguished *Toch* from *Tilghman* on the "scientific principle ground": "[i]t may be that the inventor did not know what the scientific principle was, or that, knowing it, he omitted, from accident or design, to set it forth. That does not vitiate the patent." *Id.* at 997 (citation and internal quotation marks omitted).

art fuses were blown.[195] Likewise, in *Cruciferous*, the anti-cancer activity was a scientific explanation of the result of eating the sprouts.[196] Other cases have also established that certain properties, such as solubility and melting points of chemical compounds[197] and overall capacitance of semiconductor circuitry,[198] are inherent physical characteristics of prior inventions.

In *Eli Lilly & Co. v. Barr Laboratories*, the Federal Circuit invalidated an anxiety-treatment claim because it was "a natural biological activity" upon the administration of the medicine.[199] Here, the prior art reference was a method claim for "treating anxiety in a human by administering an effective amount of fluoxetine hydrochloride," and the disputed claim covered a method of "blocking the uptake of serotonin by brain neurons . . . by administering the compound fluoxetine hydrochloride."[200] The panel found that because inhibition of serotonin uptake by the brain naturally occurs in the human body upon taking fluoxetine hydrochloride, the latter claim merely described how fluoxetine hydrochloride would physically act on patients who received the drug.[201] Therefore, the latter claim was invalid.[202]

The above examples illustrate that when an inherent feature is a scientific explanation, a theoretical mechanism, or an unrecognized advantage of a prior invention, those of ordinary skill in the art can practice the invention and reach the same result without understanding the scientific theory behind the invention. A person taking aspirin will get pain relief whether she understands the pain relieving mechanism or not, so it does not make any sense to grant a new patent on "a pain relieving method by taking aspirin through X mechanism."[203] Therefore, in this line of cases, recognition of the inherent feature (that is, the scientific theory

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195. EMI Group N. Am., Inc. v. Cypress Semiconductor Corp., 268 F.3d 1342, 1349-50 (Fed. Cir. 2001).

196. 301 F.3d at 1345-47.

197. *In re* Donohue, 766 F.2d 531, 534 (Fed. Cir. 1985) (holding that solubility characteristics and melting point range are inherent).

198. Hazani v. United States Int'l Trade Comm'n, 126 F.3d 1473, 1477 (Fed. Cir. 1997) (holding that a device, although not termed as "capacitor," inherently performs capacitor function).

199. 251 F.3d 955, 968-70 (Fed. Cir. 2001).

200. *Id.* at 968-69.

201. *Id.* at 970-71.

202. *Id.* at 971.

203. *See* Burroughs Wellcome Co. v. Barr Labs., Inc, 40 F.3d 1223, 1234 (Fed. Cir. 1994) (Lourie, J., dissenting-in-part). This example was cited by the majority in *Eli Lilly*, 251 F.3d at 971.

explaining the invention) is usually not needed to pass the "necessary and inevitable consequence" test.

It is conceivable that many cases fall in between and are neither clear-cut "missing steps or physical structures" cases nor "missing scientific explanation" cases.[204] It is unnecessary to pigeonhole each and every inherency case into one of the two categories since the purpose of distinguishing one line from the other is to facilitate courts in determining whether the disputed invention is an inevitable result of prior art. The ultimate test still rests on whether the inherent feature "necessarily and inevitably" existed before, not whether it is a scientific explanation or a structural component. In cases where the alleged inherent information is difficult to characterize, inherent anticipation should only be found when there is an absolute certainty that the missing feature was present in prior art.

2. *Cases Following Schering Generally Applied the "Necessary and Inevitable Consequence" Test Strictly*

Since the *Schering* decision in August 2003, several cases have followed the inherency doctrine established in *Schering*.[205] A quick review of these recent cases shows that courts have generally applied the "necessary and inevitable consequence" test strictly, indicating that even if *Schering* indeed creates some disincentives for inventors, its impact is rather limited.

In *Glaxo Group v. Teva Pharmaceuticals USA, Inc.*, the district court held that treating migraines with a compound called ondansertron did not inherently anticipate treating nausea and vomiting by the same drug.[206] The court found that although nausea and vomiting were the most common symptoms of migraines, the record showed that only ninety

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204. For example, it is hard to characterize the inherent feature in *Atlas Powder*. On its face, the missing ingredient in the prior art references (entrapped air) fits into the "missing physical component" category. However, the court found the entrapped air inherent based on a calculation of the percentage of the water-in-oil emulsion and the solid constituent. With 40% emulsion and 60% solid constituent, the air must have been entrapped. This calculation seems closer to a "scientific theory." *See* Atlas Powder Co. v. IRECO Inc., 190 F.3d, 1342, 1348-49 (Fed. Cir. 1999).

205. *See* Toro Co. v. Deere & Co., 355 F.3d 1313, 1321 (Fed. Cir. 2004); Glaxo Group Ltd. v. Teva Pharms. USA, Inc., No. C.A. 02-219 GMS, 2004 WL 1875017, at *19 (D. Del. Aug. 20, 2004); AstraZeneca AB v. Mut. Pharm. Co., 278 F. Supp. 2d 491, 515 (E.D. Pa. 2003), *aff'd-in-part, rev'd-in-part, and remanded*, 384 F.3d 1333 (Fed. Cir. 2004); Oakwood Labs., L.L.C. v. Tap Pharm. Prods., No. 01 C 7631, 2003 WL 22400759, at *23 (N.D. Ill. Oct. 21, 2003).

206. *Glaxo*, 2004 WL 1875017, at *18-*20.

percent of migraine patients also suffered from nausea.[207] Because the other ten percent of migraine sufferers did not experience nausea and vomiting, the court found that the relief for nausea and vomiting was not a necessary consequence of the administration of ondansetron to treat migraines.[208]

Additionally, in *Toro Co. v. Deere & Co.*, the Federal Circuit held that the defendant Deere failed to make the requisite factual showing for summary judgment of inherent anticipation, because the evidence was insufficient to show that a prior art embodiment "necessarily" performed the claimed function.[209] The patent in dispute in *Toro* covered technology for lifting and fracturing soil to encourage turf growth by injecting incompressible liquid into the soil at a jet pressure.[210] Although the prior art embodiments and the claimed invention had several overlapping parameters, the court found that Deere failed to raise a genuine issue of material fact regarding whether the prior art embodiment always performed the function of "lifting and fracturing soil to encourage turf growth."[211] Therefore, inherency was not established.[212]

These recent decisions indicate that although the Federal Circuit adopted a bright-line rule after *Schering*, the "necessary and inevitable" bar significantly limits any potential chilling effect on further research of existing technologies.

IV. CONCLUSION

Schering resolved a split within the Federal Circuit and held that inherent anticipation does not require recognition in prior art references.[213] The decision, that an inherent feature of a prior art always anticipates even if the inherent feature was unappreciated by those skilled in the art, denies patent protection on new discoveries that merely spell out or explain what had implicitly existed in prior art.[214] The inherency doctrine established in *Schering* is probably not in complete harmony with earlier Supreme Court decisions in *Tilghman*[215] and *Eibel Process*,[216] which focused on

207. *Id.* at *19.
208. *Id.*
209. 355 F.3d 1313, 1320 (Fed. Cir. 2004).
210. *Id.* at 1314.
211. *Id.* at 1320.
212. *Id.*
213. Schering Corp. v. Geneva Pharms., Inc., 339 F.3d 1371, 1378-80 (Fed. Cir.), *review en banc denied*, 348 F.3d 992 (Fed. Cir. 2003).
214. *See* Pfaff v. Wells Elecs., Inc., 525 U.S. 55, 63 (1998).
215. Tilghman v. Proctor, 102 U.S. 707, 711-12 (1881).

"secur[ing] to the inventor the reward he deserves" if the invention had advanced the art.[217] Nevertheless, to preserve the bargain carefully established by the patent system, the Federal Circuit expanded the inherency doctrine in *Schering* by eliminating the recognition requirement, ensuring that knowledge already in the public domain "remain[s] there for the free use of the public."[218] In reality, the *Schering* decision is unlikely to have a significant impact on metabolite research because of the high cost of developing new drugs in the pharmaceutical industry.[219] Outside the pharmaceutical setting, it is possible that *Schering* discourages knowledge accumulation on existing technologies to some extent. However, as long as courts strictly apply the "necessary and inevitable consequence" test, the chilling effect of *Schering* on research and development should be quite limited. In most cases, inherent anticipation would only invalidate claims that merely recite scientific explanations of preexisting subject matters.

216. Eibel Process Co. v. Minn. & Ontario Paper Co., 261 U.S. 45, 66 (1923).
217. *Id.* at 63.
218. Aronson v. Quick Point Pencil Co., 440 U.S. 257, 262 (1979).
219. *See* Miller, *supra* note 175, at 96-98.

PROSECUTION HISTORY ESTOPPEL IN THE POST-*FESTO* ERA: THE INCREASED IMPORTANCE OF DETERMINING WHAT CONSTITUTES A RELEVANT NARROWING CLAIM AMENDMENT

By Derek Walter

The *Festo* line of cases[1] has served as a battleground for the Federal Circuit and the Supreme Court to settle the matter of how the doctrine of equivalents should be applied when patent applicants narrow their claims during prosecution. In line with recent Federal Circuit guidance on claim construction,[2] the Federal Circuit's holding in *Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co.*[3] represented a strong tendency for a strict straightforward rule in which patentees are held to the literal meaning of their claims and claim amendments. Although this approach is perhaps inconsistent with Supreme Court guidance on prosecution history estoppel,[4] it has the apparent advantage of strengthening a patent's ability to more clearly demarcate the intellectual property it claims. Recent Federal Circuit cases decided in the wake of *Festo X* represent a zealous continuation of this approach, and they have perhaps seen the Federal Circuit decline to make a "fair interpretation"[5] of what a patentee has surrendered through claim amendments. The recent cases further suggest that evidentiary restrictions the Federal Circuit has placed on patentees trying to rebut prosecution history estoppel are too harsh. As a result of this situation, the

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1. This Note shall adopt the notion used by Sharp to label the various *Festo* cases. *See* Marc. D. Sharp, Note, Festo X*: The Complete Bar by Another Name?*, 19 BERKELEY TECH L.J. 111 (2004).

2. *See* Tex. Digital Sys. v. Telegenix, Inc., 308 F.3d 1193, 1201-05 (Fed. Cir. 2002).

3. 344 F.3d 1359 (Fed. Cir. 2003) [hereinafter *Festo X*].

4. *See* Lewis R. Clayton, *The Latest* 'Festo' *Ruling*, NAT'L L. J., Dec. 22, 2003, at 19 (noting that the Federal Circuit viewed the three approaches given by the Supreme Court for rebutting the *Festo* presumption not as "mere examples" but as the sole and exclusive ways of rebutting the presumption). *See generally* Sharp, *supra* note 1 (noting that the Supreme Court rejected an inflexible prosecution history estoppel doctrine and suggesting that the Federal Circuit implemented a bar to rebutting the *Festo* presumption that will be difficult and costly to overcome).

5. Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., 535 U.S. 722, 738 (2002) [hereinafter *Festo VIII*] ("There is no reason why a narrowing amendment should be deemed to relinquish equivalents . . . beyond a fair interpretation of what was surrendered.").

determination of whether a claim amendment has narrowed the scope of a patent claim has become paramount. Unfortunately, recent Federal Circuit cases have not provided clear guidance on this crucial matter.

Part I of this Note briefly summarizes the doctrine of equivalents and prosecution history estoppel. In addition, Part I summarizes the litigation leading up to *Festo X*. With this background in place, this Note details a comprehensive line of inquiry that the Federal Circuit has outlined for dealing with amended claims, including a description of the judicial presumptions that connect the doctrine of equivalents and prosecution history estoppel. This Note then highlights the most significant aspects of this inquiry in light of *Festo X*. Part II of this Note discusses recent Federal Circuit guidance on prosecution history estoppel and the doctrine of equivalents, paying particular attention to the potential problems that can arise from too loose or too strict a focus on the literal terms of a patent claim.

I. BACKGROUND

The doctrine of equivalents and prosecution history estoppel are bedrock patent law concepts and a great deal has been written on these subjects.[6] Accordingly, the coverage here shall be relatively brief.

A. The Doctrine of Equivalents

The doctrine of equivalents first appeared in *Winans v. Denmead*,[7] and its modern application has been outlined in *Graver Tank & Manufacturing Co., Inc. v. Linde Air Products Co.*[8] Although the doctrine of equivalents has existed for over a century, it still generates controversy.[9] The doctrine of equivalents evolved to correct for perceived limitations in the ability of language to fully and precisely describe the claimed subject matter.[10] In other words, there was a concern that "unscrupulous copyists" could pirate patented subject matter by making minimal modifications to the patented

6. *See, e.g.*, John R. Thomas, *On Preparatory Texts and Proprietary Technologies: The Place of Prosecution Histories in Patent Claim Interpretation*, 47 UCLA L. REV. 183 (1999); C. Alan Fu, Note, Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., 18 BERKELEY TECH. L.J. 117 (2003).

7. 56 U.S. 330 (1854).

8. 339 U.S. 605 (1950) (holding that a welding flux that was otherwise identical to a patented flux except for a substitution of manganese silicates for magnesium silicates infringed under the doctrine of equivalents).

9. *See, e.g.*, Joshua D. Sarnoff, *Abolishing the Doctrine of Equivalents and Claiming the Future After* Festo, 19 BERKELEY TECH. L.J 1157 (2004) (arguing that the doctrine of equivalents is costly, unjustified, and complicated, and thus should be abolished).

10. *Festo VIII*, 535 U.S. at 734 ("The doctrine of equivalents is premised on language's inability to capture the essence of innovation . . . .").

product so that it no longer was encompassed by the literal terms of the patent.[11] Indeed, the Court in *Graver Tank* concluded that such piracy would convert a patent into a "hollow and useless thing."[12] Accordingly, the Court held that a patent covered more than what the literal terms claimed: patentees could, in fact, argue that a product or process infringes their patents "if it performs substantially the same function in substantially the same way to obtain the same result."[13] This test, commonly referred to as the "function-way-result" test, has become the standard manner of applying the doctrine of equivalents, although the Federal Circuit has occasionally applied a more general "insubstantial differences" test.[14] This latter test views claim elements as being "equivalently present in an accused device if only 'insubstantial differences' distinguish the missing claim element from the corresponding aspects of the accused device."[15] Whatever test is applied, the doctrine of equivalents is perhaps best viewed as a limited protective measure that stretches the scope of a patent's literal claim terms just enough to prevent "fraud on the patent."[16]

Although the doctrine of equivalents is inherently limited in scope and applicability, two additional doctrines place even further constraints on its operation. The "all elements" rule requires the accused device to contain "every claimed element of the invention or the equivalent of every claimed element."[17] This approach limits the doctrine of equivalents in two ways.[18] First, it leads to disciplined and structured infringement analyses by requiring courts to focus on the individual elements of claims rather than the invention as a whole. Second, it helps potential infringers by allowing them to escape infringement if even a single claimed element is absent from their accused device. A more important constraint on the doctrine of equivalents is the doctrine of prosecution history estoppel, discussed in detail next.

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11. *Graver Tank*, 339 U.S. at 607.

12. *Id.*

13. *Id.* at 608 (quoting Sanitary Refrigerator Co. v. Winters, 280 U.S. 30, 42 (1929)).

14. *See, e.g.*, Dawn Equip. Co. v. Ky. Farms, 140 F.3d 1009, 1015-16 (Fed. Cir. 1998).

15. Sage Prods. v. Devon Indus., 126 F.3d 1420, 1423 (Fed. Cir. 1997).

16. *See Graver Tank*, 339 U.S. at 608 ("The essence of the doctrine is that one may not practice a fraud on a patent.").

17. Kustom Signals, Inc. v. Applied Concepts, Inc., 264 F.3d 1326, 1333 (Fed. Cir. 2001).

18. Philip M. Nelson, Note, *Definition for "Limitation" in the Context of Prosecution History Estoppel and the All Elements Rule: A Proposed Solution to the Troubling Dictum in* Kustom Signals v. Applied Concepts, 2003 B.Y.U. L. REV. 353, 360-61.

B. Prosecution History Estoppel

Simply put, prosecution history estoppel bars a patentee from relying on the doctrine of equivalents in an infringement lawsuit when, during prosecution, she has narrowed the scope of patent claims relating to the accused equivalent.[19] The logic of this doctrine is straightforward: if a patentee, in response to an examiner's objection, willingly narrows a claim to secure a patent, then she is presumably sending a clear signal to the public that she is surrendering the territory beyond the literal terms of the narrowed claim. Since the patentee "knew the words for both the broader and narrower claim, and affirmatively chose the latter," any concerns over the inability of language to adequately describe the claimed subject matter, which motivate the doctrine of equivalents, are inapplicable.[20] Thus, prosecution history estoppel is rooted in a desire to reinforce the public notice function of patents.[21]

Of course, if a patentee amends her claims for a reason unrelated to patentability, prosecution history estoppel will not apply.[22] However, the term "patentability" has been construed broadly. Indeed, in addition to amendments made to overcome prior art, prosecution history estoppel applies to amendments that were made to overcome rejections related to 35 U.S.C. § 101 and 35 U.S.C. § 112.[23] Also, if there is no explanation in the prosecution history for why a claim has been amended, the *Warner-Jenkinson* presumption takes effect and courts must assume that the claim was amended for reasons relating to patentability.[24] Given the minimal amount of documentation claim amendments receive[25] and the fact that the

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19. Schriber-Schroth Co. v. Cleveland Trust Co., 311 U.S. 211, 220-21 (1940) ("It is a rule of patent construction consistently observed that a claim in a patent as allowed must be read and interpreted with reference to claims that have been cancelled or rejected, and the claims allowed cannot by construction be read to cover what was thus eliminated from the patent.")

20. *Festo VIII*, 535 U.S. 722, 734-35 (2002).

21. *See* Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., 234 F.3d 558, 567 (Fed. Cir. 2000) [hereinafter *Festo VII*] (noting that one purpose of prosecution history estoppel is "preserving the notice function of the claims").

22. *See* Warner-Jenkinson Co. v. Hilton Davis Chem. Co., 520 U.S. 17, 32-33 (1997) ("Our prior cases have consistently applied prosecution history estoppel only where claims have been amended for a limited set of reasons, and we see no substantial cause for requiring a more rigid rule invoking an estoppel regardless of the reasons for a change."); *Festo VII*, 234 F.3d. at 567-68 ("[I]f a patent holder can show from the prosecution history that a claim amendment was not motivated by patentability concerns, the amendment will not give rise to prosecution history estoppel.").

23. *Festo VII*, 234 F.3d at 567.

24. *Warner-Jenkinson*, 520 U.S. at 33.

25. *See* Thomas, *supra* note 6, at 188-91, 203.

initial burden is placed on the patentee, the *Warner-Jenkinson* presumption is generally quite difficult to overcome.[26] Finally, if a patentee feels that an examiner incorrectly rejected a claim on prior art grounds, a reviewing court may not look into the correctness of that objection.[27] Rather, the court may only review the "reason (right or wrong) for the objection and the manner in which the amendment addressed and avoided the objection."[28] Thus, prosecution history estoppel can be a formidable barrier for a patentee to overcome.

C. Overview of the *Festo* Litigation

At dispute in the *Festo* cases was the validity and infringement of two patents pertaining to "magnetically coupled rodless cylinders."[29] For the purposes of this Note, the details of the technology involved in the *Festo* cases are irrelevant. The only matter of importance is that during prosecution plaintiff narrowed the scope of both patents by amending them to require a "pair of resilient sealing rings."[30] One of the patents was further amended to include a "magnetizable sleeve" limitation.[31] The *Festo* litigation focused exclusively on these two limitations.[32]

In the district court, the judge granted plaintiff summary judgment on the issue of whether defendant's cylinder, which included either a single sealing ring or more than two sealing rings, infringed plaintiff's patents on cylinders having exactly two sealing rings under the doctrine of equivalents.[33] The jury determined that the magnetizable sleeve limitation was infringed under the doctrine of equivalents.[34] On appeal, defendant asserted prosecution history estoppel,[35] noting that plaintiff had added the

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26. *See generally* Douglas Lichtman, *Rethinking Prosecution History Estoppel*, 71 U. CHI. L. REV. 151, 153-54 (2004).

27. *Warner-Jenkinson*, 520 U.S. at 33 n.7.

28. *Id.*

29. Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., No. 88-1814-MA, 1993 U.S. Dist. LEXIS 21434, at *3 (D. Mass. Apr. 27, 1993) [hereinafter *Festo I*].

30. *Festo VII*, 234 F.3d 558, 583-84 (Fed. Cir. 2000).

31. *Id.* at 584-85.

32. *See, e.g.*, Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., 72 F.3d 857, 862 (Fed. Cir. 1995) [hereinafter *Festo II*] ("The issue of infringement focused on the claim clauses relating to the guide rings and sealing rings, for some of the accused devices contained four rings and some contained only three rings; and to the magnetizable material in the sleeve of the follower. The presence of all other claim elements and limitations in the accused devices was conceded.").

33. *See Festo II*, 72. F.3d at 860-61; *Festo I*, 1993 U.S. Dist LEXIS 21434, at *28-*29.

34. *See Festo II*, 72 F.3d at 862-64.

35. *See supra* Part I.B.

sealing ring limitation during prosecution. The Federal Circuit rejected this argument and affirmed the decision of the trial court.[36] However, the Supreme Court vacated this result and remanded it to the Federal Circuit for further consideration in light of the Supreme Court's *Warner-Jenkinson* opinion.[37] In response, the Federal Circuit boldly held that prosecution history estoppel would be triggered by any narrowing amendment related to patentability and that it would absolutely bar the patentee from applying the doctrine of equivalents to the narrowed claim language.[38] Refusing to accept such an inflexible bar, the Supreme Court granted certiorari again and remanded to the Federal Circuit with guidance on how to implement a less rigid brand of prosecution history estoppel.[39]

Finally, at long last, the Federal Circuit handed down what will likely be the final word on the scope of prosecution history estoppel when a patentee amends claims during prosecution.[40] The Federal Circuit promulgated a fairly strict prosecution history estoppel doctrine, but held that patentees could still avail themselves of a few limited methods of regaining the equivalents they surrendered during patent prosecution.[41] More specifically, patentees may rebut the application of prosecution history estoppel by showing that an alleged equivalent was either unforeseeable at the time of filing or only tangentially related to the narrowed claim limitation.[42] Alternatively, the patentee may argue that there was "some other reason" the equivalent could not be described in the patent.[43]

In *Festo X*, The Federal Circuit outlined a step-by-step inquiry for handling cases where prosecution history estoppel arises.[44] Figure 1 summarizes the *Festo X* line of inquiry. Of particular interest here is the interplay between the *Warner-Jenkinson* and *Festo* presumptions. Briefly, failure to rebut the *Warner-Jenkinson* presumption triggers the *Festo* presumption,[45] which requires courts to assume that the patentee has surrendered all the

36. *See Festo II*, 72 F.3d at 863-64.

37. *See* Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., 520 U.S. 1111 (1997) [hereinafter *Festo IV*] (citing Hilton Davis Chem. Co. v. Warner-Jenkinson Co., 62 F.3d 1512 (Fed. Cir. 1995)); *supra* Part I.B.

38. *See Festo VII*, 234 F.3d 558, 574-75 (Fed. Cir. 2002).

39. *Festo VIII*, 535 U.S. 722, 740-41 (2002) (describing the circumstances when an amendment cannot be reasonably viewed as surrendering equivalents); *see also infra* note 58.

40. *Festo X*, 344 F.3d 1359 (Fed. Cir. 2003).

41. *See generally id.* at 1369-70.

42. *Id.* at 1369.

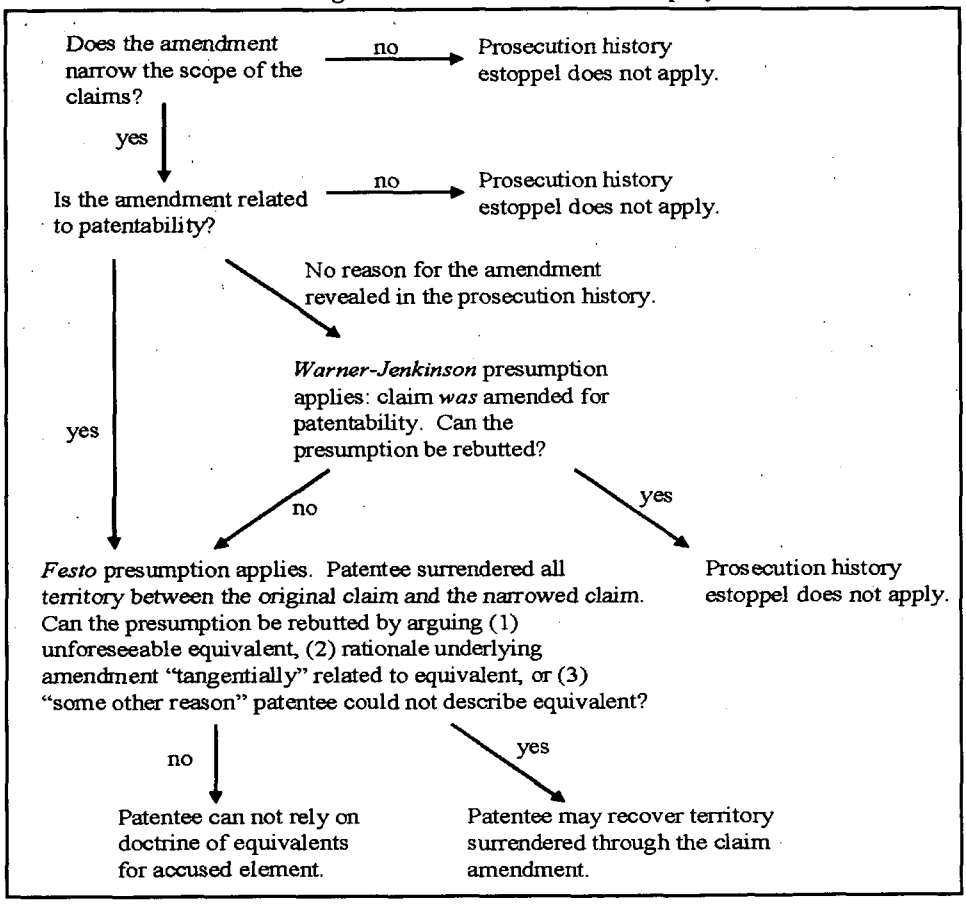
43. *Id.* at 1370.

44. *Id.* at 1366-67.

45. *Id.* at 1365-67.

territory between the original and amended claims.[46] This, in the Federal Circuit's view, precludes application of the doctrine of equivalents to any of the narrowed claim limitations.[47] However, the Federal Circuit has ruled that patentees may rebut the *Festo* presumption by any one of three means.[48] Patentees may argue (1) that the accused equivalent was unforeseeable at the time of drafting; (2) that the amendment was made for reasons only tangentially related to the equivalent in question; or (3) that there was "some other reason" the patentee could not describe the equivalent at the time of drafting.[49]

Figure 1. The *Festo X* Line of Inquiry



46. *See Festo VIII*, 535 U.S. 722, 733-34 (2002).

47. *Festo X*, 344 F.3d at 1367 ("[I]f the patentee fails to rebut the *Festo* presumption, then prosecution history estoppel bars the patentee from relying on the doctrine of equivalents for the accused element.").

48. *Id.* at 1369.

49. *Id.*

Although these avenues of rebutting the *Festo* presumption seem permissive at first glance, the deck is, in fact, stacked heavily against a patentee seeking to overcome the *Festo* presumption. Like the *Warner-Jenkinson* presumption, the *Festo* presumption places the initial burden on the patentee to show that prosecution history estoppel should not apply, putting the patentee on the defensive from the outset.[50] In addition, the Federal Circuit has placed significant limits on the evidence patentees may draw upon in attempting to rebut the presumption. For example, the *Festo X* court held that in evaluating whether the reason for amending a claim was tangential to the alleged equivalent only the prosecution record should be relied upon, but that expert testimony could occasionally be introduced to aid in the interpretation of the prosecution record.[51] In light of the scarce documentation that a patent application receives as it proceeds through prosecution,[52] this limitation severely forecloses a patentee's ability to take advantage of an ostensibly broad exception to the *Festo* presumption. The Federal Circuit placed an essentially identical evidentiary limitation on the patentee when she attempts to offer some "other reason" for the claim amendment.[53] Furthermore, the Federal Circuit has construed the "other reason" category to be "narrow" in extent, limiting its usefulness as a means for overcoming the *Festo* presumption.[54] Finally, it should be noted that the Federal Circuit, usually the final arbiter of patent disputes, is most likely in favor of a strong prosecution history estoppel doctrine. Indeed, before being overturned by the Supreme Court, the Federal Circuit had in fact instituted a strict and inflexible prosecution history estoppel bar.[55]

For the reasons outlined above, there is widespread agreement that the currently available avenues for rebutting the *Festo* presumption are only slightly more forgiving than the Federal Circuit's original inflexible bar.[56]

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50. *See* Warner-Jenkinson Co. v. Hilton Davis Chem. Co., 520 U.S. 17, 33 (1997); *Festo X*, 344 F.3d at 1365.

51. *Festo X*, 344 F.3d. at 1370.

52. *See* Thomas, *supra* note 6. *But see* R. Polk Wagner, *Reconsidering Estoppel: Patent Administration and the Failure of* Festo, 151 U. PENN. L. REV. 159, 206-09 (2004) (arguing that the prosecution history "is uniquely appropriate to solving the informational and temporal challenges presented by the administration system").

53. *Festo X*, 344 F.3d at 1370.

54. *Id.*

55. *See Festo VII*, 234 F.3d 558, 558 (Fed. Cir. 2000).

56. *See, e.g.*, Clayton, *supra* note 4; Ryan Thomas Grace, *Losing the Forest Among the Trees in the* Festo *Saga—Rationalizing the Doctrine of Equivalents and Prosecution History Estoppel in View of the Historical Justifications for Patent Prosecution*, 11 J. INTELL. PROP. L. 275, 318-19 (2004).

This situation is likely inconsistent with the intent of the Supreme Court.[57] Indeed, when discussing rebuttal of the *Festo* presumption, the Court used broad permissive language.[58] Furthermore, the Court gave little guidance on how lower courts should handle the three avenues of rebutting the *Festo* presumption, implicitly suggesting that the Court was only offering a few of the many ways in which patentees could rebut the *Festo* presumption. The Federal Circuit, however, construed the Supreme Court's language as creating only three limited escape hatches from the *Festo* presumption.[59] The Federal Circuit even went so far as to pigeonhole something as broad as "some other reason" into its own distinct category that "while vague, must be . . . narrow . . . ."[60]

In light of the difficulties associated with overcoming the *Warner-Jenkinson* and *Festo* presumptions, it is clear that the very first question in the *Festo X* inquiry (that is, does an amendment narrow the scope of a claim?) is most critical. Without a doubt, avoiding narrowing amendments now represents the safest, and perhaps singular, method of avoiding the surrender of claim territory. There has been a great deal of recent Federal Circuit guidance on this matter, and this Note now turns to a discussion of those cases.

II. RECENT FEDERAL CIRCUIT GUIDANCE ON WHETHER A CLAIM AMENDMENT NARROWS THE SCOPE OF A CLAIM

On three recent occasions, the Federal Circuit has considered how much territory prosecution history estoppel consumes when a patent appli-

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57. *See* Michael Bartolone, Note, Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co.: *The Federal Circuit Further Clarifies (or Perhaps Further Confuses) the Application of Prosecution History Estoppel*, 6 TUL. J. TECH. & INTELL. PROP. 273, 281 (2004) (arguing that there is reason to believe the Supreme Court intended for questions regarding rebuttal of the *Festo* presumption to be given "the full benefits of a trial" rather than be handled by courts as questions of law).

58. *Festo VIII*, 535 U.S. 722, 740-41 (2002) ("There are some cases, however, where the amendment cannot reasonably be viewed as surrendering a particular equivalent. The equivalent *may* have been unforeseeable at the time of the application; the rationale underlying the amendment *may* bear no more than a tangential relation to the equivalent in question; *or there may be some other reason suggesting* that the patentee could not reasonably be expected to have described the insubstantial substitute in question.") (emphasis added).

59. *Festo X*, 344 F.3d 1359, 1365 (Fed. Cir. 2003) ("*Specifically*, the Court *enumerated* three ways in which the patentee may overcome the presumption . . . .") (emphasis added).

60. *Id.* at 1370.

cant cancels a broad independent claim and rewrites narrower dependent claims in independent form.[61] In all such cases, the Federal Circuit has uniformly scaled back the scope of the patent claims to their literal terms. However, the recent cases are distinguishable, and, in some situations, there is good reason to allow the patentee continued reliance on the doctrine of equivalents.

A. *Honeywell*: The Presence of Additional Claim Limitations in Dependent Claims Creates a Presumption of Surrender If the Base Claim Is Rejected

In *Honeywell International v. Hamilton Sundstrand Corp.*,[62] plaintiff owned a patent on an aircraft auxiliary power unit (APU) that provided compressed air for the purpose of starting the plane's engines and maintaining the environment in the aircraft's cabin.[63] The APU included a feedback mechanism for preventing a potentially damaging situation, known as "surge," in which the pressure in the APU's main air duct becomes too high and the airflow rapidly reverses direction back into the APU compressor.[64] Plaintiff conceded that defendant's incorporation of air temperature into the APU's feedback mechanism precluded literal infringement, but brought suit for infringement relying on the doctrine of equivalents. In response, defendant argued that plaintiff was estopped from asserting the doctrine of equivalents based on plaintiff's amendments during prosecution.[65] Namely, defendant noted that all of plaintiff's asserted claims were originally drafted as dependent claims that were based upon a broader independent claim that lacked any limitations involving the "inlet guide vanes."[66] Upon rejection of the independent claim for obviousness under the prior art and rejection of the dependent claims for their dependence on an unacceptable base claim, plaintiff cancelled the original independent claim and redrafted the narrower dependent claims as independent claims,

61. *See generally* Honeywell Int'l v. Hamilton Sundstrand Corp., 370 F.3d 1131 (Fed. Cir. 2004) (en banc); Ranbaxy Pharms. Inc. v. Apotex, Inc., 350 F.3d 1235 (Fed. Cir. 2003); Deering Precision Instruments, LLC v. Vector Distribution Sys., Inc., 347 F.3d 1314 (Fed. Cir. 2003).

62. 370 F.3d 1131 (Fed. Cir. 2004) (en banc).

63. *Id.* at 1134.

64. *Id.*

65. *Id.* at 1137.

66. In *Honeywell*, plaintiff's APU included a set of "inlet guide vanes," the position of which could be used to assess the minimum airflow at which surge could be avoided. This minimum airflow was compared to the actual airflow conditions and a bleed-valve was opened as necessary to prevent surge. Defendant manufactured a very similar APU. However, in defendant's APU the decision to open the bleed-valve was based upon both the position of the inlet guide vanes and the ambient air temperature. *See id.* at 1137-38.

incorporating all the limitations of the original independent claim.[67] These new independent claims were ultimately accepted.

Noting that there was "no distinction between the narrowing of a pre-existing limitation and the addition of a new limitation," the Federal Circuit, reviewing the case *en banc*, held that plaintiff was estopped from asserting the doctrine of equivalents for the inlet guide vane limitation of its APU patent.[68] In so holding, the Federal Circuit effectively created a new rule for patent drafters: do not include crucial limitations in dependent claims, for if the independent base claim is rejected the doctrine of equivalents will be lost for any narrowing limitations present in the dependent claims.

One can make an argument that the Federal Circuit's holding is literally in line with the *Festo* decisions. Indeed, by canceling their broad independent base claim, plaintiffs narrowed the scope of their patent to encompass only territory including an inlet guide vane limitation. That is, with regard to inlet guide vane limitations, the scope of the original claims was infinite in extent since the original independent claim included no restrictions on the use of inlet guide vanes.[69] The amended patent, however, was bounded in the area of inlet guide vane limitations since the final claims included an inlet guide vane limitation. Thus, one might argue, the patentee clearly surrendered territory and estoppel should apply.

However, the territory taken from the patentee in *Honeywell* is peculiar because it appears to be far more vast than what patentees normally surrender through claim amendments. Case law regarding prosecution history estoppel often speaks of patentees being foreclosed from applying the doctrine of equivalents to the narrowed claim language.[70] This language is sometimes juxtaposed with language indicating that estoppel applies to the territory located between the original and amended claim language.[71]

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67. *Id.*

68. *Id.* at 1140-41, 1144.

69. The claims in *Honeywell* used the open transitional phrase "comprising" and were therefore not limited in scope to devices including only the limitations described in the claims. *See* U.S. Patent No. 4,380,893 (issued Apr. 26, 1983).

70. *See, e.g.*, *Festo VIII*, 535 U.S. 722, 739 (2002) ("[Where no explanation is established for the narrowing of a claim limitation] prosecution history estoppel would bar the application of the doctrine of equivalents as to that element."); *Honeywell*, 370 F.3d at 1139 ("However, prosecution history estoppel may bar the patentee from asserting equivalents if the scope of the claims has been narrowed by amendment during prosecution.").

71. *E.g.*, *compare Festo X*, 344 F.3d 1359, 1367 (Fed. Cir. 2003) ("[I]f the patentee fails to rebut the *Festo* presumption, then prosecution history estoppel bars the patentee from relying on the doctrine of equivalents for the accused element."), *with id.* at 1366

Thus, courts implicitly may be assuming that application of the doctrine of equivalents to the narrowed claim language usually encompasses most, if not all, of the territory between the original and amended claim language. In line with this approach, the Federal Circuit held in *Honeywell* that the patentee had surrendered not only territory encompassing APUs having no inlet guide vane limitation whatsoever, but also territory including equivalents of the inlet guide vane limitation, which was never amended during prosecution.[72]

There are a number of problems with the court's holding. First, the facts of *Honeywell* clearly show that there is not necessarily even an approximate equality between (1) the territory encompassed by applying the doctrine of equivalents to the final claim language and (2) the territory between the original and final claim language. Indeed, the original patent application was originally infinite in extent with regard to inlet guide vane limitations by virtue of its independent claim that included no such limitation. Such a vast territory cannot possibly be covered via the minor stretching of literal claim language offered by the doctrine of equivalents.[73] Thus, the doctrine of equivalents is arguably not relevant in an estoppel case like *Honeywell*.

Furthermore, as the dissent noted, plaintiff's amendments did not clearly signal a surrender of the territory encompassed by the original dependent claims.[74] Rather, in canceling the broad independent claim, plaintiff likely intended to surrender only territory encompassed by APUs having no inlet guide vane limitation at all. Why then, should the patentee be required to give up *equivalents* of the inlet guide vane element as well? Although the intent of the patentee is arguably irrelevant, *Honeywell* still does not qualify as a case in which the patentee signaled surrender by "[knowing] the words for both the broader and narrower claim, and affirmatively [choosing] the latter."[75] Indeed, given that there was no inlet guide vane limitation in the original independent claim, one could only determine that the patentee knew the words for the broader claim if one dubiously equates the absence of words with broader words.[76] In light of

("A patentee is now entitled to rebut the presumption that an 'unexplained' narrowing amendment surrendered the entire territory between the original and the amended claim limitations.").

72. *See generally Honeywell*, 370 F.3d at 1146 (Newman, J., dissenting).

73. This situation is illustrated in Figure 2 *infra*.

74. *Honeywell*, 370 F.3d at 1150-51 (Newman, J., dissenting).

75. *See Festo VIII*, 535 U.S. at 734-35; *supra* Part I.B.

76. This assumes that other language in the specification or claims that touched upon the inlet guide vane limitation did not influence the Federal Circuit in *Honeywell*. Given that the Federal Circuit failed to point out such language, this assumption seems

these considerations, courts addressing questions of prosecution history estoppel should keep in mind the distinction between the territory encompassed by applying the doctrine of equivalents to narrowed claim language and the territory between the original and amended claims. When, as in *Honeywell*, the difference between the two is so vast, courts should determine if the patentee genuinely selected narrower claim language over broader claim language before harshly scaling back the scope of the patent claims to their literal terms. Such an approach is more fair and consistent with the logic of prosecution history estoppel, and more in line with the mandate of the Supreme Court.[77]

Many other shortcomings of the *Honeywell* majority opinion were identified by the dissent.[78] Pointing to 35 U.S.C. § 112 ¶ 4,[79] the dissent noted that dependent claims are in fact intended to stand on their own, expressly including the limitations of the independent base claims.[80] From this standpoint, there was in fact no narrowing amendment to the asserted dependent claims. However, this argument can be carried further. The Federal Circuit has previously noted that "the first question in a prosecution history estoppel inquiry is whether an amendment filed in the Patent and Trademark Office . . . has narrowed the literal scope of *a claim*."[81] Under the Federal Circuit's holding in *Honeywell*, however, the question that courts must apparently ask is whether an amendment narrows the literal scope of the *patent* as a whole. This approach seems incompatible with the claim-by-claim, element-by-element line of inquiry that courts normally take in patent analysis, such as when applying the all-element rule in an infringement case.[82]

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reasonable. Indeed, rather than accurately ascertaining the scope of surrendered territory, it seems likely that the court's overriding objective in *Honeywell* was to foreclose patent drafters from dodging narrowing amendments by treating most amendments as "merely adding new claim limitations rather than narrowing preexisting ones." *Honeywell*, 370 F.3d at 1141. Furthermore, if the Federal Circuit was indeed influenced by some unspecified language in the specification or other claims, then a legitimate concern arises over whether this particular mode of applying prosecution history estoppel will lead to objective and consistent results.

77. *Festo VII*, 535 U.S. at 738 (stating that there is no reason why a narrowing amendment should be deemed to relinquish equivalents "beyond a fair interpretation of what was surrendered").

78. *See generally Honeywell*, 370 F.3d at 1146-53 (Newman, J., dissenting).

79. 35 U.S.C. § 112 ¶ 4 (2000) ("[A] claim in dependent form shall be construed to incorporate by reference all the limitations of the claim to which it refers.")

80. *Honeywell*, 370 F.3d at 1146-47 (Newman, J., dissenting).

81. *Festo X*, 344 F.3d 1359, 1366 (Fed. Cir. 2003) (emphasis added).

82. *See supra* Part I.A; *see also* Trovan, Ltd. v. Sokymat SA, 299 F.3d 1292, 1302 (Fed. Cir. 2002) (noting that inventorship is determined on a claim-by-claim basis);

On the other hand, the Supreme Court has held that "[e]stoppel arises when an amendment is made to secure the *patent* and the amendment narrows the *patent's* scope."[83] Thus, it is not entirely clear how broad the prosecution estoppel inquiry should be. Should courts analyze estoppel on an element-by-element basis, claim-by-claim basis, or should they look at whether the patent as a whole was narrowed?

Whenever possible, courts applying prosecution history estoppel should limit themselves to an element-by-element approach. As in an infringement analysis, a fine-grained element-by-element approach to estoppel will be more systematic and disciplined. In addition, carrying out a piecewise evaluation of the consequences of changing a small number of words in a claim is a manageable problem that requires courts to consider only a few variables at a time. As a result, it will lead to the most predictable outcome. A holistic approach, on the other hand, could require courts to consider a great deal of factors at once. For example, courts might have to simultaneously weigh the relative importance of a large number of amendments made to the entire patent. In addition, courts will have to determine whether a change in one claim ought to affect the scope of territory encompassed by another claim, and, if so, by how much. In a case like *Honeywell*, involving dependent claims that are inextricably bound to their base claim, it might seem natural to assign a great deal of weight to a change in a base claim when the scope of territory covered by a dependent claim is being evaluated. However, it is less clear if this approach should be carried over to cases in which courts must compare two claims that merely cover similar subject matter or share similar language. Thus, a holistic approach lends itself to a greater level of subjectivity and hence a higher degree of volatility. However, as will be discussed below, in some cases it may indeed be appropriate to consider more than one claim when determining the scope of prosecution history estoppel.[84]

Finally, the *Honeywell* dissent noted the numerous practical problems that the majority opinion creates for patent drafters.[85] By destroying the traditional paradigm of drafting broad independent claims supported by a series of successively narrower dependent claims, the majority decision

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Amazon.com, Inc. v. Barnesandnoble.com, Inc., 239 F.3d 1343, 1351 (Fed. Cir. 2001) (noting that both infringement and validity analyses must be done on a claim-by-claim basis).

83. *Festo VIII*, 535 U.S. 722, 736 (2002) (emphasis added).

84. *See infra* Part II.B.

85. *See Honeywell*, 370 F.3d at 1152-53 (Newman, J. dissenting).

will increase the cost of applying for a patent, the likelihood of litigation, and the time required for examination.[86]

B. *Ranbaxy* and *Deering*: Limitations Narrowed in Dependent Claims Create a Presumption of Surrender If the Base Claim Is Rejected

Two other Federal Circuit cases with facts very similar to *Honeywell* have been recently decided. In *Ranbaxy Pharmaceuticals, Inc. v. Apotex, Inc.*,[87] plaintiff filed a patent application directed towards the preparation of a drug.[88] The original application included one broad independent claim and nine dependent claims.[89] Of particular importance was language in the independent claim calling for the use of a "highly polar organic solvent."[90] Citing the indefiniteness of this language, the examiner rejected the claim.[91] The dependent claims, which specified a particular organic solvent for use in the preparation, were rejected for their dependence on an unacceptable base claim.[92] However, the examiner indicated these dependent claims would be acceptable if rewritten in independent form.[93] Accordingly, plaintiff abandoned the original independent claim and redrafted the dependent claims as a single independent claim specifying that the acid used be selected from "the group consisting of a sulfoxide, an amide and formic acid."[94] Upon learning that defendant was practicing the patented process using acetic acid, plaintiff sued, arguing that defendant's use of acetic acid infringed under the doctrine of equivalents.[95] Defendant argued in response that plaintiff was precluded from relying on the doctrine of equivalents because plaintiff narrowed its claims when it redrafted its dependent claims as independent claims.[96] Noting that plaintiff's claim amendment "further defined and circumscribed an existing limitation for the purpose of putting the claims in condition for allowance," the Federal Circuit held in favor of defendant.[97]

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86. *Id.* (Newman, J., dissenting).
87. 350 F.3d 1235 (Fed. Cir. 2003).
88. *Id.* at 1236-37.
89. *Id.* at 1237.
90. *Id.*
91. *Id.* at 1238.
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.* at 1240.

Deering Precision Instruments, LLC v. Vector Distribution Systems, Inc.[98] presented a situation nearly identical to *Ranbaxy*. In *Deering*, plaintiff's patent was for a lightweight portable scale.[99] Independent claim 1 of the original application carried a limitation calling for a "sliding weight movably carried by said beam for movement along said scale."[100] Claim 3, dependent on claim 1, added a limitation requiring that the sliding weight be disposed substantially in a particular plane when in its "zero position."[101] The examiner rejected original claim 1 as being obvious under the prior art.[102] In response, plaintiff redrafted claim 3 as an independent claim that was ultimately accepted.[103] However, *Deering* presented one additional twist. Namely, independent claim 9 of plaintiff's original application also included the "zero position" limitation.[104] The examiner mistakenly objected to this claim for its dependence on an unacceptable base claim.[105] Plaintiff responded by pointing out that claim 9 was in fact an independent claim and asserting that the "zero position" limitation was not disclosed in the prior art references.[106] The examiner ultimately accepted claim 9 as originally written.[107] Nevertheless, the Federal Circuit held that plaintiff was estopped from asserting the doctrine of equivalents for the "zero position" limitation based on its cancellation of independent claim 1 and redrafting of claim 3 as an independent claim.[108]

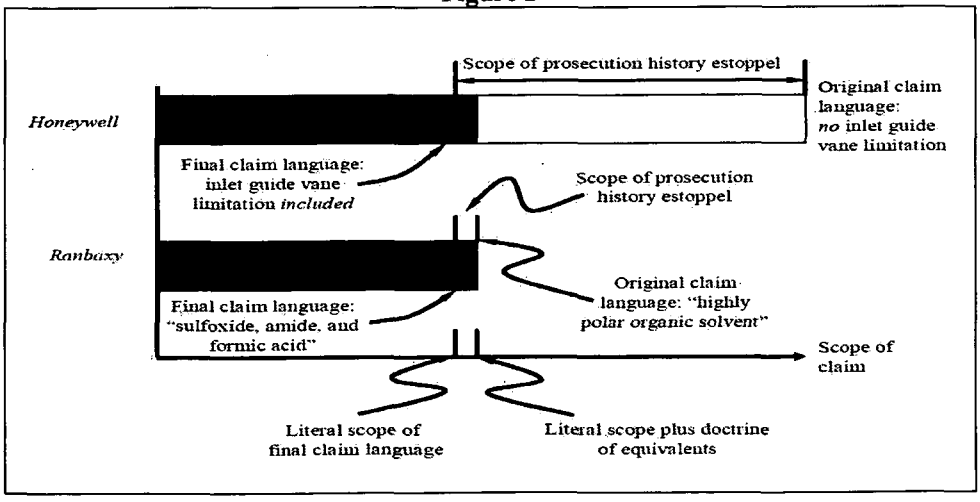
The dissent in *Honeywell* explicitly affirmed the holdings of *Ranbaxy* and *Deering*.[109] However, much of the dissent's argument against the *Honeywell* majority opinion seems applicable to *Ranbaxy* and *Deering* as well. In particular, the dissent's arguments based on 35 U.S.C. § 112 ¶ 4 are unequivocal: "[r]estating a dependent claim in independent form does not change its content or scope; the claim is of identical scope before and after it is rewritten."[110] Furthermore, the dissent's urging that a patentee

98. 347 F.3d 1314 (Fed. Cir. 2003).
99. *Id.* at 1317.
100. *Id.* at 1325.
101. *Id.* at 1319.
102. *Id.*
103. *Id.*
104. *Id.*
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.* at 1325.
109. Honeywell Int'l v. Hamilton Sundstrand Corp., 370 F.3d 1131, 1152 (Fed. Cir. 2004) (en banc) (Newman, J., dissenting).
110. *Id.* at 1147 (Newman, J., dissenting); *see also id.* at 1149 (Newman, J., dissenting) ("[R]estating a dependent claim into an independent claim of identical scope is not a narrowing amendment; and canceling a broader claim (especially one that does not men-

does not signal an intention to surrender territory by redrafting dependent claims in independent form has weight regardless of whether or not the narrowing limitation was present in the original base claim.[111] This is especially true of a case like *Deering*, in which the limitation at issue was present in a distinct and accepted independent claim, the patentee explicitly asserted that the limitation was not covered by the prior art, and the claim was ultimately accepted as written.[112] Certainly, in a case where the actual narrowing amendment is so dubious, estoppel should not be viral and infiltrate unamended claims, as was the case for application claim 9 in *Deering*.[113]

Figure 2 depicts prosecution history estoppel in both *Honeywell* and *Ranbaxy*. Note that in *Ranbaxy* the territory between the original and final claim language matches the territory encompassed by applying the doctrine of equivalents to the final claim language. This assumes that "highly polar organic solvent" may be regarded as the equivalent of "sulfoxide, amide and formic acid." In *Honeywell*, however, this is not the case. Note also that the extent of the surrendered territory in *Honeywell* is far more significant than in *Ranbaxy* owing to the absence of the inlet guide vane limitation in the original claim.

Figure 2



tion the element at issue for equivalency) is not a narrowing amendment."); *id.* (Newman, J., dissenting) ("By statute it is irrelevant whether a claim is in dependent or independent form; it is not a narrowing amendment to go from dependent form to independent form.").

111. *Id.* at 1151 (Newman, J., dissenting).

112. *Deering*, 347 F.3d at 1319.

113. *Id.* at 1326.

However, the result in *Ranbaxy* is difficult to dispute, and there is a good argument that the result in *Deering* is proper as well. In *Ranbaxy*, the claim limitation at issue was clearly present in the original independent claim. The same is arguably true in *Deering*. This was the principle upon which the dissent in *Honeywell* distinguished *Ranbaxy* and *Deering*,[114] and, unlike *Honeywell*, this places an upper bound on the extent of the surrendered territory. Naturally, this makes the surrender of territory in *Ranbaxy* and *Deering* much easier to stomach. More importantly, *Ranbaxy* and *Deering* may be distinguished from *Honeywell* because the presence of the broader limitation in the original independent claim converts *Ranbaxy* and *Deering* into cases where the patentee truly "knew the words for both the broader and narrower claim, and affirmatively chose the latter."[115] Although the broader and narrower claim languages were drawn from different claims in *Ranbaxy* and *Deering*, the claims from which the language was drawn were explicitly connected via a dependent claim relationship. Furthermore, the broader and narrower languages in both claims was undeniably directed to the same single limitation. Thus, *Ranbaxy* and *Deering* are also not cases in which concerns over subjectivity should preclude expanding the scope of the prosecution estoppel inquiry beyond the language contained in a single claim.[116]

C. *Ericsson*: The Difficulty in Reading Claims Narrowly and the Importance of How Claims Are Parsed Into Limitations

Ericsson, Inc. v. Harris Corp.[117] is a rather complicated patent infringement case in which plaintiff held a patent on an interface circuit that reduced the power supplied to a telephone set when it is not in use.[118] The disputed claim as plaintiff originally submitted it to the PTO read in part as follows:

> . . . which by the control signals effectively disconnects the speech signal amplifiers and actively connects the auxiliary amplifiers so that the speech signal amplifiers, which require power, only supply power to the telephone set when the receiver is off its cradle and a call can be made.[119]

114. *Honeywell*, 370 F.3d at 1152 (Newman, J., dissenting) (noting that unlike *Honeywell* "in Deering and Ranbaxy the dependent claim limited an element of the original independent claim, raising the presumption of surrender").

115. *Festo VIII*, 535 U.S. 722, 734-35 (2002).

116. *See* discussion *supra* Part II.A.

117. 352 F.3d 1369 (Fed. Cir. 2003).

118. *Id.* at 1371.

119. *Id.* at 1380 (Newman, J., dissenting).

After the examiner rejected the claim for anticipation and failure to satisfy §112,[120] plaintiff amended the claim to read:

> . . . which by the control signals *disables* the speech signal amplifiers and *enables* the auxiliary amplifiers so that the speech signal amplifiers, which require power, only supply power to the telephone set when the receiver is off its cradle and a call can be made.[121]

Of critical importance in *Ericsson* is the "only supply power" limitation, which both parties agreed to give its ordinary meaning. In light of this construction, defendant, who manufactured a similar interface circuit, noted at trial that its device supplied some power to the phone even in its on hook position, a finding of fact the trial court adopted.[122] Accordingly, defendant argued that the "only supply power" limitation of plaintiff's claim precluded their device from infringing.[123] The jury, however, determined that defendant's device infringed under the doctrine of equivalents.[124] Noting that such a determination would vitiate the "only supply power" limitation of plaintiff's claim, the trial judge granted defendant's motion for judgment as a matter of law of noninfringement.[125]

The Federal Circuit reversed the trial judge's ruling.[126] According to the Federal Circuit, the jury could have determined that the "only supply power" limitation referred only to power supplied by the "speech signal amplifiers" and not, more generally, to whether the speech signal amplifiers were enabled or disabled.[127] The Federal Circuit further held that the jury could also have determined that in the accused device the power that was supplied to the phone set in its on hook position originated not from the speech signal amplifiers but from the "QRA 23-25" transistors.[128] In light of these findings, the Federal Circuit held that a finding of infringement was appropriate since the narrowing amendment had nothing to do with the limitation at issue.[129]

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120. *Id.* (Newman, J., dissenting).
121. *Id.* (Newman, J., dissenting) (emphasis added).
122. *Id.* at 1372.
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.* at 1375.
127. *Id.*
128. *Id.* at 1374-75.
129. *Id.* at 1375 ("The only equivalence issue thus concerns when the speech signal amplifiers supply power, not whether they are 'enabled' or 'disabled' as opposed to 'actively connected' or 'effectively disconnected,' which was the subject of the amendment.

This reading of the claim limitation is quite generous to plaintiff. The term "disabled" is far more restrictive than the relatively open phrase "effectively disconnects." Thus, the overall claim was undeniably narrowed through amendment. Furthermore, the substituted language modifies the conditions under which power is supplied to the telephone set. However, the Federal Circuit chose to endorse a view in which the claim was parsed into fine-grained limitations that focused on the role of the speech signal amplifiers. This approach shifts the focus of the analysis away from the essence of what the claim encompasses in favor of a mechanical analysis of the claim text. In addition to being difficult to square with prior Federal Circuit guidance on the matter,[130] such an approach opens up a wide avenue for a patentee to avoid prosecution history estoppel, weakening the notice function of patents. Indeed, the dissent in *Ericsson* argued that the majority holding produces "a dramatic loophole in the Festo decisions."[131]

Ericsson is also difficult to square with the Federal Circuit's opinions in *Ranbaxy*, *Deering*, and *Honeywell*. Just as in *Ericsson*, the Federal Circuit focused strictly on the text of patent claims to assess whether a narrowing amendment had been made.[132] However, in *Ranbaxy*, *Deering*, and *Honeywell*, the Federal Circuit chose a broader context in which to evaluate the claim amendments. More specifically, in those cases, dependent claims were evaluated not just individually, but in the context of the broader independent claims upon which they depended.[133] Interestingly, in choosing a broader context, the Federal Circuit arrived at a determination that a relevant narrowing amendment had in fact been made. Thus, there appears to be a tension here: the probability of determining that there was a relevant narrowing amendment is apparently inversely proportional to the size of the context in which the amendment is evaluated.[134] For this

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In other words, the equivalence question relates to whether the speech signal amplifiers . . . only supply power to the telephone set when the receiver is off-hook. That limitation was never amended and therefore cannot be subject to the Festo presumption.").

130. For a case illustrating the Federal Circuit's prior reluctance to parse claims into small elements, see Kustom Signals, Inc. v. Applied Concepts, Inc., 264 F.3d 1326, 1333 (Fed. Cir. 2001) ("The word 'or' is not itself an 'element' of an apparatus or a step of a method, and its presence to signify alternative elements does not convert 'or' into an element. The ruling of non-infringement can not be sustained on this ground.").

131. *Ericsson*, 352 F.3d at 1380 (Newman, J., dissenting).

132. *See supra* Parts II.A-.B.

133. *Id.*

134. Nelson made a similar point regarding the consequences of determining whether claim elements are small or large. Nelson, *supra* note 18, at 364 ("The larger the relevant element is deemed to be, or the more words or phrases in the section of the claim element, the more the patentee is hurt. This is because the estoppel, which bars the patentee from asserting infringement by equivalents, now applies to a larger portion of the claims.

reason, the issues of how claims will be parsed into limitations and the context in which they will be evaluated when determining whether a narrowing amendment has been made have become absolutely crucial.

Little has been said regarding the increasingly important problem of dividing claims into limitations. One commentator has suggested that "[o]ne possible approach is to consider that a word/phrase is part of the amended limitation when the amended portion directly changes the scope of the meaning portrayed by the phrase (or words) in question and can be reasonably considered part of the same concept/feature in the claim."[135] Under this "concept/feature" approach, courts might be inclined to parse claims into fairly large limitations. *Ericsson* might have been overturned under this approach. On the other hand, Nelson has proposed that in the context of prosecution history estoppel a limitation be defined as "any word or words added by amendment or argument that reflect(s) a single, new requirement added to the claims."[136] Nelson has noted that under this "requirement" approach, "one word can indeed be a bona fide limitation."[137] Thus, the "requirement" approach will likely lead to smaller limitations than the "concept/feature" approach. Unfortunately, neither definition provides a mechanical rule for dividing claims into limitations based on the grammar of the claim. Such a grammar-based rule is probably impossible to formulate, and one may be able to do no better than rules like those discussed in this section, which simply focus the court on the task of seeking out either "features/concepts" or "requirements." Such rules, though an improvement, still leave a great deal to be desired. Most importantly, there is a great deal of ambiguity inherent in the distinction between "feature/concept" and "requirement." Indeed, in the case of a very important "requirement," the "requirement" approach may very well coalesce with the "concept/feature" approach.

Thus, it seems likely that the partitioning of claims into limitations will, to a large extent, remain a matter that courts must do on a case-by-case basis. While this clearly does not serve the goal of uniformity, it does not necessarily mean that the notice function of patents must be sacrificed.

If the relevant element consists of only one or two words, the patentee is helped because a larger portion of the claims is not barred from assertions of equivalents."). *Ericsson* provides a vivid illustration of the exact principle suggested by Nelson. *Ranbaxy*, *Deering*, and *Honeywell* are quite similar, but involve the Federal Circuit evaluating multiple claims simultaneously to determine if a narrowing amendment had been made.

135. *Patent Devices May Infringe On a Claimed Invention Under the Doctrine of Equivalents Where They Are Insubstantially Different From the Claimed Invention 99% Of The Time*, 13 Fed. Cir. B.J. 740, 742 (2004).

136. Nelson, *supra* note 18, at 378.

137. *Id.*

One possible way to strengthen the notice function of patent claims in the face of uncertain claim partitioning would be to require the patent examiner, upon receipt of a claim amendment, to clearly define the boundaries of the limitation in which the amended language resides. Just as courts defer to an examiner's objection to a claim on prior art grounds,[138] courts could treat the examiner's determination of the boundaries of a limitation containing amended claim language with deference, thereby enhancing the notice function of patents. This approach has the additional advantage of placing the job of demarcating the most critical claim limitations in the hands of those with some technical background, which is especially crucial in cases involving complex technologies. In *Ericsson*, for example, intricate questions regarding the importance of the speech-signal amplifiers and whether there were other components in the interface circuit that provided power to the telephone set would naturally arise in partitioning the claims. For the purpose of answering these questions, the examiner could also take the liberty of considering extrinsic evidence, something the Federal Circuit has been reluctant to do when dealing with prosecution history estoppel.[139]

The need for extrinsic evidence becomes more evident if one considers what would have happened had the *Ericsson* court followed the recommendation of the dissent[140] and remanded the case to the district court for a determination of whether plaintiff could have rebutted the *Festo* presumption. A hypothetical *Ericsson* remand would have most likely focused on whether the accused equivalent was tangential to the narrowing amendment. Certainly, the issue of whether power was supplied to the telephone set by the speech signal amplifiers or the QRA 23-25 transistors would have become paramount. The Federal Circuit also considered this issue, and it pointed to evidence consisting of defendant's engineering notes and data sheets suggesting that the QRA 23-25 transistors were not part of the speech signal amplifiers.[141] In addition, it pointed to expert testimony that cut both ways on this issue.[142] The Federal Circuit has mandated that courts should only consider evidence contained in the prosecution history when evaluating whether the *Festo* presumption is rebuttable

138. *See* Warner-Jenkinson Co. v. Hilton Davis Chem. Co., 520 U.S. 17, 33 n.7 (1997); *supra* Part I.B.

139. *See supra* Part I.C.

140. Ericsson, Inc. v. Harris Corp., 352 F.3d 1369, 1381 (Fed. Cir. 2003) (Newman, J., dissenting).

141. *Id.* at 1375.

142. *See id.*; *id.* at 1352 n.2.

through a showing of tangentialness.[143] In light of this mandate, it is entirely possible that none of this highly relevant evidence would have been considered on remand. Although the expert testimony might have been allowed, it would have been disfavored relative to evidence contained in the prosecution history. Certainly, unless the engineering notes and data sheets were placed in the prosecution history, they would have been disregarded entirely. Thus, *Ericsson* illustrates that the Federal Circuit's evidentiary limitations are likely too restrictive, especially in highly technical cases like *Ericsson*.

Although *Ericsson* is troubling, it is worth noting that its precedential impact may be limited. Since *Ericsson* was heard on appeal from a judgment as a matter of law (JMOL) verdict,[144] it is possible the Federal Circuit was motivated by a strong desire to preserve the sanctity of the jury verdict. In addition, defendant apparently did not argue for either application of the *Festo* presumption or remand on the issue.[145] Thus, it is entirely possible that the Federal Circuit would have responded differently had this not been the case.

III. CONCLUSION

With its holdings in *Honeywell*, *Ranbaxy*, and *Deering*, the Federal Circuit sent a clear message: prosecution history estoppel will be strictly applied. In light of its most recent *Festo* decision, this message was unsurprising. Nevertheless, in *Honeywell*, the Federal Circuit arguably went too far in its zeal to implement a strict prosecution history estoppel rule. Indeed, *Honeywell* suggests that dependent claims can now be quite dangerous. *Honeywell* also represents a troubling example of the Federal Circuit implementing prosecution history estoppel by mechanically foreclosing application of the doctrine of equivalents to the finalized claim language absent critical language that precisely defined the outer boundary of the original unamended claim. Without such language, the scope of territory consumed by prosecution history estoppel can be excessive. More importantly, the absence of such language suggests that the patentee did not affirmatively select narrower claim language over broader claim language. In such circumstances, prosecution history estoppel is perhaps inappropriate. In contrast to *Honeywell*, the claims in *Ranbaxy* and *Deering* did include precise language defining the outer limits of the original unamended

143. *Festo X*, 344 F.3d 1359, 1370 (Fed. Cir. 2003); *see supra* Part I.C.
144. *Ericsson*, 352 F.3d at 1373.
145. *Id.* at 1375 n.4.

claim. This is the key factor that makes prosecution history estoppel palatable.

Ericsson presents a case that is difficult to reconcile with *Honeywell*, *Deering*, and *Ranbaxy*. Although there might have been some factors unrelated to the merits of the case that influenced the Federal Circuit, *Ericsson* is still a surprising illustration of a finding of infringement via the doctrine of equivalents. In the post-*Festo* era, such results will likely be rare. In contrast to *Honeywell*, *Deering*, and *Ranbaxy*, *Ericsson* further illustrates that Courts are far less likely to determine that a relevant narrowing amendment was made when claim limitations are interpreted within a narrow context. Thus, if the Federal Circuit persists with a rigid prosecution history estoppel rule, clearer guidance must be given on how claims will be parsed into limitations and how broadly of a context they will be evaluated in.

Ideally, the Federal Circuit would have treated *Ericsson* as presenting the question of whether the patentee could have rebutted the *Festo* presumption via a "tangentialness" argument. However, had this been done, it is likely that some highly relevant evidence would have gone unconsidered in light of the Federal Circuit's partiality for evidence contained within the prosecution history. Thus, *Ericsson* also suggests that the restrictions the Federal Circuit has placed on the evidence courts may consider in evaluating whether the *Festo* presumption has been rebutted are perhaps too narrow, especially in highly technical cases.

INEQUITABLE CONDUCT CLAIMS IN THE 21ST CENTURY: COMBATING THE PLAGUE

By Katherine Nolan-Stevaux

> "[T]he habit of charging inequitable conduct in almost every major patent case has become an absolute plague."[1]

In an *ex parte* patent prosecution system, patent validity depends on the quality of the information available to the examiner. Consequently, patent applicants are under a strict duty to disclose all relevant prior art materials of which they are aware.[2] The Federal Circuit has emphasized this duty by stating that "[t]he highest standards of honesty and candor on the part of applicants in presenting such facts to the office are thus necessary elements in a working patent system. We would go so far as to say they are essential."[3] In the United States, the duty to disclose is enforced during litigation through the affirmative defense of inequitable conduct.[4] When asserted successfully, this defense prevents a patentee who knowingly withheld relevant prior art information from enforcing her patent rights.

In theory, the United States Patent and Trademark Office (PTO) ensures that issued patents do not claim knowledge in the public domain, and it does so by upholding the standards of novelty and nonobviousness.[5] Unless the PTO can prove by a preponderance of the evidence that a claimed invention has been described previously, it must issue a patent on the invention.[6] Consequently, an examiner's access to relevant prior art strongly influences whether claims in a patent application will issue. In

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1. Burlington Indus. v. Dayco Corp., 849 F.2d 1418, 1422 (Fed. Cir. 1988).
2. 37 C.F.R. § 1.56 (2004).
3. Hycor Corp. v. Schlueter Co., 740 F.2d 1529, 1538 (Fed. Cir. 1984) (quoting Norton v. Curtiss, 433 F.2d 779, 794 (C.C.P.A. 1970)).
4. *See generally* Michael A. Weidinger, *Inequitable Pleading: Defendants' Particular Burden in Patent Infringement Suits*, 62 GEO. WASH. L. REV. 1178 (1994).
5. *See* 35 U.S.C. §§ 102, 103 (2000).
6. The burden of showing non-patentability rests on the PTO. *See id.* § 102; *In re* Oetiker, 977 F.2d 1443, 1445 (Fed. Cir. 1992). In addition, examiners must produce a prima facie case of obviousness, whereas applicants are not required to submit evidence of nonobviousness. *See* UNITED STATES PATENT & TRADEMARK OFFICE, MANUAL OF PATENT EXAMINING PROCEDURE § 2142, at 2100-128-29 (8th ed. 2001) [hereinafter MPEP], *available at* http://www.uspto.gov/web/offices/pac/mpep/mpep.htm. Furthermore, under 37 C.F.R. § 1.114(d) (2004), examiners cannot issue a truly final rejection since applicants may file an unlimited number of continuations.

many fields, applicants are better informed on the availability and relevance of prior art than are examiners.[7] As a result, examiners are more likely to issue invalid patents because material references are not before them rather than because of an inability to understand available references.[8]

Improperly granted patents incur significant social and economic costs.[9] The doctrine of inequitable conduct aims to remedy these ills by stripping patent rights from undeserving individuals post hoc. However, many legitimate patentees must defend their patents against frivolous allegations, creating a substantial strain on the courts and the patent system in general. The practice of asserting a defense of inequitable conduct, regardless of the merits of the defense in a given case, has reached the breaking point.

This Note recommends three conservative reforms to the implementation of inequitable conduct allegations aimed at reducing the number of frivolous allegations. These proposals are in line with particular reforms advocated by the National Academy of Sciences (NAS) and the Federal Trade Commission (FTC).[10] Part I discusses the foundations of the doctrine of inequitable conduct and the current state of the law. Part II addresses the policy arguments underlying inequitable conduct and provides an empirical study on how district courts have applied the law in the past ten years. The Part shows that in summary judgment proceedings, 42% of the allegations of inequitable conduct were dismissed because they failed to raise genuine issues of material fact requiring disposition in trial, and in trials and post-trial motions, courts failed to find clear and convincing evidence of inequitable conduct 70% of the time. Thus, a substantial majority of inequitable conduct allegations fail to uncover clear and convincing evidence of wrongdoing. Based on these findings, Part III outlines four

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7. *See* Jay P. Kesan & Marc Banik, *Patents as Incomplete Contracts: Aligning Incentives for R&D Investment with Incentives to Disclose Prior Art*, 2 WASH. U. J.L. & POL'Y 23, 32 (2000).

8. *See* David Hricik, *Aerial Boundaries: The Duty of Candor as a Limitation on the Duty of Patent Practitioners to Advocate for Maximum Patent Coverage*, 44 S. TEX. L. REV. 205, 220-21 (2002) (discussing how validity depends on disclosure and the problems stemming from this dependence).

9. *See* Hricik, *supra* note 8, at 222; Mark D. Janis, *Reforming Patent Validity Litigation: The "Dubious Preponderance"*, 19 BERKELEY TECH. L.J. 923, 923-24 (2004); Kesan & Banik, *supra* note 7, at 23-24, 32-33; Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 NW. U. L. REV. 1495, 1515-20 (2001).

10. FED. TRADE COMM'N, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY (2003) [hereinafter FTC REPORT], *available at* http://www.ftc.gov/opa/2003/10/cpreport.htm; NAT'L ACAD. OF SCIS., A PATENT SYSTEM FOR THE 21ST CENTURY (Stephen A. Merrill et al. eds., 2004) [hereinafter NAS STUDY].

possible reforms to curb the number of unsubstantiated inequitable conduct charges: (1) eliminate the doctrine of inequitable conduct; (2) award attorneys' fees to patentees when there are no issues of material fact supporting the allegations; (3) lower the presumption of validity for prior art not examined during prosecution; and (4) encourage the submission of statements of relevance of prior art during prosecution. This Note discusses the insurmountable limitations associated with the first proposition and, therefore, only advocates the adoption of proposals two through four as a means of combating the inequitable conduct plague.

I. BACKGROUND

A. Origin of the Doctrine of Inequitable Conduct

Inequitable conduct is a judicially created patent law doctrine founded in the equitable doctrine of unclean hands.[11] In equity jurisprudence generally, a party seeking relief must not have unclean hands itself if it wishes the court to act in its behalf.[12] The Supreme Court appealed to this equitable doctrine and recognized a private right of action for inequitable conduct in the specific context of patent infringement in the landmark case *Keystone Driller Co. v. General Excavator Co.*[13] In this case, the patentee (who assigned his rights to the plaintiff) learned of a prior, public use of his claimed inventions prior to initiating an infringement suit.[14] He then prepared an affidavit for the prior user to sign in exchange for "valuable considerations," stating that his prior public use was merely an abandoned experiment.[15] When the defendant deposed the prior user, the user failed to disclose the terms under which he had signed the affidavit.[16] Although the Supreme Court did not explicitly state it, the patents were rendered effectively unenforceable by the patentee's conduct in suppressing prior art connected to the patents-in-suit.[17]

Although often termed "fraud on the [p]atent [o]ffice,"[18] inequitable conduct encompasses behavior broader than common law fraud. Tradi-

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11. Keystone Driller Co. v. Gen. Excavator Co., 290 U.S. 240, 244-45 (1933). All references to inequitable conduct in this Note refer to the doctrine in the context of patent law.

12. *See* Wheeler v. Sage, 68 U.S. 518, 530-31 (1863); Bein v. Heath, 47 U.S. 228, 247 (1848).

13. 290 U.S. at 246-47.

14. *Id.* at 243.

15. *Id.*

16. *Id.*

17. *Id.* at 247.

18. *See, e.g.*, Norton v. Curtiss, 433 F.2d 779, 793 (C.C.P.A. 1970).

tionally, courts have employed the term "fraud" to describe conduct so reprehensible on its face that it formed the basis of an actionable wrong. Because severe penalties result when parties are found guilty of common law fraud, such a finding requires the presence of four factors: misrepresentation of a material fact; scienter, or knowledge or belief that the information is false; justifiable reliance upon the misrepresentation; and injury to the party deceived.[19] In contrast, in an action at equity, fraud can be raised as an affirmative defense.[20] If a defendant's claim is held to be valid, a court will refuse to enforce any judgment in the plaintiff's favor. Inequitable conduct falls into this latter category of "fraud." Inequitable conduct encompasses affirmative acts (submission of false or misleading information to the PTO) as well as omission of material information, unlike common law fraud.[21] Therefore, inequitable conduct has a broader reach than traditional common law fraud.

In 1945, the Supreme Court explicitly recognized inequitable conduct by a patent applicant as bar to enforcement of a patent in the case *Precision Instrument Manufacturing Co. v. Automotive Maintenance Machinery Co.*[22] The Court stated that:

> [a] patent by its very nature is affected with a public interest. . . . The far reaching social and economic consequences of a patent, therefore, give the public a paramount interest in seeing that patent monopolies spring from backgrounds free from fraud or other inequitable conduct and that such monopolies are kept within their legitimate scope.[23]

Since *Precision Instrument*, the law has continually evolved, and with the creation of the Federal Circuit, has acquired more coherence in its application.[24] For example, many district courts agree that, when pled as an affirmative defense, allegations of inequitable conduct must be pled with particularity according to Federal Rules of Civil Procedure 9(b).[25]

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19. *See, e.g.*, W. PROSSER & W. KEETON, LAW OF TORTS, §§ 105-110 (5th ed. 1984).

20. *Id.*

21. J.P. Stevens & Co. v. Lex Tex Ltd., 747 F.2d 1553, 1559 (Fed. Cir. 1984).

22. 342 U.S. 806 (1945).

23. *Id.* at 816.

24. See Robert J. Goldman, *Evolution of the Inequitable Conduct Defense in Patent Litigation*, 7 HARV. J.L. & TECH. 37 (1993), for a history of the development of the doctrine.

25. FED. R. CIV. P. 9(b); *see* 6 DONALD S. CHISUM, CHISUM ON PATENTS § 19.03[6][b][ii] (2004) [hereinafter CHISUM ON PATENTS]. See Chiron Corp. v. Abbott Labs., 31 U.S.P.Q.2d 1848, 1850 (N.D. Cal. 1994), for a discussion of the policy rationale behind applying FED. R. CIV. P. 9(b) to inequitable conduct.

B. Test for Inequitable Conduct

A finding of inequitable conduct is based on a two-step test: (1) whether the withheld information meets a threshold test of materiality and intent to mislead and (2) whether the applicant's conduct is so culpable, based on a balancing of the materiality and intent under the circumstances, that the patent should be rendered unenforceable.[26] Because materiality and intent are often intertwined, the necessary level of intent may decrease to support a finding of inequitable conduct if a reference is found to be highly material.[27] Furthermore, inequitable conduct requires clear and convincing evidence of the intentional failure to disclose material information[28] due to the presumption of validity that accompanies all issued patents.[29] Once a court finds that an applicant engaged in inequitable conduct during prosecution of a patent, the entire patent is invalidated. Inequitable conduct "goes to the patent right as a whole, independently of particular claims."[30] Therefore, even where the lack of candor and disclosure does not extend to all claims, a court will nonetheless hold the entire patent unenforceable.[31]

1. Materiality[32]

The level of materiality required to support a finding of inequitable conduct is currently unclear. Prior to the establishment of the Federal Circuit, courts had employed at least three distinct standards of materiality: (1) an objective "but for" standard; (2) a subjective "but for" standard; and (3) a "but it may have" standard.[33] The Federal Circuit endorsed a fourth

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26. Am. Hoist & Derrick Co. v. Sowa & Sons, Inc., 725 F.2d 1350, 1364 (Fed. Cir. 1984).

27. Digital Equip. Corp. v. Diamond, 653 F.2d 701, 716 (Fed. Cir. 1981).

28. Kingsdown Med. Consultants, Ltd. v. Hollister Inc., 863 F.2d 867, 872 (Fed. Cir. 1988).

29. 35 U.S.C. § 282 (2000). "Clear and convincing evidence" lies between the "beyond a reasonable doubt" and the "preponderance of the evidence" standards. Buildex Inc. v. Kason Indus., Inc., 849 F.2d 1461, 1463 (Fed. Cir. 1988).

30. *In re* Clark, 522 F.2d 623, 625 (Fed. Cir. 1975).

31. *See generally* 6 CHISUM ON PATENTS, *supra* note 25, § 19.03[6][b][iii].

32. The majority of the analysis of inequitable conduct in this Note is restricted to the standards articulated by the Court of Appeals for the Federal Circuit. It should be noted that the previous standard of materiality appears to have been rooted in general fraud principles. *See* Norton v. Curtiss, 433 F.2d 779, 794 (C.C.P.A. 1970). Furthermore, inequitable conduct allegations rising in conjunction with antitrust allegations are beyond the scope of this Note.

33. *See, e.g.*, Plastic Container Corp. v. Cont'l Plastics of Okla., Inc., 607 F.2d 885, 899 (10th Cir. 1979); Gemveto Jewelry Co. v. Lambert Bros., 542 F. Supp. 933, 939-40 (S.D.N.Y. 1982). The "but it may have" standard endorses an inquiry into whether the

standard, based on PTO Rule 1.56 ("Rule 56").[34] In doing so, the court remarked that Rule 56 appears to encompass the other standards and that its definition of materiality closely aligns "with how one ought to conduct business with the PTO."[35] Yet, the Federal Circuit noted that it did not intend to be bound by any one standard, given that materiality and intent are often interrelated.[36]

Just as the applicable standard of materiality has evolved over time, the Rule 56 definition of materiality has also evolved. Rule 56 specifically deals with the duty of disclosure that applicants must uphold before the PTO. Prior to 1992, Rule 56 required disclosure of information material to the application "where there is a substantial likelihood that a reasonable examiner would consider it important in deciding whether to allow the application to issue as a patent."[37] In 1992, the PTO amended Rule 56 to address criticisms concerning a perceived lack of certainty in the standard and to reduce the frequency at which defendants raised the inequitable conduct defense in litigation.[38] The new Rule 56 states:

> Under this section, information is material to patentability when it is not cumulative to information already of record or being made of record in the application, and
>
> (1) It establishes, by itself or in combination with other information, a prima facie case of unpatentability of a claim; or
>
> (2) It refutes, or is inconsistent with, a position the applicant takes in:
>
> (i) Opposing an argument of unpatentability relied on by the Office, or
>
> (ii) Asserting an argument of patentability.
>
> A prima facie case of unpatentability is established when the information compels a conclusion that a claim is unpatentable under the preponderance of evidence, burden-of-proof standard, giving each term in the claim its broadest reasonable construction consistent with the specification, and before any considera-

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relevant facts "might reasonably have affected" a PTO examiner's determination of patentability. *Gemveto Jewelry*, 542 F. Supp at 940.

34. Am. Hoist & Derrick Co. v. Sowa & Sons, Inc., 725 F.2d 1350, 1362-63 (Fed. Cir. 1984). Prior to 1992, Rule 56(a) defined material information as that "where there is a substantial likelihood that a reasonable examiner would consider it important in deciding whether to allow the application to issue as a patent." 37 C.F.R. § 1.56 (1991).

35. *Am. Hoist*, 725 F.2d at 1363.

36. *Id.*

37. 37 C.F.R. § 1.56(a) (1991).

38. Duty of Disclosure, 57 Fed. Reg. 2021, 2023 (Jan. 17, 1992).

> tion is given to evidence which may be submitted in an attempt to establish a contrary conclusion or patentability.[39]

The Federal Circuit has yet to determine whether the revision to Rule 56 promulgated by the PTO should apply in determining materiality. According to the Federal Circuit, the revised rule "was not intended to constitute a significant substantive break with the previous standard."[40] The court consistently has applied the pre-1992 rule to cases in which the patents at issue were prosecuted prior to 1992.[41] However, in some cases the court has applied both standards[42] or has applied only the post-1992 version of Rule 56, leaving district courts unsure of which standard should apply.[43] Thus, although the Federal Circuit has centered its definition of materiality in Rule 56, the current standard is still in flux.

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39. 37 C.F.R. § 1.56 (2004).

40. Hoffman-La Roche, Inc. v. Promega Corp., 323 F.3d 1354, 1368 n.2 (Fed. Cir. 2003).

41. *See, e.g.*, CFMT, Inc. v. YieldUP Int'l Corp., 349 F.3d 1333, 1342-43 (Fed. Cir. 2003) (reversing finding of inequitable conduct on applications filed in 1985 and 1988 because statements at issue were not inaccurate and PTO examiner had not relied on those statements to find application was not obvious); Bristol-Myers Squibb Co. v. Rhone-Poulenc Rorer, Inc., 326 F.3d 1226, 1231, 1234 (Fed. Cir. 2003) (finding inequitable conduct based on pre-1992 standard where patent in question was submitted to PTO in 1989); *Promega*, 323 F.3d at 1372 (remanding determination of inequitable conduct during prosecution of patent filed in 1987 for district court's determination whether the conduct amounted to inequitable conduct under the circumstances); GFI, Inc. v. Franklin Corp., 265 F.3d 1268 (Fed. Cir. 2001) (affirming district court's verdict of inequitable conduct during the prosecution of a patent filed in 1991); Li Second Family Ltd. v. Toshiba Corp., 231 F.3d 1373 (Fed. Cir. 2000) (affirming finding of inequitable conduct for patents filed as continuations-in-part of applications filed in 1973 and 1977); Elk Corp. of Dallas v. GAF Bldg. Materials Corp., 168 F.3d 28, 31 (Fed. Cir. 1999) (finding non-disclosure of prior art was material); Kimberly-Clark Corp. v. Johnson & Johnson, 745 F.2d 1437, 1457 (Fed. Cir. 1984) (finding materiality is limited to claims not abandoned during prosecution); *Am. Hoist*, 725 F.2d at 1350 (refusing to limit materiality to Rule 56 alone).

42. *See, e.g.*, Dayco Prods., Inc. v. Total Containment, Inc., 329 F.3d 1358 (Fed. Cir. 2003) (finding information not material under either standard).

43. *See, e.g.*, Paragon Podiatry Lab. v. KLM Labs., Inc., 984 F.2d 1182, 1190 (Fed. Cir. 2003) (discussing prima facie case of unpatentability without explicitly mentioning the post-1992 rule); Critikon, Inc. v. Becton Dickinson Vascular Access, Inc., 120 F.3d 1253 (Fed. Cir. 1997) (overturning district court's decision on inequitable conduct where failure to disclose prior art patent was material to examiner's decision that Critikon's patent disclosed novel mechanism).

2. *Intent to Deceive*

Inequitable conduct also requires proof of intent to deceive, although such intent need not be shown directly.[44] Initially, a finding of gross negligence supported the requisite intent to deceive.[45] Thus, applicants who purposefully neglected their duty to disclose risked the unenforceability of their patents. Beginning in 1987, with *FMC Corp. v. Manitowoc Co.*,[46] the Federal Circuit retreated from this position, stating that gross negligence alone did not mandate a finding of intent to deceive. In 1988, in *Kingsdown Medical Consultants, Ltd. v. Hollister, Inc.*,[47] the Federal Circuit *en banc* held that a finding of gross negligence did not justify an inference of intent to deceive. Rather, the Federal Circuit held that "all the evidence, including evidence indicative of good faith, must indicate sufficient culpability to require a finding of intent to deceive."[48] Thus, under the current standard, intent to deceive must be supported by clear and convincing evidence, although direct evidence of this intent is not required.

Since *Kingsdown*, cases dealing with intent can be categorized in three ways: those in which there is a clear intent to deceive, those in which high degree of materiality justifies a lower standard of intent, and those in which a court finds no intent. Although cases of clear intent to deceive are rare, *Bristol-Myers Squibb Co. v. Rhone-Poulenc Rorer, Inc.*[49] illustrates the high water mark of such cases. The Federal Circuit, under the abuse of discretion standard, upheld the district court's finding of intent to deceive where an attorney knew that an article he failed to disclose would have shown that the invention in a patent application was not enabled, yet still wrote broad claims to cover the invention. Because the attorney was aware of the duty to disclose and failed to credibly justify his failure to do so, he had the requisite intent to deceive.[50]

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44. Hycor Corp. v. Schueter Co., 740 F.2d 1529, 1539 (Fed. Cir. 1984); *see* Goldman, *supra* note 24, at 76-85 (outlining the evolution of the Federal Circuit's position on the requisite level of intent required to find inequitable conduct).

45. *In re* Jerabek, 789 F.2d 886, 891 (Fed. Cir. 1986); J.P. Stevens & Co. v. Lex Tex Ltd., 747 F.2d 1553, 1553 (Fed. Cir. 1984); *Hycor*, 740 F.2d at 1540 (ruling that deliberate scheming not required to find intent); Driscoll v. Cebalo, 731 F.2d 878, 885 (Fed. Cir. 1984); Orthopedic Equip. Co. v. All Orthopedic Appliances, 707 F.2d 1376, 1383 (Fed. Cir. 1983).

46. 835 F.2d 1411, 1415 n.9 (Fed. Cir. 1987).

47. 863 F.2d 867, 876 (Fed. Cir. 1988) (en banc).

48. *Id.* (citations omitted). For a detailed discussion of the intent to deceive standard post-*Kingsdown*, see Lynn C. Tyler, Kingsdown *Fifteen Years Later: What Does It Take to Prove Inequitable Conduct?*, 13 FED. CIR. B.J. 267 (2003).

49. 326 F.3d 1226 (Fed. Cir. 2003).

50. *Id.* at 1239-41.

Frequently, a withheld reference is highly material and therefore a lesser level of intent is sufficient to support a finding of inequitable conduct. In *Semiconductor Energy Laboratory Co. v. Samsung Electronics Co.*,[51] the Federal Circuit found that the plaintiff, Semiconductor Energy, had the requisite intent to justify a finding of inequitable conduct. The inventor, a Semiconductor Energy employee, submitted a Japanese language version of a material prior art reference in its entirety, but only a partial, one-page translation that failed to disclose all of the elements of the full-length patent.[52] In addition, the plaintiff indicated that the reference in question was relevant only to one of the claims in the plaintiff's patent application, yet clear and convincing evidence demonstrated otherwise.[53] Thus, the Federal Circuit found that the district court's finding of intent by inference was not clearly erroneous.[54]

II. DISCUSSION

Since the creation of the Federal Circuit, various parties have asserted that inequitable conduct charges have risen to plague proportions.[55] Between 1988 and 2001, the number of terminated patent lawsuits doubled from approximately 1,200 to 2,400 per year. This dramatic increase primarily was due to an increase in the number of patents issued, because the relative rate of litigation did not increase.[56] However, given that the absolute number of patent suits has increased, once again, inequitable conduct has come under the microscope.[57] Recently, both the NAS and the FTC released reports containing proposals for reform of the patent system, including reforms that alter the inequitable conduct doctrine.[58]

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51. 204 F.3d 1368 (Fed. Cir. 2000).

52. *Id.* at 1377-78.

53. *Id.*

54. *Id.* at 1383.

55. *See* Burlington Indus., Inc. v. Dayco Corp., 849 F.2d 1418, 1422 (Fed. Cir. 1988); Donald S. Chisum, *Best Mode Concealment and Inequitable Conduct in Patent Procurement: A Nutshell, a Review of Recent Federal Circuit Cases and a Plea for Modest Reform*, 13 SANTA CLARA COMPUTER & HIGH TECH. L.J. 277 (1997); Donald S. Chisum, *Patent Law and the Presumption of Moral Regularity: A Critical Review of Recent Federal Circuit Decisions on Inequitable Conduct and Willful Infringement*, 69 J. PAT. & TRADEMARK OFF. SOC'Y 27 (1987); Laurence H. Pretty, *Inequitable Conduct in the PTO—Is the "Plague" Entering Remission?*, 71 J. PAT. & TRADEMARK OFF. SOC'Y 46 (1989); Note, *Can Intellectual Property Law Regulate Behavior? A "Modest Proposal" for Weakening Unclean Hands*, 113 HARV. L. REV. 1503 (2000); *see also* 6 CHISUM ON PATENTS, *supra* note 25, § 19.03[5][b] n.7.

56. *See* NAS STUDY, *supra* note 10, ch. 1, at 32.

57. *See generally* FTC REPORT, *supra* note 10; NAS STUDY, *supra* note 10.

58. NAS REPORT, *supra* note 10, at 5-8; *see* FTC REPORT, *supra* note 10, Executive Summary at 8-10, 13-14.

Any reforms of inequitable conduct must take into consideration both the policy rationales underlying the doctrine as well as the problems that exist with the current system. Consistent with these requirements, the following sections first address the rationales underlying inequitable conduct and then present the results of an empirical study examining district court cases in the past ten years in which inequitable conduct was a decisive issue.

A. Policy Rationales for Inequitable Conduct

The doctrine of inequitable conduct can be viewed as a mechanism both to promote innovation through the duty to disclose and to deter patent applicants from hiding valuable information in order to obtain a patent.

1. Duty to Disclose

The United States, unlike most jurisdictions, imposes a duty to disclose upon all parties to a patent application.[59] Because the United States does not have a formal opposition proceeding during which an applicant's competitors may submit relevant prior art before a patent issues, the PTO depends upon examiners and applicants to cover the full scope of the prior art.[60] Although patent filings have increased, the number of examiners per thousand patents has decreased by approximately twenty percent since around 1999.[61] Given Congress' reluctance to increase the number of examiners, the duty of disclosure is crucial. Since the burden is on the PTO to prove by a preponderance of the evidence that the claimed invention was not in the prior art and, once issued, the patent is presumed valid, there is a strong policy rationale to ensure that the PTO has access to all necessary information needed to deny patents to undeserving applicants. Studies estimate that between 83% to 97% of patents filed are issued by the PTO, justifying fears over the existence of "bad" patents.[62] With such

59. *See* Hricik, *supra* note 8, at 231.

60. The duty to disclose is discharged only when all material information known to the applicant was cited by or submitted to the PTO, as dictated by 37 C.F.R. §§ 1.97(b)-(d), 1.98 (2004). For details on submission of the information disclosure statement (IDS), see Todd L. Juneau & Jill K. MacAlpine, *Protecting Patents from the Beginning: The Importance of Information Disclosure Statements During Patent Prosecution*, 82 J. PAT. & TRADEMARK OFF. SOC'Y 577 (2000).

61. NAS STUDY, *supra* note 10, at 51.

62. *See id.* at 53 (describing studies done by two different groups on two different data sets attempting to correct for the presence of continuing applications, which differ with the PTO's own data which claims a lower percentage of continuances).

a high rate of patent issuance, it is very likely that improperly granted patents do issue.[63]

Improperly granted patents impose additional transaction costs on potential deal-making parties because they must evaluate patent portfolios to assess the validity of patents that have undergone PTO review.[64] Due to the relative ease of obtaining patents coupled with the potential of winning large damage awards in infringement litigation, rent-seeking entrepreneurs may establish speculative patent acquisition and enforcement enterprises, hoping to collect license fees on questionable patents.[65] Furthermore, patentees, when doubtful that their patents will be upheld, generally set low license fees. Lured by such low license fees, potential infringers choose to license questionable patents rather than challenge their validity. Consequently, low license fees enable a patentee to collect rent despite the invalidity of her patent.[66] In addition, invalid patents that result in litigation impose costs on accused infringers who are forced to defend their activities.[67]

Furthermore, improperly granted patents stifle innovation. First, patents on items in the public domain—or slight modifications thereof—result in the removal of objects from the public domain, conferring market power on the patent holder who may resort to litigation to enforce his patent rights. Granting patents for such inventions that do not meet the novelty, utility, and nonobviousness standards unjustly rewards patentees at the expense of the public, who will pay higher prices for products due to the opportunity to exclude others from buying, making, or selling a product based on the patented technology.[68] Second, such "bad" patents may

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63. *See* Robert P. Merges, *As Many as Six Impossible Patents Before Breakfast: Property Rights for Business Concepts and Patent System Reform*, 14 BERKELEY TECH. L.J. 577, 589-91 (1999).

64. *See* Hricik, *supra* note 8, at 222. Such costs are not limited to invalid patents, however, and can constitute hidden costs in many industries. *See, e.g.*, NAS STUDY, *supra* note 10; Bronwyn H. Hall & Rosemary Ham Ziedonis, *The Patent Paradox Revisited: An Empiricial Study of Patenting in the U.S. Semiconductor Industry*, 32 RAND J. ECON. 101, 107-11 (2001).

65. *See* Hricik, *supra* note 8, at 222. For an example of one such rent-seeking entrepreneur, see Susan Hansen, *Lawyer Brings Lemelson's Lucrative IP Career to an End*, RECORDER, May 5, 2004 (describing how Lemelson used his patent portfolio to intimidate other companies to settle rather than face litigation despite the widely held view that his patents were invalid).

66. *See* Hricik, *supra* note 8, at 222.

67. *See* Lemley, *supra* note 9, at 1530-31 (stating that because attorneys' fees are awarded only in exceptional cases, as a practical matter, accused infringers usually get fees if they can prove that a suit was filed in bad faith despite the fact that 35 U.S.C. § 285 only applies to a "prevailing party").

68. NAS STUDY, *supra* note 10, at 46.

encourage infringement, consequently raising transaction costs, and possibly discouraging investment because of potential investors' doubts about the validity of target patents.[69] Competitors may choose to design around the "bad" patent easily, but some fields are more resistant to such activities because of the subject matter or the economics involved.[70] In some fields, companies may avoid the time-consuming activity of challenging bad patents in order to preserve time-sensitive research opportunities.[71] Third, firms may seek to expand their patent portfolios, not necessarily to exploit the patents themselves, but to create a bigger arsenal for asserting patents against competitors in infringement counterclaims.[72] Such a strategy not only costs competitors additional legal fees, but also potential future innovation, as researchers will be diverted from innovative activity to aid in defending against infringement claims.[73]

In order to avoid such "bad" patents and their concomitant social costs, examiners must have access to the most relevant prior art. The best source of such prior art is the applicant or her attorney. Although patent examiners are specialists within various scientific domains and have ready access to a database of issued patents, they lack comparable access to non-patent prior art.[74] As a result, examiners are more likely to compare the claims in an application against issued patents rather than against other prior art. For fields of rapid innovation, examiners will likely lack access to the most relevant information.[75] Unlike examiners, applicants are experts in their respective fields with the most up-to-date information. Furthermore, applicants' attorneys are acquainted with prior art from multiple clients.[76] Thus, the robust duty to disclose aims to provide examiners with information

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69. *See* Merges, *supra* note 63, at 593-94.

70. *See* FTC REPORT, *supra* note 10, ch. 2, at 21-22. Where patented technology must conform to an industry or consumer standard, competitors may find it economically impossible to design around a particular patent. For biotechnology, six months of time diverted to design around a patent may take that particular opportunity off the table. *Id.* ch. 3, at 21-22. Furthermore, since patent litigation in this field may cost a party up to five to seven million dollars, litigation costs may exceed the potential revenue of the technology in question, were it to be developed further. *Id.*

71. *See id.* ch. 3, at 21-22 (discussing that in the field of biotechnology, by the time a court has determined the validity of a particular patent, the research opportunity has passed).

72. *See id.* ch. 2, at 30-32.

73. *See id.* (Greenhall's comments). Note that such a strategy is effective only against companies involved in innovation and does nothing to prevent firms that do not produce products from threatening infringement or demanding royalties or licenses.

74. Furthermore, patent examiners are also pressed for time.

75. *See* FTC REPORT, *supra* note 10, ch. 5, at 7.

76. Generally speaking—of course, this assertion is not true of, say, in-house attorneys.

they may lack, in order to ensure that issued patents are deserving of their presumption of validity.

However, although the duty to disclose aims to address the problems inherent in an *ex parte* system, it does not go far enough. Because the duty to disclose does not impose a duty to search for material information,[77] applicants may choose to ignore potentially relevant sources in order to increase the chances of their own patents issuing. In addition, by limiting the duty of candor to the applicant and her attorney, prior art known by others in an applicant's laboratory or research group need not be revealed. The PTO neither investigates nor rejects applications for failure to disclose information known by those other than the applicant or attorney.[78] Therefore, reforms should aim to eliminate the negative incentives produced under the current system.

2. *Deterrence Mechanism*

In addition to assuring that patents are worthy of the presumption of validity, the doctrine of inequitable conduct punishes those who seek to improperly profit from the system. Analogizing to criminal prosecution, compliance with Rule 56 requires both enforcement and a penalty for violation of the duty to disclose. Our society views with distaste bad-faith procurement of material goods, and patents are no different from other forms of wealth since they grant the right to prevent others from making, using, or selling a product based on patented knowledge.[79] Failure to comply with the duty to disclose exposes the patentee to charges of inequitable conduct if her patent is litigated. However, given that only approximately two percent of patents are ever litigated,[80] the patent applicant might expect her lack of full disclosure to go unnoticed. Consequently, the patent applicant has both the motive to avoid full disclosure or a full search of the prior art as well as the opportunity—she has more information about prior art than the PTO—to behave strategically. Accordingly, to deter such opportunistic behavior, courts impose large penalties, including unenforceability of the patent in suit and fee-shifting, for violation of the duty to disclose.[81] Viewed from this vantage point, inequitable conduct also func-

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77. *See* MPEP, *supra* note 6, § 2001.06, at 2000-05 (limiting the duty to disclose to the information inventors "are *aware* of").

78. *See id.* § 2010, at 2000-11-12 (explaining that courts are a better forum through which such claims can be decided and stating that such PTO determinations would increase costs without commensurate increases in patent quality).

79. *See* Paul M. Janicke, *Do We Really Need So Many Mental and Emotional States in United States Patent Law?*, 8 TEX. INTELL. PROP. L.J. 279, 292 (2000).

80. *See* Lemley, *supra* note 9, at 1501.

81. *See* Shubha Ghosh & Jay Kesan, *What Do Patents Purchase? In Search of Optimal Ignorance in the Patent Office*, 40 HOUS. L. REV. 1219, 1236-37 (2004); Michael J.

tions as a penalty default to discourage applicants from playing strategic games. Patent applicants may avoid penalties by disclosing all material prior art of which they are aware at the outset.[82]

Thus, the doctrine of inequitable conduct simultaneously serves to ensure that issued patents are valid and that applicants abide by the rules of the system or else face a large penalty. Any reforms to this system should strive to balance these two underlying policy goals.

B. Is There Really a Plague?

As discussed in the previous section, inequitable conduct before the PTO leads to the improper issuance of patents. Common consensus holds that a "plague" of inequitable conduct existed in the 1980s, and one recent dissenting opinion by Judge Newman suggests that the plague is upon us once again.[83] Yet no one has attempted to evaluate such claims before asserting that the system must be fixed.

Because enforcement of inequitable conduct is limited to litigation, any evaluation of the existence of a plague must focus on the charges brought in litigation.[84] A plague of inequitable conduct exists where parties with valid patents frequently are forced to defend against frivolous claims of inequitable conduct. Where such claims are not frivolous—where inequitable conduct allegations are successful—all parties in the system are rewarded: the patent is declared unenforceable and the perpetrator is penalized for her actions. Thus, parties are no longer forced to design around or license a "bad" patent or leave the particular field of research occupied by the patent. Accordingly, only if a preponderance of inequitable conduct charges fail would a plague truly exist.

In order to determine if we are in the midst of a plague, I analyzed inequitable conduct claims over the past ten years. Two hundred forty-four

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Meurer, *Controlling Opportunistic and Anti-Competitive Intellectual Property Litigation*, 44 B.C. L. REV. 509, 535-38 (2003) (explaining how fee-shifting deters undesired behavior).

82. *See* Clarissa Long, *Patent Signals*, 69 U. CHI. L. REV. 625, 668-70 (2002) (discussing inequitable conduct as a penalty linked to inadequate disclosure in prosecution); R. Polk Wagner, *Reconsidering Estoppel: Patent Administration and the Failure of Festo*, 151 U. PA. L. REV. 159, 212-15 (2002) (explaining penalty rules in the context of prosecution history estoppel).

83. Hoffman-La Roche, Inc. v. Promega Corp., 323 F.3d 1354, 1372 (Fed. Cir. 2003) (Newman, J., dissenting) (arguing that the plague is upon the system again); *see* Cargill, Inc. v. Sears Petroleum & Transp. Corp., 334 F. Supp. 2d 197, 230 (N.D.N.Y. 2004).

84. Although it is likely that decisions to seek a patent or to initiate infringement litigation may be influenced by suspicions of inequitable conduct, it is difficult to document the frequency of such decisions. Consequently, a better measure of whether such a plague exists is the use of inequitable conduct charges in litigation.

court opinions were issued between January 1, 1995 and December 31, 2004, in which allegations of inequitable conduct were decided in either summary judgment motions or following a bench trial (including post-trial motions for reconsideration or for a new trial).[85]

During the ten years, courts issued 119 summary judgment decisions in which they addressed the issue of inequitable conduct (Table 1).[86]

Table 1. Summary Judgment Decisions Addressing Inequitable Conduct from 1995-2004[87]

	Declined to grant summary judgment on inequitable conduct	Granted summary judgment, found no inequitable conduct	Granted summary judgment, found inequitable conduct
Summary Judgment	50% (59)	42% (50)	8% (10)

In half of all motions for summary judgment (when not declared moot based on other findings), district courts rejected inequitable conduct claims, because allegations surviving to the summary judgment stage raised enough of an inference to warrant proceeding to trial. Such data suggest that inequitable conduct during patent prosecution may be a significant problem. If inequitable conduct occurs regularly during prosecution, then Justice Newman's fear of a plague of unsubstantiated allegations is false. However, courts found that there were no genuine issues of material fact in 42% of the summary judgment motions on inequitable conduct and granted summary judgment for patentees. From this data, it appears that parties frequently allege inequitable conduct where courts find no evidence of it. Thus, patent holders are often forced to defend against charges without merit, supporting the idea of a plague of frivolous charges. In only 8% of cases did courts grant summary judgment for the defendant, indica-

85. My sample was generated using the search terms "patent & 'inequitable conduct'" and searching the database of Federal IP District Court Cases on Westlaw. I excluded motions for a preliminary injunction, because such cases focus on the likelihood of success. In 2002, approximately 2500 patent cases were terminated, which includes judgments, dismissals, settlements, and transfers. NAS STUDY, *supra* note 10, ch. 2, at 32, fig. 2-3. Thus, inequitable conduct allegations are a small percentage of all cases terminated each year.

86. The data included in this set represent cases in which defendants, asserting inequitable conduct as a defense to infringement, sought summary judgment on a finding of inequitable conduct; cases in which plaintiffs alleged inequitable conduct by defendant in the context of a declaratory judgment; and cases in which plaintiffs sought a finding of no inequitable conduct.

87. The numbers in parentheses represent the number of cases in each category out of a total of 119.

tive of the rare circumstances in which patentees blatantly engaged in inequitable conduct.[88] Overall, the summary judgment data suggest that defendants in patent infringement suits may allege inequitable conduct too routinely without adequate factual support for such allegations. However, without knowing the ultimate outcome of the cases in which these summary judgment motions were raised, it is difficult to make a definitive determination of whether inequitable conduct allegations constitute a plague.[89]

In order to address this issue, I examined district court decisions in which allegations of inequitable conduct were decided. From January 1, 1995, until December 31, 2004, 125 such cases were decided (Table 2).

Table 2. District Court Decisions Finding Inequitable Conduct Post-Trial from 1995-2004

	Found inequitable conduct	Failed to find inequitable conduct
District Court Decisions	30% (37)	70% (88)

Seventy percent of the time, courts failed to find that the information withheld by applicants during prosecution met the requisite standard of materiality and intent. Assuming that summary judgment motions claiming inequitable conduct were filed prior to trial in these cases, courts likely found that defendants alleged sufficient material facts of inequitable conduct to warrant a trial on this issue.[90] Therefore, it is unlikely that these claims of inequitable conduct were without any basis in fact. In only 30% of cases did courts find inequitable conduct during prosecution of the patent(s)-in-suit, indicating that a substantial minority of commercially important patents are obtained by failing to uphold the duty to disclose.

In general, where courts ruled on both the validity and enforceability of patents, courts generally held that valid patents also were not unen-

88. *See* Burlington Indus., Inc. v. Dayco Corp., 849 F.2d 1418, 1422 (Fed. Cir. 1988) ("A summary judgment that a reputable attorney has been guilty of inequitable conduct, over his denials, ought to be, and can properly be, rare indeed.").

89. One additional complication arises when parties choose to settle rather than to proceed to trial after losing summary judgment on the issue of inequitable conduct: one cannot determine the role played by inequitable conduct in such cases.

90. However, only eleven summary judgment decisions included in Table 1 are represented in the data of Table 2. This may mean that the parties in a majority of cases in the Table 2 data set did not file summary judgment motions on inequitable conduct. Another explanation is that a majority of the cases in which genuine issues of material fact were found in Table 1 proceeded to settlement or licensing agreements and, therefore, are not represented in the second data set in Table 2.

forceable due to inequitable conduct (Table 3). Out of the thirty-seven cases in which courts found inequitable conduct, courts determined the validity of the patents-in-suit in only nineteen cases.[91] Out of the eighty-eight cases in which courts did not find inequitable conduct, they determined the validity of the patents-in-suit in seventy-five cases.[92]

Table 3. Validity of Patents With Respect to Findings of Inequitable Conduct

	Patent(s) Valid	Patent(s) Invalid
Inequitable conduct found and validity ruled upon (18 total)[93]	11% (2)	89% (16)
No inequitable conduct found and validity ruled upon (74 total)[94]	75% (56)	25% (18)

The most striking finding is that where courts find inequitable conduct, they generally also find that claims at issue in the patents are invalid. Indeed, in 89% of cases, courts found patents both unenforceable and invalid. However, given the paucity of such cases in the current data set, it is difficult to determine whether such a correlation would apply more broadly. Nevertheless, these data suggest that the material information that applicants withhold from the PTO during prosecution would prevent a patent from issuing. In contrast, where courts find no inequitable conduct, the patents-in-suit are more likely than not to be found valid, even in light of the additional prior art at issue in the inequitable conduct allegations.

Combining the findings of Tables 1 and 2 demonstrates that courts fail to find inequitable conduct 75% of the time (Table 4).

91. However, in one of these cases involving two patents-in-suit, one patent was held to be valid and the other invalid, although both were determined to be unenforceable. This case was not included in the data in Table 3.

92. However, in one of these cases which involved two patents-in-suit, the court declared one patent valid and other invalid, and both enforceable. This case was not included in the data in Table 3.

93. *Supra* note 91.

94. *Supra* note 92.

Table 4. Percentage of Total Decisions in Which Inequitable Conduct Is Found[95]

	No Inequitable Conduct Found	Inequitable Conduct Found
Summary Judgment Decisions	50 cases	10 cases
Trial & Post-trial Decisions	88 cases	37 cases
TOTAL	75% (138 cases)	25% (47 cases)

These empirical data suggest that the patent system often enables potentially infringing parties to attack valid patents by alleging inequitable conduct where none exists. Therefore, reforms should be implemented to decrease the prevalence of such unwarranted attacks. In light of these findings, Part III evaluates several proposals bearing on inequitable conduct.

III. REFORMING THE SYSTEM

Many in the patent community believe that the patent system needs strengthening, although the interested parties have yet to reach consensus on the necessary reforms.[96] Any reforms to the doctrine of inequitable conduct should take into consideration how parties in litigation employ the doctrine. Although inequitable conduct likely influences both the decision of inventive enterprises to seek patents and their behavior in asserting those patents against alleged infringers, such behavior is difficult to study since most parties are unlikely to indicate that their patents are likely unenforceable. Accordingly, this Note addresses only those behaviors that can be measured.

Reforms should be implemented to strengthen the inequitable conduct doctrine based on policy rationales, while lessening the doctrine's effect on patentees who are unjustly forced to defend against it. Specifically, such proposals should decrease the number of unsubstantiated inequitable conduct charges and should encourage applicants to submit all relevant prior art references. This Part outlines four such proposals, based on the FTC and NAS Reports, taking into consideration the empirical data from Part II. The first proposal, and one that the NAS recommends, calls for the elimination of the doctrine of inequitable conduct.[97] Such a proposal may make sense in light of the data in Table 3, which shows that most patents declared unenforceable are also declared invalid. However, as discussed

95. Note that this table excludes summary judgment decisions in which genuine issues of material fact pertaining to inequitable conduct existed (i.e., column one of Table 1).

96. *See, e.g.*, FTC REPORT, *supra* note 10; NAS STUDY, *supra* note 10, at 1.

97. NAS STUDY, *supra* note 10, at 123.

below, the rare cases in which a valid patent was declared unenforceable indicate the problems with such a reform. The second proposal, also heralded by the NAS, suggests that attorneys' fees be awarded to a prevailing patentee when courts determine that allegations against which they were forced to defend lacked merit.[98] The third proposal suggests that the presumption of validity should attach only to prior art analyzed by the examiner. In the final proposal, which the FTC recommends, patent applicants are required to provide brief statements of relevance for each prior art reference when requested to do so by an examiner.[99] This Note rejects the first reform because it fails to recognize the benefits provided by the inequitable conduct doctrine, but recommends the implementation of the last three reforms as the most efficient at reducing the number of frivolous allegations of inequitable conduct.

A. Eliminating Inequitable Conduct

At first glance, based on the findings outlined in Table 3, the simplest proposal for reforming abuses of the inequitable conduct doctrine would be to eliminate the doctrine entirely. In 89% of cases, where district courts found inequitable conduct, they also found that the patents in question were invalid. Thus, even in the absence of the inequitable conduct doctrine, such patents would still be invalidated. Furthermore, patent holders are improperly "taxed" for no valid reason because they are forced to incur additional costs beyond those involved in asserting infringement and defending against invalidity 75% of the time, where their patents are judged to be both valid and enforceable.[100] In the corporate setting, these patent holders incur both the direct costs of deposing their own researchers regarding what prior art they knew and when they knew of it and the indirect costs of reduced future invention because researchers must stop their work to focus on the issues involved in litigation (not to mention the reduced funds for research and development). Eliminating inequitable conduct would eliminate these costs. Although this proposal might seem extreme, the NAS made this very recommendation.

However, this reform ignores two crucial benefits arising from the inequitable conduct doctrine, namely, the deterrence effects for bad actors and the quality control effects on all patents.[101] First, *Purdue Pharma v.*

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98. *Id.*

99. FTC REPORT, *supra* note 10, Executive Summary, at 13.

100. *Supra* Table 3 at p.17.

101. *See Edited & Excerpted Transcript of the Symposium on Ideas Into Action: Implementing Reform of the Patent System*, 19 BERKELEY TECH. L.J. 1053, 1118 (stating Professor Lemley's fears of what may transpire if the inequitable conduct defense is eliminated).

Endo Pharmaceuticals,[102] in which the patent was found valid but unenforceable due to inequitable conduct, demonstrates the necessity of the deterrence value of inequitable conduct. Second, the policy rationales underlying inequitable conduct are important enough to warrant only minor modifications to the doctrine, rather than its entire eradication.

In *Endo Pharmaceuticals*, the plaintiff, Purdue Pharma ("Purdue"), claimed a formulation of controlled-release oxycodone that controlled pain in 90% of patients.[103] The specification of the patents-in-suit claimed that such a result had been "surprisingly discovered."[104] Although the district court held that the patents covering the formulation were valid, Endo Pharmaceuticals ("Endo") contended that Purdue misrepresented the material fact that it "surprisingly discovered" that the controlled range at which oxycodone was effective was less than in other formulations.[105] During trial, Dr. Kaiko, the inventor, admitted that he had "no scientific proof" at the time he filed the application that the invention exhibited a reduced dosage range.[106] Purdue was unable to demonstrate any basis for Dr. Kaiko's "insight."[107] The district court found that any reasonable examiner would have concluded that Purdue's lack of scientific proof that the claimed invention provided analgesic relief at a reduced dosage was material.[108] Furthermore, the district court found that Purdue had the intent to deceive. Dr. Kaiko admitted at trial that there were "no set of procedures and methods" in place prior, during, or subsequent to the prosecution of the patents-in-suit to determine that oxycodone was a stronger analgesic as claimed.[109] An internal memo written by Dr. Kaiko stated that "[w]hile the theoretical argument may be relatively strong using available data, it may be difficult to demonstrate these claims within the context of efficacy studies. Thus, any acceptance of a priority program for controlled-release oxycodone should not assume that all these claims can be demonstrated."[110] Given that the "surprising discovery" was essential to the issuance of the patents-in-suit and that Purdue was unable to prove at trial that it had reduced the invention to practice, the district court found that the material misrepresentations were serious enough to warrant rendering the patents-in-suit unenforceable.

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102. 70 U.S.P.Q.2d 1185 (S.D.N.Y. 2004).
103. *Id.* at 1194.
104. *Id.*
105. *Id.* at 1204.
106. *Id.*
107. *Id.* at 1205.
108. *Id.*
109. *Id.* at 1206-07.
110. *Id.* at 1207.

Absent the doctrine of inequitable conduct, Purdue's patents would still be valid as none of the information discussed at trial would qualify as prior art references. From a policy perspective, the monopoly right should be granted only to deserving parties. Particularly when dealing with pharmaceuticals, public interest demands access to generic formulations when the patents covering brand-name drugs expire.[111] In addition, given the reliance of the PTO examiner on the applicant's duty to disclose and the duty of candor, allowing applicants to get around prior art by using past-tense in prophetic examples undermines the patent system and undermines faith in the presumption of validity.

Second, any proposal to eliminate inequitable conduct ignores the benefits provided to patent holders and inventors everywhere when inequitable conduct allegations succeed and lead to the unenforceability of a patent. Viewing the prevalence of inequitable conduct charges solely as a plague deserving of eradication ignores the cost of improperly granted patents to participants in the system. For example, few would allege that a plague of frivolous lack of enablement charges exists, despite the high rate at which such charges are brought.[112] Like the duty to disclose and the related doctrine of inequitable conduct, the enablement standard ensures that applicants before the PTO adequately disclose their invention to the public in exchange for the right to exclude others from making or using the invention during the life of the patent. Both requirements enable PTO examiners to ensure that patents deserve to be issued with a presumption of validity because they are useful, novel, and nonobvious over prior inventions. The cost of "bad" patents issuing through failure to disclose is borne by other innovators who are forced to pay questionable license fees in order to continue their work, to design around "bad" patents, or, depending on the nature of the field, to abandon a particular field of study. Thus, when substantial numbers of inequitable conduct charges succeed, the worry of a possible plague is outweighed by the value to innovators and society as a whole.

B. Reforming the Award of Attorneys' Fees

The expense incurred by patent holders defending against unsubstantiated inequitable conduct charges is one significant problem with the inequitable conduct doctrine. The so-called plague consists of the approximately 42% of inequitable conduct allegations which fail to raise issues of material fact in summary judgment motions (Table 1) and the approxi-

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111. *See* FTC REPORT, *supra* note 10, ch. 3, at 11 n.51.

112. In contrast to enablement allegations, the NAS Study specifically advocates for reforming the best mode requirement to reduce the subjective elements of litigation. *See* NAS STUDY, *supra* note 10, at 7, 120-21.

mately 70% of cases in which courts fail to find inequitable conduct (Table 2). If prevailing patentees were awarded fees incurred by defending against frivolous inequitable conduct claims, the plague effectively could be neutralized.[113]

Currently, attorneys' fees are awarded to a prevailing party only in exceptional cases and at the court's discretion under § 285 of the patent statute.[114] Although inequitable conduct before the PTO constitutes an "exceptional case,"[115] courts rarely award attorneys' fees in this context, because the prevailing party must demonstrate an exceptionally obvious case of inequitable conduct through clear and convincing specific evidence.[116] In the past ten years, in those cases where inequitable conduct was so clear as to warrant summary judgment against patent holders, parties prevailing on these claims received attorneys' fees only 40% of the time. In contrast, in the forty-three summary judgment decisions from the same time period where courts found no genuine issues of material fact in support of inequitable conduct claims, no district court awarded attorneys' fees to a prevailing patentee.[117] Thus, courts view inequitable conduct as a worse offense than wrongly claiming that the adverse party engaged in inequitable conduct.

However, frivolous inequitable conduct charges should be viewed equal to inequitable conduct itself. Awarding fees to prevailing patentees faced with charges of inequitable conduct fits within the definition of bad faith or borderline conduct already used in determining the presence of exceptional circumstances in awarding fees under § 285.[118] Because inequitable conduct is an affirmative defense akin to fraud, allegations must be supported by particularized facts in the complaint; thus, alleged infringers generally amend their original complaint, after at least some discovery has begun, to allege inequitable conduct. Therefore, parties wishing to allege inequitable conduct already have a reasonable idea about the success of

113. Such a proposal would be the reverse of the bounties described and advocated in Joseph Scott Miller, *Building a Better Bounty: Litigation-Stage Rewards for Defeating Patents*, 19 BERKELEY TECH. L.J. 667 (2003). However, the basic premise is similar: socially undesirable actions should be punished.

114. 35 U.S.C. § 285 (2000).

115. *Id.*; *see also* Hoffman-LaRoche, Inc. v. Invamed Inc., 213 F.3d 1359, 1365 (Fed. Cir. 2000).

116. Stevenson v. Sears, Roebuck & Co., 713 F.2d 705, 712-13 (Fed. Cir. 1983).

117. In two cases, fees were awarded, but in neither of these cases did the court cite the unfounded claim of inequitable conduct to support the awards.

118. *See* Read Corp. v. Portec, Inc., 970 F.2d 816, 831 (Fed. Cir. 1992) (holding that litigation itself may warrant award of fees); Spectra-Physics, Inc. v. Coherent, Inc., 827 F.2d 1524, 1537 (Fed. Cir. 1987) (requiring bad faith as basis for awarding fees); Bayer Aktiengesellschaft v. Duphar Int'l Research B.V., 738 F.2d 1237, 1242 (Fed. Cir. 1984) (awarding fees where position taken by party in litigation was frivolous).

the merits of their claim. Where the proponents have yet to find evidence that could reasonably support the materiality and intent requirements, such claims should be discouraged. Therefore, encouraging courts to award § 285 fees when the proponent of inequitable conduct charges fails to raise an issue of genuine material fact would discourage frivolous allegations.

Furthermore, awarding fees to prevailing patentees encourages applicants to fulfill their duty to disclose. Although at first glance, it may seem unlikely that the behavior of patentees will change by sanctioning those who raise unsubstantiated allegations of inequitable conduct, such an award will ensure that those who do comply with the duty to disclose are not penalized through litigation expenses incurred in their defense. Parties fulfilling their duty will be less likely to face charges of inequitable conduct, and where such allegations fail to raise genuine material issues, they will be compensated for any expenses incurred in defending against such charges.

Given that the awarding of attorney's fees would be at the discretion of the court, one may wonder how this policy would change the current state of affairs. However, awarding fees for frivolous allegations of inequitable conduct would give judges a lever by which they can change the behavior of the parties before the court. In cases in which a judge found that it was a difficult call whether patentee's belief that a non-disclosed reference was withheld in good faith as cumulative to other disclosures, such fees should not be awarded. But, for cases in which there are insufficient material facts alleged to defeat a motion for summary judgment by the patentee, courts would likely award fees and rightly so. For the duty to disclose to function properly, patentees must have faith that they will not be forced to defend, at great cost, such frivolous assaults. Moreover, as outlined in Part III.D below, applicants may be asked to give a brief statement of relevance of all submitted references, and must further state whether other references exist but are believed to be cumulative. Thus, overall, awarding attorneys' fees under § 285 to prevailing patent holders would penalize parties who are unjustified in charging inequitable conduct and would extend relief to patent holders who fulfill their duty to disclose during prosecution.

C. Reforming the Presumption of Validity

As mentioned in Part II.A, the duty to disclose supplements the information before a PTO examiner to ensure that every patent issued is worthy of the presumption of validity. Because of this connection, the FTC report recommends lowering the presumption of validity given to an issued patent in order to make it easier to challenge improperly granted patents.[119]

119. FTC REPORT, *supra* note 10, Executive Summary, at 8-10.

Currently, the presumption of validity applies regardless of whether the PTO examined the prior art asserted by a challenger.[120] Most participants in the patent system agree that PTO examiners are overworked and unable to properly evaluate patents; consequently, many believe that a lesser degree of deference to the PTO is warranted. Accordingly, a lesser presumption of validity should attach to their work.[121] The FTC Report recommends changing the burden of proof standard from clear and convincing to preponderance of the evidence in light of the fact that such a high standard makes improperly granted patents difficult to overturn.[122]

Such a recommendation ignores the function of the standard of validity to society as a whole. As Mark Janis has written,[123] the presumption of validity has both expressive and instrumental functions. The words of the standard may be changed without affecting the underlying symbolic message that attaches to the presumption of validity. Even were one to succeed in changing both the words and the underlying message, the cure may be more painful than the problem it was designed to solve if it leaves society believing that patents are less valuable.[124] For example, the standard and the presumption are thought to be compelling to both judges and juries[125] and may encourage innovation overall. Given such considerations, the FTC Report's recommendation seems extreme, especially in the context of inequitable conduct.

However, a limited change to the presumption that issued patents are valid would be appropriate to address one particular concern, namely, that the presumption should not apply when an examiner has not reviewed relevant prior art. In such cases, for such unexamined prior art, the presumption should be based on a preponderance of the evidence. Thus, where a challenger asserts that a patent is invalid due to anticipation based on prior not before the PTO, she would only need to prove such a claim based on the preponderance of the evidence. A lower presumption of validity applicable to prior art not before an examiner would encourage applicants to fulfill their duty to disclose: the more prior art disclosed, the fewer possible references that would be subject to the lower preponderance of evidence burden of proof standard. Simultaneously, such a change might give applicants an incentive to search for prior art, despite the lack of such a requirement in the duty of disclosure.[126]

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120. *See* Am. Hoist v. Sowa & Sons, Inc., 725 F.2d 1350, 1360 (Fed. Cir. 1981).
121. *See* Lemley, *supra* note 9, at 1528-29.
122. FTC REPORT, *supra* note 10, ch. 5, at 28.
123. *See* Janis, *supra* note 9, at 925.
124. *See id.* at 927.
125. *See* FTC REPORT, *supra* note 10, ch. 5, at 27.
126. *See* 37 C.F.R § 1.56 (2004).

Under such a system, the patent and all the prior art examined during its prosecution would issue with a presumption of validity and could be defeated only by clear and convincing evidence from a challenger. However, only for unexamined prior art, the presumption of validity would be lessened to a preponderance of the evidence standard. Limiting the lower standard to non-examined prior art would lessen any fears that patents would be presumed to be less worthy, as more relevant art will be considered by the PTO under the new presumption. Consequently, the weakening of the standard in those select cases would not likely change the overall perception of the value of patents. However, if applicants continue to flood the examiner with prior art that she does not have time to examine, then such a change might not have any effect, which leads to the fourth proposed reform discussed below.

D. Providing Statements of Relevance

In general, participants in the FTC hearings felt that patent applicants substantially fulfill their duty to disclose, and rather than withholding prior art, the typical patent applicant floods the examiner with references.[127] If the presumption of validity is to retain its meaning, inventors must have confidence that examiners are competent and capable of analyzing all submitted references. By recommending that applicants submit statements of relevance, describing how each prior art reference is relevant to the invention in the application upon the request of an examiner, an examiner would be able to meaningfully analyze applications during a finite time frame, reducing opportunity for error and increasing the efficiency of the examination.[128] Although some participants in the FTC hearings feared that statements of relevance would increase allegations of inequitable conduct, because most allegations of inequitable conduct center on the failure to disclose information, it seems unlikely that such concerns would be borne out in practice.[129] Any increased costs incurred by such a reform would likely outweigh the current costs incurred by defending against frivolous claims of inequitable conduct. Furthermore, submission of brief statements would decrease the likelihood that material references would

127. FTC REPORT, *supra* note 10, ch. 5, at 11 n.73-n.74.

128. *See* Jay P. Kesan, *Carrots and Sticks to Create a Better Patent System*, 17 BERKELEY TECH. L.J. 763, 770, 773-75 (2002) (advocating for an expanded disclosure system with explanations of how the claims differ from the prior art and attaching the presumption of validity only to disclosed prior art).

129. *See* FTC REPORT, *supra* 10, ch. 5, at 11-13. While applicants would still be open to the charge that they mischaracterized the relevance of the reference, once the examiner notes that she has read the reference, it is much more difficult for a challenger to successfully allege inequitable conduct, due to the presumed ability of the examiner to understand the information before her.

get buried in the flood of submitted references, as examiners would be most likely to request statements of relevance in such cases. Statements of relevance are already required for submissions of foreign-language prior art references;[130] thus, where the benefits are substantial, applicants already provide explanations. Given that the two FTC reforms examined here would likely increase the ability of the examiner to efficiently analyze prior art reference and would provide incentives to make sure that examiners obtain all relevant references, issued patents would deserve the clear and convincing presumption of validity and the latter two reforms will make them more resistant to defeat on grounds of invalidity.

IV. CONCLUSION

The plague of inequitable conduct lies not in the number of charges brought each year, but in the number of unwarranted charges. When such charges are successful, inventive entities are encouraged in their work and are free to pursue inventive activity unfettered by worries about the effects of "bad" patents. In the past ten years, over 40% of motions for summary judgment on inequitable conduct failed to allege sufficient facts to proceed to the trial stage and, at trial, 70% of allegations of inequitable conducts failed. Thus, patentees are subjected to numerous frivolous inequitable conduct charges, and the application of the doctrine should be reformed to address this problem. The three proposals outlined in this Note seek to promote the efficiency of both the prosecution and litigation systems in the United States by rewarding the inventor who fulfills her duty to disclose and simultaneously dissuading unsubstantiated allegations of inequitable conduct.

130. 37 C.F.R. § 1.98(a)(3)(i) (2004).

ADDITIONAL DEVELOPMENTS—PATENT

BIOGEN IDEC MA INC. V. TRUSTEES OF COLUMBIA UNIVERSITY

2004 WL 1839726 (D. Mass. Aug. 13, 2004)

The district court denied Biogen Idec MA's motion for a preliminary injunction to prevent the Trustees of Columbia University's from terminating their license agreements, holding that while Biogen was likely to prove that Columbia's patents are invalid and unenforceable, Biogen failed to prove it would be irreparably harmed by the denial of the injunction.

In the early 1990s, plaintiff drug companies Biogen and Genzyme Corporation licensed from Columbia University all patents deriving from a 1980 patent on a recombinant DNA technology known as cotransformation (the "Axel patents"). In August 2002, Biogen, believing the patents had expired and its license terminated, stopped royalty payments to Columbia. The university informed Biogen and Genzyme that they were obligated to continue royalty payments because a new patent had issued which derived from the Axel patents, U.S. Patent No. 6,455,275 ("the '275 patent").

Biogen and other drug companies brought suit against Columbia in July 2003, challenging the validity and enforceability of the '275 patent. The plaintiffs argued that the '275 patent covers essentially the same technology as the earlier patents, and is therefore invalid under the doctrine of non-statutory double-patenting or, in the alternative, is unenforceable because of prosecution laches. In March 2004, as a result of the non-payment of royalties, Columbia notified plaintiffs it was terminating their licenses. Plaintiffs sought a preliminary injunction to prevent Columbia's termination.

On the invalidity claim, plaintiffs presented expert testimony explaining why the claims of the '275 patent are not patently distinct over claims of an earlier patent and therefore, are invalid for obviousness type double patenting. The court noted that Columbia offered no evidence to rebut the testimony, relying instead solely on the presumption of the patent's validity. On the laches claim, the court found that the 22-year interval between application and issuance of the patent and other delays in prosecution strongly suggested deliberate delay for the purpose of increasing commercial value of the patents; Columbia failed to offer explanations for this delay.

However, the district court denied the motion for a preliminary injunction, holding that although the plaintiffs established a likelihood of success on the merits, they failed to show they would suffer irreparable harm if the request was denied, largely because there was "no threat that [the drug companies would] be restrained from manufacturing or distributing their respective drugs during the pendency of this case."

BRISTOL-MYERS SQUIBB CO. V. PHARMACHEMIE B.V.

361 F.3d 1343 (Fed. Cir.), rehearing en banc denied, 2004 U.S. App. LEXIS 10300 (Fed. Cir. Apr. 21, 2004)

The Federal Circuit held that under certain circumstances, a restriction requirement placed on a parent application does not apply to a subsequent continuation application for purposes of a double patenting defense under 35 U.S.C. § 121. Specifically, this is the case when a restriction on a parent application is separately imposed and the continuation application record does not support the inference that earlier restrictions carry forward.

Research Corp. Technologies, Inc. is the owner of two patents claiming methods for treating malignant tumors with certain platinum coordination compounds and compositions containing those compounds. Bristol-Myers Squibb Co. ("Bristol-Myers") is the exclusive licensee of the more recently issued patent ("the '927 patent"). Pharmachemie B.V. ("PBV") sought FDA approval to market a cancer treatment drug covered by the '927 patent. Bristol-Meyers brought suit against PBV alleging patent infringement. PBV claimed that the '927 patent was invalid for double patenting over the '707 patent (the '927 patent's parent application). On summary judgment, the district court held that the application that lead to the '927 patent was filed as a result of a restriction requirement placed on the '707 patent application because the restriction was never withdrawn, revoked or cancelled. Thus, according to the district court, PBV could not cite the '707 patent as a reference against the '927 patent for double patenting purposes under 35 U.S.C. § 121. PBV appealed to the Federal Circuit.

The Federal Circuit reversed the district court's judgment and remanded. The Federal Circuit stated that the success of PBV's double patenting claim turned on whether Bristol-Myers could assert a defense against double patenting under 35 U.S.C. § 121. The court explained that PBV could not use the '707 patent as a reference against the '927 patent if Bristol-Myers could claim that the application that resulted in the '927 patent was filed as a result of a restriction placed on the '707 patent. Therefore, the Federal Circuit focused on the different restrictions that the patent examiners placed on the parent application and continuation applications. The Federal Circuit noted that the examiner for the continuation application did not reinstate or even refer to the parent application restriction requirement, and so the court agreed with PBV that the later restriction requirement was different from and inconsistent with the earlier restriction requirement. Thus, the court held that the restriction requirement was not in effect at the time of the filing of the application that matured into the '927 patent, and the '927 patent could not have been filed as a result of that restriction requirement.

COOPERATIVE RESEARCH AND TECHNOLOGY ENHANCEMENT (CREATE) ACT OF 2003

H.R. 2391

The Cooperative Research and Technology Enhancement (CREATE) Act of 2003 amends the Patent Act, 35 U.S.C. § 103(c), to include collaborative researchers affiliated with more than one organization under the "safe harbor" provision of § 103(c).

In 1984 Congress enacted a series of patent law amendments, including changes to 35 U.S.C § 103, that created a safe harbor against anticipation for inventions that resulted from the joint efforts of researchers by disallowing the sharing of nonpublic information or secret prior art to deny the grant of a patent. In the 1997 case *Oddzon Productions, Inc. v. Just Toys, Inc.*, the Federal Circuit limited the reach of the safe harbor to circumstances where a joint invention was developed by researchers within a single organization. This case produced a situation where an invention that was otherwise patentable might be rendered non-patentable because of the exchange of information between research partners who represented more than one institution. Under this interpretation of § 103, there was no requirement that such information be publicly disclosed or commonly known. The potential chilling effect of the *Oddzen* holding led to passage of the CREATE Act.

The CREATE Act provides patent protection to inventions that are born from collaborative arrangements between multiple organizations. The Act permits all collaborative researchers to enjoy the same protections from the use of secret prior art as are enjoyed by those who work for a single enterprise by defining the phrase "owned by the same person or subject to an obligation of assignment" to include circumstances in which the parties have entered into a qualifying joint research agreement before making the invention. To gain the benefit of the amended section, the following conditions must be met: 1) the invention and the prior art subject matter must be owned by one or more of the parties to the joint research agreement, and the claimed invention must be made after the date of such agreement; 2) the invention must arise from work performed by or on behalf of the natural or legal persons that are party to the eligible joint research agreement; and 3) the identities of the parties to the joint research agreement must be disclosed in the patent.

This bill applies prospectively only, but includes applications pending at the USPTO on the date of enactment.

HIGH CONCRETE STRUCTURES V. NEW ENTERPRISE STONE & LIME CO.

377 F.3d 1379 (Fed. Cir. 2004)

The Federal Circuit ruled that the unintentional omission of information commonly known in the inventor's field does not violate the best mode requirement.

High Concrete Structures ("HCS") secured a patent for a loading fixture that makes it easier to secure heavy concrete pillars on truck beds, thus economizing on space and reducing the need for oversize transports. Once a crane lowered the concrete onto the loading fixture, the invention allowed the load to be positioned and secured with the minimal use of heavy equipment such as cranes. HCS sued New Enterprise Stone & Lime Company ("New Enterprise") for patent infringement. New Enterprise moved for summary judgment and claimed that it was not liable because the patent was invalid. In its patent application, HCS did not disclose that for very heavy loads, optimal stabilization is achieved through use of a crane. Section 112 of the Patent Act requires an inventor to identify the best known mode for the use of an invention. Because of the omission, the trial court held that HCS failed to disclose the best mode of using the invention, and the court granted New Enterprise's summary judgment motion.

The Federal Circuit reversed. The court stated that a best mode violation occurs if the inventor "knew of and *intentionally* concealed a better mode than was disclosed" (emphasis added). The court found that HCS's omission was not intentional because for safety purposes, the use of a crane with very heavy loads was well known in the cargo loading industry. The court stated that while HCS's invention claimed to minimize the need for such machinery, an ordinary cargo operator should still realize that the use of a crane is always an option to help stabilize heavy loads. The Federal Circuit held that "known ways of performing a known operation cannot be deemed intentionally concealed absent evidence of intent to deliberately withhold that information." Since New Enterprise did not offer evidence of intentional concealment, the Federal Circuit reversed the grant of summary judgment and remanded the case for consideration of the patent infringement claim.

IN RE CURTIS

354 F.3d 1347 (Fed. Cir. 2004)

The Federal Circuit held that when the evidence indicates persons having ordinary skill in the relevant art cannot predict the operability in the invention of any species other than the one disclosed, a patentee will not be deemed to have invented species sufficient to constitute the genus by virtue of having disclosed a single species.

The patentees (collectively "Curtis") filed a patent application claiming they "unexpectedly discovered" that dental floss, when made with a floss filament coated with microcrystalline wax ("MCW"), would provide a coefficient of friction that hits the right balance between usability and effectiveness. Two continuation-in-part applications ensued, resulting in two issued patents. In the first patent, Curtis repeated the language of the original application about the MCW, but nowhere did he mention other kinds of coating materials that could increase the coefficient of friction. In the second patent and a related reissue application, Curtis added genus claims that read on "at least one friction enhancing coating."

Subsequently, a third party challenged the later broader claims based on a prior-art patent that was not before the Patent and Trademark Office (PTO) during the prosecution of the second patent. The PTO, merging the reexamination challenge and the reissue request, ruled that the disclosure in the first patent did not provide written description support for the later-claimed generic subject matters, and therefore Curtis could not benefit from the earlier priority date. The PTO issued a final rejection. Curtis appealed to the Board of Patent Appeals and Interferences, which ultimately affirmed the examiner's decision. Curtis then appealed to the Federal Circuit.

The Federal Circuit held that a disclosure of a species does not always suffice to describe a genus. In supporting its decision, the court considered the unexpected aspects of the invention, the lack of mention of other materials in the patents, and statements regarding the difficulty of the art. In addition, the court rejected declarations filed by Curtis during the PTO proceedings since they came more than ten years after the filing of the earlier patent. The court held that the applicable test is whether, upon reading the disclosure of a species, a person of ordinary skill in the art would "instantly recall" other species of the later-claimed broad genus. Applying that test, the court held that no evidence in the record indicated one of ordinary skill had stored in their minds any friction-enhancing coating other than the MCW.

JACOBS V. NINTENDO OF AMERICA, INC.

370 F.3d 1097 (Fed. Cir. 2004)

The Federal Circuit held that the language in a settlement agreement between a patentee and a supplier granted an implied license to defendant manufacturer's infringing use of the supplier's product, even absent proof under the non-infringing use doctrine.

Plaintiff Jacobs owned a patent for a video game controller that allows the player to direct on-screen motion of game characters by tilting a hand-held device. Plaintiff previously sued Analog Devices, Inc. ("Analog"), charging inducement and contributory infringement based on Analog's sale of accelerometers (a tilt-sensitive mechanism) to other manufacturers as components in controllers that infringed on plaintiff's patent. The settlement agreement between plaintiff and Analog included a covenant-not-to-sue clause for any infringement of the patent by Analog. The agreement also granted Analog a license "to make, use, sell, import and export components, including micromachined accelerometers, for use in tilt-sensitive control boxes."

After the settlement with Analog, plaintiff filed a separate suit against Nintendo, charging that its "Kirby Tilt 'n Tumble," a game cartridge which operates as a tilt controller, infringed Jacobs' patent. The trial court granted summary judgment for Nintendo, holding that plaintiff's settlement agreement with Analog gave Nintendo an implied license to use Analog accelerometers in a manner that infringed Jacobs' patent.

Plaintiff appealed, arguing application of the non-infringing use doctrine. This doctrine would allow Nintendo an implied license to use Analog's accelerometers only if Nintendo could prove that the accelerometers had no non-infringing uses. Only then, Jacobs argued, could an implied license to practice his patent be found, because the lack of any non-infringing uses would render Analog's right to sell the accelerometer valueless.

The Federal Circuit acknowledged the usual requirement of proof of no non-infringing uses to find an implied license to infringe, but countered that this doctrine does not apply where there is an express agreement between parties. The court pointed to the language in the agreement that allowed Analog to sell accelerometers "for use in tilt-sensitive control boxes." This language gave Analog the express right to make and sell accelerometers for uses that, absent the agreement, would infringe the patent.

The court also analogized to a general principle of contract law which states that a party may not assign a right, receive consideration for it ,and then take action that would render the right commercially worthless. This principle negated plaintiff's contention that the settlement agreement allowed Analog to sell accelerometers for a certain purpose, but did not protect Analog's customers from using Analog accelerometers for that same purpose.

MONSANTO CANADA INC. V. SCHMEISER

2004 S.C.C.D.J. LEXIS 31 (S.C.C. May 21, 2004)

The Supreme Court of Canada ruled that a farmer infringed Monsanto's patents by using genetically modified canola seeds of unknown origin containing patented genes and cells, but that no damages were owed because the farmer's profits were no different than they would have been if he had planted and harvested ordinary canola.

Monsanto owns and licenses a patent on the genes and cells that confer resistance to certain herbicides, including one called Roundup. Canola seeds containing the patented genes and cells are sold as Roundup Ready. Monsanto discovered that 95-98% of the 1998 canola crop of Percy Schmeiser, a Canadian farmer who did not hold a license to the patent, consisted of Roundup Ready plants.

Although the origin of the plants on Schmeiser's property is unclear, the court acknowledged that the Roundup Ready could have blown onto his farm from a neighboring property. In any event, the court determined that Schmeiser then collected, saved, and planted the seeds, eventually cultivating and selling a crop of canola composed mostly of Roundup Ready plants. When Monsanto discovered the crop, initially from samples taken on public road allowances bordering Schmeiser's fields, it brought suit for patent infringement.

In ruling for Monsanto, the Canadian Supreme Court first affirmed the legitimacy of the Roundup patent. Though Canadian law forbids patenting higher organisms, the court held that the Monsanto patent was correctly limited to the genes and cells conferring herbicide resistance. The court also dismissed Schmeiser's argument that, if the patents were thus narrowly construed, his possession of whole plants couldn't violate Monsanto's patents. Instead, the court held that Monsanto's right to control the use of its gene extended to plants containing it: "Infringement through use is thus possible even where the patented invention is part of, or composes, a broader unpatented structure or process." Such a construction does not violate the prohibition on patenting whole organisms, but simply affirms an inventor's exclusive control over the use and distribution of her invention.

Though the court largely ruled in Monsanto's favor, it took pains to emphasize that it was concerned not with "the innocent discovery by farmers of 'blow-by' patented plants on their land" but only with the farmers' subsequent commercial use of those plants. Additionally, the court rejected any claim of damages for Monsanto, holding that the company would only be entitled to recoup profits Schmeiser earned from the invention. Because Schmeiser took no steps to benefit from the Roundup Ready platns—he did not use Roundup weed killer or alter his farming techniques—his profits were "precisely what they would have been had [he] planted and harvested ordinary canola."

NOELLE V. LEDERMAN

355 F.3d 1343 (Fed. Cir. 2004)

The Federal Circuit held that in order for a priority filing date to apply to a subsequent claim for an antibody, the previous patent had to sufficiently describe the antigen to which the antibody has binding affinity. The court further held that no interference-in-fact exists where the inventions fail to satisfy both prongs of the "two-way" test, which the Board of Patent Appeals and Interferences ("Board") in the instant case described as the "one-way distinctiveness" test.

Lederman, Chess, and Yellin (collectively "Lederman") described and claimed the human form of CD40CR monoclonal antibody and the hybridomal cell line that produced the antibody in Patent No. 5,474,771 ("the '771 patent"). The '771 patent had an effective filing date of November 15, 1991. Noelle claimed the same antibody and hybridomal cell line, along with the genus, mouse, chimeric ("hybrid"), and humanized form of the antibody, in application Serial No. 08/742,480 ("the '480 application"), which was filed on November 1, 1996 and was the second continuation of the application Serial No. 07/835,799 ("the '799 application") filed on February 14, 1992.

The Patent Office declared an interference in 1999. Lederman sought to have Noelle's claims rejected with regard to its mouse, genus, and human forms of the CD40CR antibody. The Board determined that Noelle satisfied the written requirement of 35 U.S.C. § 112 as of the date the '480 application was filed with respect to the mouse form but not with respect to the human and genus forms. Since the parent '799 application did not describe the human or genus antigens or antibodies, the Board found that the human and genus claims covered new matter, and therefore, the '480 application did not warrant the earlier priority date of the '799 application with respect to those claims. The Board further found that Lederman's '771 patent and another patent anticipated Noelle's genus and human forms as prior art. Thus, the Board rejected the '480 application claims relating to the genus and human forms of the antibodies. Lastly, the Board found no interference-in-fact because one skilled in the art would not have had a "reasonable expectation of success" of isolating the human CD40CR antibodies from the mouse antigen. Noelle appealed.

The Federal Circuit held that the disclosure of a "'*fully characterized* antigen,' either by its structure, formula, chemical name, or physical properties, or by depositing the protein in a public repository" would enable an applicant to then claim an antibody by its binding affinity to the described antigen. The court then found that Noelle did not sufficiently describe the human form of the CD40CR antigen in its earlier application and therefore could not claim the human antibody in its later application. The Federal Circuit also held that Noelle could not claim the genus form of the antibody by simply describing the mouse form; therefore, Noelle was not entitled to a priority filing date based on the previous application. Finally, the court affirmed the Board's finding that prior art patents anticipated Noelle's human and genus claims.

In reviewing the Board's decision that there was no interference-in-fact, the Federal Circuit noted that it had previously approved of the two-way test, which requires invention A to anticipate or make obvious invention B and vice versa, and that the Board had applied this test under the name of the "one-way descriptiveness test." The court affirmed

the Board's finding of no interference-in-fact as proper and supported by substantial evidence.

SMITHKLINE BEECHAM CORP. V. APOTEX CORP.

365 F.3d 1306 (Fed. Cir. 2004)

The Federal Circuit held a pharmaceutical patent invalid for public use due to clinical trials conducted by the patentee, noting that the experimental use doctrine does not apply when the patentee tests features that are not claimed in the patent. The court also reversed a claim construction in which the court wrote a limitation into an unlimited chemical compound claim for policy reasons, declaring that the scope of patent claims can be neither broadened nor narrowed for abstract policy considerations.

Smithkline Beecham Corp. ("Smithkline") sued Apotex Corp. ("Apotex") for infringing its patent on the active ingredient in plaintiff's antidepressive drug Paxil—specifically, a claim that recited only, "Crystalline paroxetine hydrochloride hemihydrate." The alleged infringement arose from Apotex's manufacture of a rival drug based on a variant compound, which produced trace amounts of the claimed compound in the production process. The district court determined that Smithkline's double-blind clinical trials qualified as experimental uses, and therefore it held that the patent was not invalid for public use under 35 U.S.C. § 102(b). As for the infringement claim, the district court reasoned that it would be contrary to public policy to construe plaintiff's patent so broadly that it could cover mere *trace* amounts of the claimed compound. Therefore, the court limited claim 1 to the compound "in commercially significant amounts." Under that construction, the district court held that Apotex's drug did not infringe the patent. Alternatively, the district court ruled that if the defendant's drug infringed under a broader construction of claim 1, then the defendant was still not liable for infringement because plaintiff caused the infringement. Smithkline appealed and defendant cross-appealed.

The Federal Circuit affirmed the judgment but on different grounds. The court stated that policy should not drive patent claim construction, and that judges are not in the business of rewriting patent claims, poorly drafted or otherwise. Based on the revision of the claim construction, the court found that Apotex's product infringed claim 1 of the plaintiff's patent. However, the court further ruled that the defendant was not liable for patent infringement because the patent was invalid. Smithkline argued that the experimental use doctrine exempted the clinical trials from the definition of public use under § 102(b). However, since Smithkline tested the *effects* of the drug on depression but failed to claim the effects in their patent, the court held that the experimental use doctrine did not apply because plaintiff did not test claimed features in its reduction to practice; therefore, the clinical trials fell under the public use bar, and the court invalidated the patent.

Judge Gajarsa concurred, stating that the patent was invalid under § 101. He explained that broad patents that encompass products that "spread, appear, and 'reproduce' through natural processes" are invalid because they cover improper subject matter.

UNIVERSITY OF ROCHESTER V. G.D. SEARLE & CO.

358 F.3d 916 (Fed. Cir.), reh'g en banc denied, 375 F.3d 1303, cert. denied, 160 L. Ed. 2d 484 (2004)

The Federal Circuit ruled that a pharmaceutical patent was invalid for lack of written description under 35 U.S.C. § 112 where the patent claimed a method of administering a compound in a human to achieve a therapeutic effect but failed to disclose any such compound, suggest how to make it, or proffer any evidence that the inventors knew of the compound when the patent application was filed.

University of Rochester ("Rochester") owned U.S. Patent No. 6,048,850 ("the '850 patent"), claiming a method for selectively inhibiting cyclooxygenase-2 (COX-2) activity in a human host through administering a non-steroidal compound. Traditional anti-inflammatory drugs function by inhibiting not only COX-2, which is responsible for inflammation, but also COX-1, which protects the stomach lining. Rochester sued G.D. Searle & Co., Monsanto Co., Pharmacia Corp., and Pfizer Inc. (collectively "Pfizer"), alleging that Pfizer infringed the '850 patent by selling its COX-2 inhibitors Celebrex and Bextra for treatment of inflammation. The district court granted Pfizer's motion for summary judgment, invalidating the '850 patent for failure to comply with the written description and enablement requirements. Rochester appealed.

The Federal Circuit affirmed the district court's ruling on the written description ground. Writing for the three-judge panel, Judge Lourie first rejected Rochester's argument that the written description requirement does not exist independent of the enablement requirement. The court stated that despite their significant overlap, the written description, enablement, and best mode requirements are independent of each other. Thus, an invention may be enabled without being sufficiently described, and vice versa. The court noted that the Federal Circuit's precedent "clearly recognizes a separate written description requirement," and cited the rule articulated in recent cases such as *Regents of the University of California v. Eli Lilly & Co.*, 119 F.3d 1559, 1568 (Fed. Cir. 1997), and *Enzo Biochem, Inc. v. Gen-Prob Inc.*, 323 F.3d 965, 968 (Fed. Cir. 2002): A patentee must disclose an invention in enough detail so that one skilled in the art may "visualize or recognize" the identity of the invention. Extending the written description standard developed in *Lilly* for DNA inventions to chemical inventions, the court stated that the written description requirement involves a "precise definition, such as by structure, formula, chemical name, or physical properties, not a mere wish or plan for obtaining the claimed . . . invention."

The court also rejected Rochester's arguments that the written description requirement only applies in the priority context. The court reasoned that the statute does not limit the written description requirement to cases with priority issues. Furthermore, while the '850 patent is directed to a method, rather than a composition of matter as in precedent cases, the court considered this difference a mere semantic distinction. Regardless of whether it claims a compound or a method that requires its use, the patent must contain an adequate description of the compound in question.

The court found that the '850 patent failed to adequately describe the claimed invention. Because the claimed method depends on a compound that selectively inhibits COX-2 activity and yet the patent discloses no such compound, the court concluded that one

skilled in the art could not practice the claimed invention on the patent's specification. Thus, the court upheld the district court's decision invalidating the '850 patent.

A JUDICIAL SAFE HARBOR UNDER THE ANTI-CYBERSQUATTING CONSUMER PROTECTION ACT

By J. Ryan Gilfoil

The Anti-Cybersquatting Consumer Protection Act (ACPA)[1] of 1999 provides trademark owners with a means of combating cybersquatters. While the ACPA was aimed at the classic domain-name speculator,[2] the Act has also been asserted against a different class of would-be malefactors: "cybergripers." A cybergriper, often a former customer of the mark owner, registers an Internet domain name similar to the mark. The cybergriper then establishes a website at the domain criticizing the mark owner and airing his dissatisfaction with the mark owner's business practices. In contrast to the squatter, the cybergriper's aim is to disparage the mark owner's business, rather than to profit from the domain name or website. Some early cases under the ACPA confronted cybergripers with less-than-clean hands; the gripers' statements, sites, or registration activity incriminated them.[3] Although the outcomes of these cases were arguably correct, the courts' reasoning in some ways represented an overzealous application of the ACPA, which was not intended to prohibit criticism or parody.[4]

In 2004, courts decided several cases ("the 2004 cases") involving pure cybergriping, with little or no evidence of an attempt to profit from the domain names.[5] In each instance, the court refused to find liability.

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1. 15 U.S.C. § 1125(d) (2000).

2. Legislative history behind the ACPA enumerates examples of cybersquatting: "register[ing] well-known brand names . . . in order to extract payment from the rightful owners;" "register[ing] . . . marks with the hope of selling them to the highest bidder;" "divert[ing] customers . . . to the cybersquatter's own site, many of which are pornography sites;" and "defraud[ing] consumers." S. REP. NO. 106-140, at 5-6 (1999) [hereinafter SENATE REPORT].

3. In two cases, the gripers' statements indicated intent to resell and profit from the domain names, while the sites' content or links to commercial content vitiated claims of legitimate noncommercial use. People for the Ethical Treatment of Animals v. Doughney, 263 F.3d 359, 369 (4th Cir. 2001); Morrison & Foerster LLP v. Wick, 94 F. Supp. 2d 1125, 1131-33 (D. Colo. 2000). In another case, the griper's "typo-squatting"—registration of misspelled variations of the plaintiff's trademark—indicated bad faith. Toronto-Dominion Bank v. Karpachev, 188 F. Supp. 2d 110, 114 (D. Mass. 2002).

4. *See* SENATE REPORT, *supra* note 2, at 9 ("[N]oncommercial uses of a mark, such as for comment, criticism, parody, news reporting, etc., are beyond the scope of the bill's prohibitions . . . .").

5. TMI Inc. v. Maxwell, 368 F.3d 433 (5th Cir. 2004); Lucas Nursery & Landscaping, Inc. v. Grosse, 359 F.3d 806 (6th Cir. 2004); Bosley Med. Inst., Inc. v. Kremer, No.

These cases present an opportunity to examine how the ACPA functions against a class of domain name registrants who were not squarely in Congress's sights when the ACPA was passed.[6]

Part I of this Note provides a primer on the domain name system and the elements of the ACPA. Part II briefly describes the 2004 cases. Part III examines the application of the ACPA to two types of domain names frequently used for cybergriping. This Note contends that the 2004 cases establish a judicial safe harbor for pure criticism of a mark owner regardless of the domain name used, and that this judicial safe harbor reflects a correct interpretation of the ACPA in light of congressional intent. This Note also examines the activities a cybergriper can take or fail to take that may jeopardize the judicial safe harbor.

I. BACKGROUND

A. The Domain Name System

Every computer on the Internet is identified by a unique Internet Protocol or "IP" address, a binary number consisting of 32 ones and zeros.[7] Other computers use this IP address to route data, such as webpages, to and from the computer, just as a street address is used to route paper mail. Obviously, calling up CNN's news servers by entering 32 ones and zeros into a web browser would be quite cumbersome, so a computer on the Internet may be assigned a domain name. A domain name is a unique alphanumeric "string,"[8] such as <cnn.com> or <dartmouth.edu>, that corresponds to a unique IP address.[9] The domain name can be used instead of the IP address to locate the computer.

Since people prefer to deal with readable domain names, while computers prefer purely numeric IP addresses, computers called "domain name servers" or "DNS servers" are available to translate domain names into IP addresses, and vice versa.[10] When a user enters the domain name

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01-1752 WQH (JMA), 2004 U.S. Dist. LEXIS 8336 (S.D. Cal. Apr. 30, 2004); Mayflower Transit, LLC v. Prince, 314 F. Supp. 2d 362 (D.N.J. 2004).

6. The cases run counter to early predictions that the ACPA would "favor Internet commerce over other legitimate uses of the Internet, particularly those primarily employed by individuals." Allon Lifshitz, Recent Development, *Cybersquatting*, 38 HARV. J. ON LEGIS. 529, 545 (2001).

7. Marshall Brain, *How Domain Name Servers Work*, HOWSTUFFWORKS, *at* http://computer.howstuffworks.com/dns2.htm (last visited Feb. 26, 2005).

8. A sequence of letters, numbers, and other characters.

9. *Id.*, *at* http://computer.howstuffworks.com/dns3.htm.

10. *Id.*, *at* http://computer.howstuffworks.com/dns1.htm.

<cnn.com> into his browser, he indicates that he wants the default webpage of the <cnn.com> domain. The user's computer contacts a domain name server to find out the IP address that corresponds to <cnn.com>. The user's computer can then properly address its request for news and send it to CNN's servers.

Because IP addresses are unique, domain names must be unique: there can be only one <cnn.com>.[11] Domain names are "registered," or activated and assigned to owners, on a first-come, first-served basis.[12] No one verifies whether a registrant has a legitimate claim to a domain name.[13]

B. The ACPA

As the Internet became increasingly commercialized, prescient individuals saw an opportunity to profit by registering domain names similar to famous trademarks. Because domain names are unique, a squatter who registers <cocacola.com> prevents the manufacturer of Coke from using that domain name.[14] Further, since registration is a first-come, first-served, largely unregulated process, all that a squatter has to do to register <cocacola.com> is be the first applicant. Prior to the passage of the ACPA, trademark owners typically sued squatters under the Federal Trademark Dilution Act (FTDA).[15] But dilution lawsuits were "expensive and uncertain,"[16] in part because of the stringent requirement that the underlying mark be famous.[17] Congress therefore enacted the ACPA to specifically prohibit cybersquatting.

The ACPA imposes liability on a person who, with "a bad faith intent to profit from" a distinctive or famous mark, "registers, traffics in, or uses a domain name" that is "identical or confusingly similar to" the mark.[18] In addition, in the case of a famous mark, the "identical or confusingly simi-

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11. *Id.*, *at* http://computer.howstuffworks.com/dns3.htm. However, multiple unique domain names may be assigned to one IP address.

12. *Domain Name Disputes*, BITLAW, *at* http://www.bitlaw.com/internet/domain.html (last visited Feb. 26, 2005).

13. *Id.*

14. Use of a trademark on a physical product is, in contrast, non-rivalrous and thus less powerful. Accordingly, the legal standard for liability for such use is more demanding and is predicated on the mark owner's actual use of the mark in commerce. *See* David J. Franklyn, *Owning Words in Cyberspace: The Accidental Trademark Regime*, 2001 WIS. L. REV. 1251, 1253.

15. 15 U.S.C. § 1125(c) (2000); *see, e.g.*, Panavision Int'l, L.P. v. Toeppen, 141 F.3d 1316 (9th Cir. 1998); *see also* Lifshitz, *supra* note 6, at 529-36 (describing limits of pre-ACPA legal weapons against cybersquatters).

16. H.R. REP. NO. 106-412, at 6 (1999).

17. 15 U.S.C. § 1125(c)(1).

18. *Id.* § 1125(d)(1)(A).

lar" requirement may be met by a domain name that is instead "dilutive of" the mark.[19] To succeed in an ACPA claim, the plaintiff must prove three elements: 1) plaintiff's mark is distinctive or famous; 2) defendant's domain name is identical or confusingly similar to plaintiff's mark; and 3) defendant registered, trafficked in, or used the domain name with a bad-faith intent to profit.[20] The ACPA provides nine factors for the court to evaluate when determining whether the defendant had a bad-faith intent to profit.[21] The first three factors take into account a defendant's prior rights

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19. *Id.* § 1125(d)(1)(A)(ii)(II).
20. Mayflower Transit, LLC v. Prince, 314 F. Supp. 2d 362, 367 (D.N.J. 2004).
21. The factors are:
    (I) the trademark or other intellectual property rights of the person, if any, in the domain name;
    (II) the extent to which the domain name consists of the legal name of the person or a name that is otherwise commonly used to identify that person;
    (III) the person's prior use, if any, of the domain name in connection with the bona fide offering of any goods or services;
    (IV) the person's bona fide noncommercial or fair use of the mark in a site accessible under the domain name;
    (V) the person's intent to divert consumers from the mark owner's online location to a site accessible under the domain name that could harm the goodwill represented by the mark, either for commercial gain or with the intent to tarnish or disparage the mark, by creating a likelihood of confusion as to the source, sponsorship, affiliation, or endorsement of the site;
    (VI) the person's offer to transfer, sell, or otherwise assign the domain name to the mark owner or any third party for financial gain without having used, or having an intent to use, the domain name in the bona fide offering of any goods or services, or the person's prior conduct indicating a pattern of such conduct;
    (VII) the person's provision of material and misleading false contact information when applying for the registration of the domain name, the person's intentional failure to maintain accurate contact information, or the person's prior conduct indicating a pattern of such conduct;
    (VIII) the person's registration or acquisition of multiple domain names which the person knows are identical or confusingly similar to marks of others that are distinctive at the time of registration of such domain names, or dilutive of famous marks of others that are famous at the time of registration of such domain names, without regard to the goods or services of the parties; and
    (IX) the extent to which the mark incorporated in the person's domain name registration is or is not distinctive and famous within the meaning of subsection (c)(1) of [15 U.S.C. § 1125].

15 U.S.C. § 1125(d)(1)(B)(i). In contrast with trademark dilution, there is no commercial use requirement, but commercial use is relevant to the bad-faith inquiry under the fourth

to the domain name due to trademark ownership, the defendant's own legal name, or the defendant's sale of goods. The next two factors examine the nature of the defendant's site, accounting for noncommercial or fair use of the domain name, and for the defendant's intent to lure the mark owner's customers to his site by confusing them. The next three factors examine the defendant's behavior, taking into account offers to sell the domain, defendant's use of a false name when registering the domain, or defendant's history of domain-name squatting. And the last factor accounts for the strength of the trademark.

The first two elements of ACPA liability—whether the mark is distinctive and whether the domain name is similar to the mark—are fairly straightforward. Accordingly, the court's inquiry usually centers around determining whether a defendant showed a bad-faith intent to profit. Although the nine bad-faith factors enumerated by the ACPA guide this inquiry, the ACPA factors are not exclusive, and the court is free to assign to the factors any relative weight it chooses.[22] In other words, the court has wide latitude to discern bad-faith intent from the facts of each case. Furthermore, the ACPA provides a legislative safe harbor for those defendants who "believed and had reasonable grounds to believe that the use of the domain name was a fair use or otherwise lawful."[23] Thus, either an absence of bad-faith intent to profit, or a genuine and reasonable belief that one's use of a domain name is legitimate, will preclude liability under the ACPA. However, in practice, defendants rarely invoke the legislative safe harbor, perhaps because of the more nebulous nature of the fair use defense.[24]

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and fifth factors. *See* P. Wayne Hale, Note, *The Anticybersquatting Consumer Protection Act* & Sporty's Farm L.L.C. v. Sportsman's Market, Inc., 16 BERKELEY TECH. L.J. 205, 218-25 (2001) (contrasting the ACPA and the FTDA); Jian Xiao, Note, *The First Wave of Cases Under the ACPA*, 17 BERKELEY TECH. L.J. 159, 162 (2002) (same).

22. *See* 15 U.S.C. § 1125(d)(1)(B)(i) ("In determining whether a person has a bad faith intent . . . a court may consider factors such as, but not limited to" the nine enumerated factors.); *see also* Adam Silberlight, *Domain Name Disputes Under the ACPA in the New Millennium: When Is Bad Faith Intent to Profit Really Bad Faith and Has Anything Changed with the ACPA's Inception?*, 13 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 269, 283-84 (2002) (discussing a court going beyond the enumerated factors to impose ACPA liability).

23. 15 U.S.C. § 1125(d)(1)(B)(ii); *see also* Xiao, *supra* note 21, at 174-75 (discussing recent cases in which the defendant invoked the legislative safe harbor).

24. *But see* Rohr-Gurnee Motors, Inc. v. Patterson, No. 03 C 2493, 2004 U.S. Dist. LEXIS 2068, at *14 (N.D. Ill. Feb. 9, 2004) (accepting the § 1125(d)(1)(B)(ii) fair use defense in approving defendant's motion for attorney's fees). Further, even partial bad faith may preclude the protection of the explicit safe harbor provision. Virtual Works, Inc. v. Volkswagen of Am., Inc., 238 F.3d 264, 270 (4th Cir. 2001) ("We do not think

Legislative history indicates that the primary motivations for the ACPA were promoting e-commerce, combating fraud and public confusion, and protecting the consumer goodwill to which mark owners are entitled.[25] Congress's examples of prohibited behavior included the classic domain-name speculator and the squatter who diverts traffic to a commercial or pornographic site.[26] In contrast, the Senate Report to the ACPA states that noncommercial uses such as "comment, criticism, [or] parody" are "beyond the scope" of the ACPA.[27]

II. THE CYBERGRIPER CASES

A. Liability for Gripers

Several earlier cases decided under the ACPA found liability for cybergripers.[28] In 2000, a district court in Colorado decided *Morrison & Foerster LLP v. Wick*.[29] In that case, the defendant registered variations on the name of law firm Morrison & Foerster (MoFo) in order to "get even" with corporate America.[30] He used the domains to post disparaging comments aimed at MoFo and links to sites having racist or otherwise unsettling content.[31] The court held that the defendant's expressed desire to "mess with" corporate America and "see these people squirming" strongly suggested bad faith.[32]

The *Morrison & Foerster* court also found support for liability under the fifth factor of the ACPA because the defendant, by using a domain similar to MoFo's trademark, intended to divert MoFo's customers by creating a likelihood of confusion.[33] In addition, under the sixth factor, the court found an offer to sell based on information the defendant provided

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Congress intended the safe harbor to protect defendants operating, at least in part, with unlawful intent."); *see also* Lifshitz, *supra* note 6, at 541 (noting that the defendant must prove "both a subjective and objective belief that his use of the domain name was fair or lawful").

25. SENATE REPORT, *supra* note 2, at 4-5.

26. *Id.* at 5-6.

27. *Id.* at 9. However, Congress noted that parodic or critical use of a domain name would not *alone* preclude liability. Otherwise, a bad-faith registrant might post a pretextual parody in order to inoculate himself against ACPA liability. *Id.*

28. *But see, e.g.*, Northland Ins. Cos. v. Blaylock, 115 F. Supp. 2d 1108 (D. Minn. 2000).

29. 94 F. Supp. 2d 1125 (D. Colo. 2000).

30. *Id.* at 1127, 1133.

31. *Id.* at 1128.

32. *Id.* at 1133.

33. *Id.* at 1132.

when he registered the domains.[34] The court rejected the defendant's claim that his sites were bona fide, noncommercial parodies under the fourth factor because the domain names themselves did not simultaneously call to mind and criticize MoFo.[35]

Later, in 2001, the Fourth Circuit decided *People for the Ethical Treatment of Animals v. Doughney* (*PETA*).[36] Here, the defendant posted a parody site entitled "People Eating Tasty Animals" at <peta.org>, a domain name identical to the animal rights organization's service mark.[37] Importantly, the site included links to organizations promoting eating meat, wearing fur and leather, hunting, and other similar pursuits.[38] The court first evaluated PETA's trademark infringement claim. Under this claim, the court found the parody site's links, along with the likelihood of diverting consumers seeking PETA's official site, sufficient to render the parody site "in connection with" the sale of goods.[39] The court appeared to apply this finding to its ACPA analysis, reasoning that a use in connection with the sale of goods could not be a noncommercial use under the fourth factor.[40] Further, under the sixth factor, the court found that the defendant's statements on his site and in the press suggesting a settlement indicated intent to profit.[41]

Finally, in 2002, a district court in Massachusetts decided *Toronto-Dominion Bank v. Karpachev*.[42] In that case, the griper posted criticism of the plaintiff banking and investment firm at sixteen domain names, each a misspelled variation on the plaintiff's name.[43] The site likened the plaintiff to Nazis and Soviet communists and described the real-life murder of some of the firm's employees by a disgruntled customer.[44] The court focused on the defendant's intent to divert consumers and his registration of multiple domain names under the fifth and eighth factors.[45] The court con-

34. *Id.*
35. *Id.* at 1131, 1134-35.
36. 263 F.3d 359 (4th Cir. 2001).
37. *Id.* at 362-63.
38. *Id.* at 363.
39. *Id.* at 364-66.
40. *See id.* at 369.
41. *Id.* at 368. The defendant made the statements prior to the filing of the lawsuit. *Id.* at 363.
42. 188 F. Supp. 2d 110 (D. Mass. 2002).
43. *Id.* at 111.
44. *Id.* at 112 & n.3.
45. *Id.* at 114.

clusorily rejected the defendant's claim of fair use under the fourth factor.[46]

B. The 2004 Cases Reject Liability for Gripers

The 2004 cases[47] share a common fact pattern. A customer had a bad experience with a seller of goods or services. The customer registered a domain name consisting of a variant of the seller's trademark or service mark and posted a website at that domain name. On the website, the customer described the seller's alleged malfeasance and urged readers to take their business elsewhere. In response, the seller sued under the ACPA. The courts in all four cases found no liability under the ACPA due to a lack of bad-faith intent to profit.

In *Mayflower Transit, LLC v. Prince*, for example, the fourth bad-faith factor was determinative: the court held that cybergriping was a "bona fide noncommercial or fair use of the mark," consistent with the previously-recognized right to use a trademark for parody or other commentary.[48] According to the court, the ACPA was not intended to prevent cybergriping.[49] The court also held that the absence of an attempt to sell the domain name to the mark owner indicated a lack of bad faith.[50] The Fifth Circuit employed a similar analysis in *TMI Inc. v. Maxwell*.[51]

In *Lucas Nursery & Landscaping, Inc. v. Grosse*, the Sixth Circuit reached a similar conclusion, focusing primarily on the absence of an offer to sell the domain name. According to the court, without "intent to trade on the goodwill of another's mark," there was no bad faith.[52] Finally, in *Bosley Medical Institute, Inc. v. Kremer*,[53] while the southern California district court apparently applied the ACPA incorrectly,[54] it found that the

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46. *See id.*

47. TMI Inc. v. Maxwell, 368 F.3d 433 (5th Cir. 2004); Lucas Nursery & Landscaping, Inc. v. Grosse, 359 F.3d 806 (6th Cir. 2004); Bosley Med. Inst., Inc. v. Kremer, No. 01-1752 WQH (JMA), 2004 U.S. Dist. LEXIS 8336 (S.D. Cal. Apr. 30, 2004); Mayflower Transit, LLC v. Prince, 314 F. Supp. 2d 362 (D.N.J. 2004).

48. *Mayflower*, 314 F. Supp. 2d at 369-70.

49. *Id.* at 369.

50. Bad faith is relevant under the sixth factor. *See id.* at 371.

51. 368 F.3d at 436-39.

52. 359 F.3d at 810 (quoting SENATE REPORT, *supra* note 2, at 9).

53. No. 01-1752 WQH (JMA), 2004 U.S. Dist. LEXIS 8336 (S.D. Cal. Apr. 30, 2004).

54. The court stated that the plaintiff's cybersquatting claims were based upon 15 U.S.C. § 1125(d), the ACPA. *Id.* at *18. But the court analyzed the claims as though they were infringement claims, requiring commercial use and likelihood of confusion. *Id.* at *20-*30. These are not requirements of the ACPA, though commercial use and likelihood

noncommercial nature of the sites and the absence of an attempt to sell justified the defendant's exoneration.[55]

III. DISCUSSION

This Part examines the application of the ACPA to two situations that arose in the 2004 cases: griping at domains having a name similar to the mark, or "same-name griping;" and griping at "-sucks" domains, or "pejorative-suffix griping." The Part describes whether, and how, the ACPA applies to each type of gripe site and concludes that the 2004 cases establish a judicial safe harbor for pure-criticism sites. This Part contends that a griper may jeopardize the judicial safe harbor by taking such steps as: linking to sites offering goods for sale or even simply promoting economic activity; making statements that can be construed as offers to sell the domain names, including offers to settle; posting offensive content or even simply overheated criticism; registering numerous gripe sites; or providing incomplete or misleading registration information.

A. Same-Name Griping

Same-name griping consists of setting up a complaint site at a domain name identical or confusingly similar to the mark, such as <mayflower-vanline.com> where the service mark is MAYFLOWER and the mark owner is a moving company.[56]

1. Applying the ACPA

By definition, a same-name case meets the "identical or confusingly similar" prong of the ACPA. Assuming the plaintiff meets the fame or distinctiveness prong, liability hinges on the third prong: the bad-faith intent to profit inquiry, guided by the nine enumerated factors. The 2004 cases illustrate the discretionary nature of the court's inquiry into bad-faith intent to profit by either ignoring most of the enumerated factors and focusing instead on the fourth and sixth factors, or analyzing all the factors but weighing the fourth and sixth very heavily.[57] Either way, the 2004 cases

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of confusion may be relevant under, for instance, the fifth bad-faith factor. *See* discussion of the ACPA *supra* Part I.B.

55. *See Bosley*, 2004 U.S. Dist. LEXIS 8336, at *24-*27.

56. *See* Mayflower Transit, LLC v. Prince, 314 F. Supp. 2d 362, 365-66 (D.N.J. 2004).

57. Perhaps because of the wide latitude to inquire into bad faith granted by the ACPA, courts rarely invoke the Act's explicit "safe harbor" provision, 15 U.S.C. § 1125(d)(1)(B)(ii). In the 2004 cases, only *Mayflower* applies the statutory safe harbor, and even then only cursorily. *See id.* at 369.

illustrate that the fourth and sixth factors are the most important in the context of a mark owner seeking to prevent online criticism. These factors favor, respectively, a defendant who makes a "bona fide noncommercial" use of the mark in his website and a defendant who does not offer to sell the domain name.[58]

For instance, *Mayflower* addresses the other factors but indicates that the fourth factor ultimately guides its decision. Under the fourth factor, the defendant made a bona fide noncommercial use of the MAYFLOWER mark that precluded bad faith.[59] That bona fide noncommercial use was criticism. *Lucas* emphasized the sixth factor instead. Without an offer to sell the domain name, there is no intent to profit.[60] *TMI* focused on both the fourth and sixth factors, emphasizing the use of the site as a vessel for criticism and the absence of an attempt to sell.[61] And while *Bosley*, as mentioned above, misapplied the ACPA, its conclusion amounts to an exoneration of the defendant on the fourth factor. According to the *Bosley* court, criticism is a legitimate noncommercial purpose.[62]

The 2004 holdings on the fourth factor represent a departure from some early cases under the ACPA and other areas of trademark law. Several earlier decisions held that simply by registering a domain name similar to a trademark, one prevents consumers from reaching the mark owner's site and thereby engages in a commercial use;[63] the commercial nature of the use precludes the protection of the fourth factor. The 2004 case law is more in accordance with congressional intent behind the ACPA. If Congress provided for the possibility of noncommercial use even when the domain name is "identical or confusingly similar to" the

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58. 15 U.S.C. § 1125(d)(1)(B)(i)(IV), (VI) (2000). As is suggested by the fact that the ACPA contemplates the possibility of noncommercial use, the "mere use of another's name on the Internet . . . is not per se commercial use." *See* Bally Total Fitness Holding Corp. v. Faber, 29 F. Supp. 2d 1161, 1166 (C.D. Cal. 1998); *see also* 4 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 24:97.2 (2004).

59. *Mayflower*, 314 F. Supp. 2d at 369.

60. *See* Lucas Nursery & Landscaping, Inc. v. Grosse, 359 F.3d 806, 810 (6th Cir. 2004).

61. *See* TMI Inc. v. Maxwell, 368 F.3d 433, 439-40 (5th Cir. 2004).

62. *See* Bosley Med. Inst., Inc. v. Kremer, No. 01-1752 WQH (JMA), 2004 U.S. Dist. LEXIS 8336, at *27 (S.D. Cal. Apr. 30, 2004).

63. *See, e.g.*, E.&J. Gallo Winery v. Spider Webs Ltd., 286 F.3d 270, 275 (5th Cir. 2002). For a similar holding under non-ACPA causes of action, see People for the Ethical Treatment of Animals v. Doughney, 263 F.3d 359, 365-66 (4th Cir. 2001), and Planned Parenthood Fed'n of Am., Inc. v. Bucci, No. 97 Civ. 0629 (KMW), 1997 U.S. Dist. LEXIS 3338, at *15 (S.D.N.Y. Mar. 24, 1997).

mark, then clearly a per se rule that considers such a domain name to be a commercial use is inappropriate.[64]

Instead, the 2004 cases establish that criticism constitutes a bona fide *noncommercial* use within the meaning of the fourth factor of the ACPA. Further, the courts' emphasis on the fourth and sixth factors of the ACPA appears to create a judicial safe harbor for a same-name griper who does not attempt to sell the domain name and does not include commercial content in his site.[65] The gripers did not offer products or services, display banner advertising, link to other sites offering products for sale,[66] or make any statements that could be reasonably construed as attempts to sell the domain name to the mark owners. Further, their criticism was a response to a dispute, not a cover-up for classic domain-name speculating. Since courts are free to weigh these factors more heavily than the other factors, the absence of these activities, in accordance with congressional intent, justifies a holding that the griper lacks the bad-faith intent to profit required by the ACPA.

2. *Stepping Outside the Judicial Safe Harbor*

The judicial safe harbor does not automatically protect a gripe site simply because it criticizes the mark owner. A griper can take, or fail to take, actions that may jeopardize the judicial safe harbor. The first three ACPA factors almost always weigh against the same-name griper.[67] The

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64. *See* 15 U.S.C. § 1125(d)(1)(A)(ii)(I), (d)(1)(B)(i)(IV) (2000).

65. Other cases holding similarly under the ACPA include *Northland Insurance Companies v. Blaylock*, 115 F. Supp. 2d 1108 (D. Minn. 2000). *But see, e.g.*, Toronto-Dominion Bank v. Karpachev, 188 F. Supp. 2d 100, 114 (D. Mass. 2002) (holding a gripe site to not be a "fair use").

66. With the possible exception of *Bosley*, where the gripe site may have contained links to industry websites. *Bosley*, 2004 U.S. Dist. LEXIS 8336, at *24.

67. The first ACPA factor inquires into the defendant's own trademark rights in the domain name. 15 U.S.C. § 1125(d)(1)(B)(i)(I). For instance, many companies could claim trademark rights in the domain name <delta.com>: an airline, a faucet manufacturer, and a dental insurance provider, among others. The typical same-name griper will himself have no trademark rights in the domain name. The second factor looks for something similar, a situation where the defendant's legal name *is* the domain name. *Id.* § 1125(d)(1)(B)(i)(II). Unless the griper happens to be named John Deere or Betty Crocker, he or she will be out of luck. (In early 2004, 17-year-old Mike Rowe agreed to relocate his website at <mikerowesoft.com> after reaching an agreement with Microsoft. The terms of the settlement included a free Xbox game console. *Microsoft to Take Over MikeRoweSoft.com*, CNN.COM, Jan. 26, 2004, *at* http://www.cnn.com/2004/TECH/internet/01/26/mikerowesoft.settle.ap). The third factor asks whether the defendant has previously made a "bona fide" use of the domain name to offer goods or services. 15 U.S.C. § 1125(d)(1)(B)(i)(III). By "bona fide," the statute likely is referring to a situation

ninth factor could go either way: it weighs against the griper if the mark is particularly well-known or distinctive and in his favor if not.[68] However, as noted above, the 2004 cases' focus on the fourth and sixth factors means that these factors are not likely to be determinative. The courts are likely to focus instead on behavior relevant under the other bad-faith factors.

a) Commercial Use

Selling or intending to sell competing goods clearly takes the registrant outside the safe harbor.[69] But a griper might take smaller steps toward commercial activity. For instance, a griper might place banner advertisements or links to commercial sites on his site.[70] The ads and links would be most relevant to the fourth factor, which requires noncommercial use. In the 2004 cases, the courts considered the absence of commercial ads or links to weigh in the defendants' favor.[71] Further, courts have held the presence of such ads or links sufficient to weigh the fourth factor against the defendant. In *PETA*, links to organizations promoting meat, fur, and leather, along with the likelihood of diverting consumers, were sufficient to vitiate a claim of noncommercial use.[72] In contrast, the court in *Bosley* was unwilling to find commercial use from tangential commercial content. The *Bosley* website criticized a hair clinic and contained links to other hair industry websites.[73] These sites in turn featured links to commercial sites.[74] Thus, banner ads or links to clearly commercial sites probably pre-

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similar to the first factor: a defendant who has been using the mark for unrelated goods. A same-name griper will lose on this factor as well.

68. *See Gallo*, 286 F.3d at 276; Sporty's Farm L.L.C. v. Sportsman's Market, Inc., 202 F.3d 489, 499 (2d Cir. 2000).

69. *See Sporty's Farm*, 202 F.3d at 499. *See generally* Hale, *supra* note 21 (analyzing the case).

70. *See* Lifshitz, *supra* note 6, at 532 (describing a dispute in which advertising revenue supported a conclusion under a trademark infringement claim that the cybersquatter's use was "in commerce").

71. *See* TMI Inc. v. Maxwell, 368 F.3d 433, 438 (5th Cir. 2004); *Bosley*, 2004 U.S. Dist. LEXIS 8336, at *24; Mayflower Transit, LLC v. Prince, 314 F. Supp. 2d 362, 371-72 (D.N.J. 2004).

72. People for the Ethical Treatment of Animals v. Doughney, 263 F.3d 359, 364-65, 369 (4th Cir. 2001). In another infringement case, not involving the ACPA, the defendant's links to his own web design company, and to his girlfriend's blouse company, constituted use of the plaintiff's mark in connection with the advertising of goods. Taubman Co. v. Webfeats, 319 F.3d 770, 775 (6th Cir. 2003). A use in connection with the advertising of goods would likely not be a noncommercial use under the ACPA.

73. *Bosley*, 2004 U.S. Dist. LEXIS 8336, at *24.

74. *Id.*

clude the fourth-factor safe harbor, while links to general industry sites are more likely safe.

A cybergriper might offer and charge for services on his site such as a dating service for jilted consumers. Such behavior would likely weigh against the safe harbor. In *Bosley*, for instance, it was relevant that the defendant was "not engaged in his own business enterprise."[75] In *TMI*, the Fifth Circuit noted the absence of evidence that the defendant had any intent to charge for the use of his site.[76] Additionally, a website that solicits contributions—or even that is simply part of a broad political movement that solicits contributions—has been held to be "commercial" under other areas of the Lanham Act.[77]

b) Offers to Sell

As described above, the presence or absence of an offer to sell the domain name can weigh heavily into the bad-faith inquiry under the sixth factor. *Mayflower* suggests that a court will take into account the griper's frustration with his unpleasant commercial experience and interpret his statements in a more charitable light.[78] In that case, the court read the griper's demand that the moving company "'do something' about the dispute" as a demand for change in the company's business practices rather than a demand for a payout.[79] In *Bosley*, the griper sent a letter threatening to harm the company's business by disseminating criticism over the Internet, but offering to "discuss" the matter first.[80] According to the court, the letter did not constitute an offer to sell the domain name, though the possibility of a quid pro quo was perhaps implicit.[81] Similarly, in *Interstellar Starship Services, Ltd. v. Epix Inc.*, an offer to sell made by the defendant's attorney during settlement negotiations, without the defendant present, did not constitute bad faith.[82]

On the other hand, the court found an implicit offer to sell in *Morrison & Foerster* based on the information the defendant provided when he registered the disputed domain names. In that case, the griper registered the domain under the name "NameIsForSale.com."[83] The website at <nameis-

75. *Id.*
76. *TMI*, 368 F.3d at 438.
77. Planned Parenthood Fed'n of Am., Inc. v. Bucci, No. 97 Civ. 0629 (KMW), 1997 U.S. Dist. LEXIS 3338, at *19 (S.D.N.Y. Mar. 24, 1997).
78. *See* Mayflower Transit, LLC v. Prince, 314 F. Supp. 2d 362, 369 (D.N.J. 2004).
79. *Id.*
80. *Bosley*, 2004 U.S. Dist. LEXIS 8336, at *26.
81. *See id.*
82. 304 F.3d 936, 947 (9th Cir. 2002).
83. Morrison & Foerster LLP v. Wick, 94 F. Supp. 2d 1125, 1127 (D. Colo. 2000).

forsale.com> encouraged visitors to "[n]ame the property" (that is, the domain name) they wanted to sell or buy.[84] In *PETA*, the defendant's explicit statements swayed the sixth factor against him. The griper had made comments on his website and in the press suggesting that PETA "settle" with him or "make him an offer."[85] For a defendant engaged in the business of selling domain names, a simple offer to "assist" the mark owner may constitute an offer to sell.[86] Further, the mere fact that the defendant has offered to sell *other* domain names may weigh against him.[87]

However, a griper likely may sell the domain without fear if the mark owner initiates the transaction. According to *Taubman Co. v. Webfeats*, decided under another section of the Lanham Act, acceptance of an offer "under threat of litigation" does not indicate the griper's initial intent was to sell the domain name.[88]

c) Offensive Content

The manner in which the griper conveys his criticism may also jeopardize his safe harbor. Courts have drawn a distinction between criticism that is "bona fide" under the fourth factor and that which is simply a pretext for inconveniencing the mark owner or for claiming fair use.[89] For instance, it appears that racist or pornographic content, or slurs against the plaintiff, may not be a bona fide noncommercial use. The websites in the 2004 cases, where the defendants were exonerated, consisted primarily of warnings to other consumers and descriptions of the gripers' mistreatment at the hands of the plaintiffs.[90] In contrast, the griper's site in *Morrison & Foerster* contained disparaging comments such as "Greed is good!" and "Parasites No Soul . . . No Conscience . . . NO PROBLEM."[91] The defen-

84. *Id.* at 1132.

85. People for the Ethical Treatment of Animals v. Doughney, 263 F.3d 359, 368 (4th Cir. 2001).

86. E.&J. Gallo Winery v. Spider Webs Ltd., 286 F.3d 270, 275-76 (5th Cir. 2002) (citing the defendant's offer to "assist" the plaintiff as evidence the defendant intended to sell the domain to the plaintiff).

87. *Id.*

88. Taubman Co. v. Webfeats, 319 F.3d 770, 776 (6th Cir. 2003).

89. *See, e.g.*, Shields v. Zuccarini, 254 F.3d 476, 485-86 (3d Cir. 2001).

90. TMI Inc. v. Maxwell, 368 F.3d 433, 435 (5th Cir. 2004) (a narrative of the dispute); Lucas Nursery & Landscaping, Inc. v. Grosse, 359 F.3d 806, 808 (6th Cir. 2004) (complaints about the hasty nature of plaintiff's work); Bosley Med. Inst., Inc. v. Kremer, No. 01-1752 WQH (JMA), 2004 U.S. Dist. LEXIS 8336, at *4 (S.D. Cal. Apr. 20, 2004) ("numerous derogatory and critical statements" about plaintiff); Mayflower Transit, LLC v. Prince, 314 F. Supp. 2d 362, 366 (D.N.J. 2004) (warnings such as "do not do business with [plaintiffs] . . . . Don't be their next victim!").

91. Morrison & Foerster LLP v. Wick, 94 F. Supp. 2d 1125, 1128 (D. Colo. 2000).

dant also posted links to sites with offensive names such as <www.jewkike.com>.[92] The court concluded that the site simply was "not bona fide parody."[93] While the court did not cite the offensive content of the defendant's site as a basis for its rejection of the parody defense, one can reasonably infer that the scurrilous nature of the slurs played some role in the court's decision.[94] Such a view would be in accordance with congressional intent that a pretextual parody not serve as an inoculant against the ACPA.[95]

It is worth noting that while the 2004 cases did not address the parody defense specifically, by allowing same-name griping on other grounds they avoid an uncomfortable holding of *Morrison & Foerster*. In that case, the griper claimed that the First Amendment protected his use of the domain name as a parody.[96] The court rejected this defense because the griper's *domain names*[97] were not themselves parodies: they did not simultaneously refer to and ridicule the law firm of Morrison & Foerster.[98] The court considered irrelevant whether the *website* at the domain was a parody. But it is difficult to see how any meaningful parodic message could be conveyed within the limited length and character set of a domain name. Legislative history suggests that Congress intended to provide a parody

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92. *Id.*

93. *Id.* at 1131; *see also* Lucent Techs., Inc. v. Lucentsucks.com, 95 F. Supp. 2d 528, 535-36 (E.D. Va. 2000) (noting in dicta that an "*effective* parody . . . would seriously undermine" a claim of bad faith) (emphasis added).

94. *See* Silberlight, *supra* note 22, at 297 (observing that the *Morrison & Foerster* court disapproved of the defendant's "personal, vengeful tactics").

95. SENATE REPORT, *supra* note 2, at 9 ("To recognize such an exemption would eviscerate the protections of the bill by suggesting a blueprint for cybersquatters who would simply create criticism sites in order to immunize themselves from liability despite their bad-faith intentions."). Congress was also concerned about pornographic sites posted by squatters, so presumably such sites would not be bona fide noncommercial uses. *See id.* at 6. An additional case that is difficult to reconcile with the 2004 decisions can perhaps best be understood as falling under a "pretextual" exception to the judicial safe harbor. In *Toronto-Dominion Bank*, where the griper compared the plaintiff to Nazis and described a murder that could have been interpreted as a threat, the court conclusorily rejected a claim to fair use. Toronto-Dominion Bank v. Karpachev, 188 F. Supp. 2d 110, 111, 114 (D. Mass. 2002). Because the court did not explain its reason for rejecting the defense, one can only speculate that the court was swayed by the wild nature of the griper's accusations. *See id.* at 114.

96. *Morrison & Foerster*, 94 F. Supp. 2d at 1134.

97. The domain names included <morrisonfoerster.com>, <morrisonandfoerster.com>, <morrisonforester.com>, and <morrisonandforester.com>. *Id.* at 1127.

98. *See id.* at 1134-35.

defense against squatting.[99] Yet the *Morrison & Foerster* holding would amount to a per se rule against parody for a same-name griper.[100]

d) False Identification

Under the seventh factor, a griper who uses false contact information when he registers the domain increases his chance of liability.[101] In *Morrison & Foerster*, the griper failed to supply his full name and address, instead giving a P.O. box and e-mail address.[102] The court viewed this as evidence of bad faith.[103] In contrast, in *Northland Insurance Companies v. Blaylock*, the court refused to weigh this factor against the defendant even though he had provided a false company name in his registration.[104] The fact that the defendant provided his correct address and subsequently corrected the false company name weighed in his favor.[105]

e) Multiple Registrations

A griper who registers multiple domain names similar to the mark increases his chance of liability under the eighth factor.[106] The factor targets the classic "warehouser" of domain names who registers domains by the dozen in order to extort payment from mark owners. The exact number of domain names necessary to suggest bad faith is unclear. In *Mayflower*, the griper registered three domains, each similar to the name of a party involved in the dispute.[107] The court held that the factor cut both ways: on

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99. *See* SENATE REPORT, *supra* note 2, at 9.

100. *But see* Xiao, *supra* note 21, at 176 (arguing that the *Morrison & Foerster* court's holding on parody is consistent with the ACPA's purpose of curtailing cybersquatting).

101. *See* 15 U.S.C. § 1125(d)(1)(B)(i)(VII) (2000).

102. *Morrison & Foerster*, 94 F. Supp. 2d at 1132.

103. *Id.*

104. The defendant registered the domain under the name "North Land Insurance Company," a name nearly identical to the plaintiff's. 115 F. Supp. 2d 1108, 1124 (D. Minn. 2000).

105. *Id.* at 1124-25.

106. 15 U.S.C. § 1125(d)(1)(B)(i)(VIII).

107. The domain names were <mayflowervanline.com> for the national moving company, Mayflower Transit; <lincolnstoragewarehous.com> for Lincoln Storage Warehouses, an affiliated agent of Mayflower; and <cumberlandinsurancegrp.com> for an insurer involved in the claim. Mayflower Transit, LLC v. Prince, 314 F. Supp. 2d 362, 365-66 (D.N.J. 2004); *see also* TMI Inc. v. Maxwell, 368 F.3d 433, 434-35, 440 (5th Cir. 2004) (considering a defendant who registered two variations on the plaintiff's TRENDMAKER HOMES mark: <trendmakerhome.com> and <trendmakerhome.info> and holding that because the defendant registered the two domains "for the same purposes," and only registered the ".info" domain after the ".com" registration expired, this factor did not harm the defendant).

one hand, the defendant indeed registered multiple domains; on the other hand, all the registrations related to involved parties and "could reasonably be considered part of [defendant's] wider criticism of the . . . incident" that prompted his dissatisfaction.[108] In contrast, in *Toronto-Dominion Bank*, the griper registered sixteen misspelled variations of the plaintiff's TD WATERHOUSE mark.[109] The eighth factor therefore weighed against the defendant.[110]

f) Implicit Disclaimers

Diverting the mark owner's customers to the gripe site may weigh against the griper under the fifth bad-faith factor. The factor weighs against a defendant if the following elements are met: 1) intent to divert consumers from the mark owner's official site, 2) for commercial gain or with intent to disparage, 3) by creating a likelihood of confusion.[111] It is difficult for a same-name griper to argue successfully that he did not intend to divert consumers given that he chose a domain name identical to the mark.[112] Thus, the griper seems to meet the first element. A pure-criticism site would not seem to meet the "commercial gain" requirement, but would meet the alternate "intent to disparage" criterion of the second element.[113] However, arguably, a griper should be exonerated on this factor by the third element. Pejorative content on the gripe site should alert the consumer that this is not the mark owner's official site, thus eliminating any likelihood of confusion. In other words, pejorative content serves as an implicit disclaimer.

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108. *Mayflower*, 314 F. Supp. 2d at 369; *see also TMI*, 368 F.3d at 440 (weighing the eighth factor in favor of a same-name griper where he registered a second domain name only after registration of his first gripe site expired).

109. Toronto-Dominion Bank v. Karpachev, 188 F. Supp. 2d 110, 111 (D. Mass. 2002).

110. *Id.* at 114.

111. *See* 15 U.S.C. § 1125(d)(1)(B)(i)(V). While the "likelihood of confusion" language suggests a trademark infringement-style inquiry, the courts typically conduct a superficial analysis rather than a multi-factor inquiry in the manner of *AMF, Inc. v. Sleekcraft Boats*, 599 F.2d 341 (9th Cir. 1979).

112. *But see TMI*, 368 F.3d at 440 (holding the fact that the domain name was nearly identical to the mark insufficient to show intent to divert). If the mark owner does not have a website, the fifth factor automatically weighs in favor of the griper. Lucas Nursery & Landscaping, Inc. v. Grosse, 359 F.3d 806, 810 (6th Cir. 2004).

113. *But see* Northland Ins. Cos. v. Blaylock, 115 F. Supp. 2d 1108, 1114, 1124 (D. Minn. 2000) (weighing the fifth factor in favor of a cybergriper because of a lack of intent to "tarnish," even though the site "house[d] complaints and criticism of plaintiff's business").

Gripe cases under the ACPA have not consistently adhered to this view. In *Mayflower*, for instance, the court found the fact that consumers attempting to reach the company's official site might inadvertently reach the gripe site sufficient to turn the fifth factor against the defendant, despite the site's pejorative content.[114] Similarly, in *Morrison & Foerster*, the court held that "a user may wonder about [law firm] Morrison & Foerster's affiliation with the sites or endorsement of the sites," even though the gripe sites contained paranoid, anti-Semitic, and anticorporate rantings.[115] On the other hand, the *Bosley* court, although not explicitly analyzing the fifth factor, noted that pejorative content would "immediately alert a visitor . . . that he had not accessed" the mark owner's official site.[116]

Arguably, even if pejorative content dispels any likelihood of confusion once the consumer has looked at the gripe site, the court should weigh the fifth factor against the defendant based on the trademark infringement doctrine of initial interest confusion.[117] Initial interest confusion is one way a likelihood of confusion may arise under a trademark infringement claim. It occurs when an unscrupulous seller uses someone else's mark to get a customer's initial attention, even if the seller immediately thereafter makes clear that his goods are not the same as the mark owner's. A classic example involves a fast-food restaurant, brand X, that erects a highway billboard telling motorists there is a brand Y restaurant at this exit. Only after motorists get off the highway do they discover that there is no brand Y here, only brand X. Consumers are no longer confused, but having gone to the trouble of getting off the highway, many consumers will simply throw up their hands and take X rather than hold out for Y.

In the Internet context, the use of the mark as the domain name could cause initial interest confusion because, as noted in *Morrison & Foerster*, perhaps the most common method of finding a website is to type in the company name with the suffix ".com."[118] The consumer seeking MoFo, like the motorist seeking brand Y, naturally expects to find the law firm at

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114. Mayflower Transit, LLC v. Prince, 314 F. Supp. 2d 362, 368 (D.N.J. 2004).

115. *See* Morrison & Foerster LLP v. Wick, 94 F. Supp. 2d 1125, 1132 (D. Colo. 2000). Other cases weighing the fifth factor against a registrant include E.&J. Gallo Winery v. Spider Webs Ltd., 286 F.3d 270, 276 (5th Cir. 2002); People for the Ethical Treatment of Animals v. Doughney, 263 F.3d 359, 369 (4th Cir. 2001); and Toronto-Dominion Bank v. Karpachev, 188 F. Supp. 2d 110, 114 (D. Mass. 2002).

116. Bosley Med. Inst., Inc. v. Kremer, No. 01-1752 WQH (JMA), 2004 U.S. Dist. LEXIS 8336, at *30 (S.D. Cal. Apr. 30, 2004).

117. *See, e.g.*, Interstellar Starship Servs., Ltd. v. Epix Inc., 304 F.3d 936, 942 (9th Cir. 2002).

118. *See Morrison & Foerster*, 94 F. Supp. 2d at 1132.

<morrisonandfoerster.com>,[119] but instead finds a gripe site.[120] However, under many circuits' approach to initial-interest confusion, a griper is likely in the clear because of the wide disparity between the "goods" he offers—criticism—and the goods offered by the mark owner.[121]

g) Explicit Disclaimers

An explicit notice on the gripe site, indicating that it is not the mark owner's site, is also relevant under the fifth factor of the ACPA. The *Bosley*, *Lucas*, and *Taubman* courts all held that a disclaimer dispelled any potential confusion.[122] In addition, a link to the mark owner's official site helps ward off a claim of bad faith.[123] On the other hand, because it only takes effect once the consumer has reached the gripe site, a disclaimer would likely have no effect under the fifth factor if the court were to accept a plaintiff's claim of initial-interest confusion.[124]

B. Pejorative-Suffix Griping

Pejorative-suffix griping consists of setting up a complaint site at a domain name that includes the mark, or a close variation on it, and an additional pejorative suffix, such as "sucks" or "beware" or "warning." For example, a pejorative-suffix griper might register <mayflowervanlinebeware.com>.[125]

1. *Applying the ACPA*

In contrast to a same-name griper, when the ACPA is applied to a pejorative-suffix griper, it is not even clear that we reach the bad-faith factors. The ACPA requires that the domain name be "identical or confus-

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119. Internet domain names cannot use ampersands.

120. One area where the analogy with the motorist example fails is that in the motorist example, the brand X restaurant created the confusion by erecting the billboard. On the Internet, the griper does not do anything to create consumers' expectation that MoFo will be at <morrisonandfoerster.com>.

121. *See, e.g.*, Nissan Motor Co. v. Nissan Computer Corp., 378 F.3d 1002, 1018-19 (9th Cir. 2004); Checkpoint Sys., Inc. v. Check Point Software Techs., Inc., 269 F.3d 270, 297 (3d Cir. 2001); Deere & Co. v. MTD Holdings, Inc., No. 00 Civ. 5963 (LMM), 2004 U.S. Dist. LEXIS 2550, at *45-*47 (S.D.N.Y. Feb. 19, 2004).

122. Lucas Nursery & Landscaping, Inc. v. Grosse, 359 F.3d 806, 810 (6th Cir. 2004); Taubman Co. v. Webfeats, 319 F.3d 770, 776 (6th Cir. 2003) (considering another section of the Lanham Act); Bosley Med. Inst., Inc. v. Kremer, No. 01-1752 WQH (JMA), 2004 U.S. Dist. LEXIS 8336, at *29-*30 (S.D. Cal. Apr. 30, 2004).

123. Rohr-Gurnee Motors, Inc. v. Patterson, No. 03 C 2493, 2004 U.S. Dist. LEXIS 2068, at *14-15 (N.D. Ill. Feb. 9, 2004) (holding that the defendant's link from her gripe site to the plaintiff's site weighed in favor of her reasonable belief of fair use).

124. See the discussion of implicit disclaimers *supra* Part III.A.2.f.

125. *See* Mayflower Transit, LLC v. Prince, 314 F. Supp. 2d 362, 365 (D.N.J. 2004).

ingly similar to" a non-famous mark.[126] But in a pejorative-suffix case, the domain name is not identical to the mark. Nor is it confusingly similar to the mark, because the pejorative suffix should dispel any confusion. No consumer would reasonably believe, for instance, that <chevysucks.com> was in any way affiliated with Chevrolet. Recent pejorative-suffix cases confirm this view.[127]

The language of the ACPA suggests another route against a pejorative-suffix griper, at least for an owner of a famous mark. For a famous mark, the domain name need not be "identical or confusingly similar to" the mark to engender liability; it may also be "dilutive of" the mark.[128] The ACPA is not clear, however, as to what it means by "dilutive of" in this context, and how the "dilutive of" test should be applied.[129]

a) Defining the "Dilutive of" Requirement

It seems reasonable to assume that the ACPA refers to the FTDA, which created the federal dilution cause of action in 1995.[130] Dilution under the FTDA refers to the "lessening of the capacity of a famous mark to identify and distinguish goods or services," regardless of whether the mark owner and other parties compete in the marketplace and regardless of the likelihood of consumer confusion.[131] There are two types of dilution identified by scholars.[132] The classic type of dilution is "blurring," which occurs when another party uses a famous mark to identify other, unrelated goods.[133] Although there is no likelihood of confusion, and thus no trademark infringement, the "capacity of [the] famous mark to identify" the original goods is weakened because the famous mark may no longer call to mind the original goods and those goods alone.[134] For instance, the BUICK trademark is strongly linked to cars, and only cars, in most con-

126. 15 U.S.C. § 1125(d)(1)(A)(ii) (2000).

127. *See* Lucent Techs., Inc. v. Lucentsucks.com, 95 F. Supp. 2d 528, 535 (E.D. Va. 2000); *see also Taubman*, 319 F.3d at 778 (holding that a pejorative suffix removes any possibility of confusion under an infringement cause of action).

128. 15 U.S.C. § 1125(d)(1)(A)(ii)(II).

129. This Note does not consider dilution as applied to same-name griping. The "dilutive of" language in the ACPA is superfluous for a same-name griper because a same-name griper's domain name is, by definition, "identical or confusingly similar to" the mark. *See* 15 U.S.C. § 1125(d)(1)(A)(ii)(II).

130. *See id.* § 1125(c); Moseley v. V Secret Catalogue, Inc., 537 U.S. 418, 420-21 (2003).

131. *See* 15 U.S.C. § 1127.

132. 4 MCCARTHY, *supra* note 58, § 24:67.

133. *See id.* § 24:68.

134. *See* 15 U.S.C. § 1127.

sumers' minds; an aspirin sold under the same name would dilute the BUICK mark by weakening that link.[135]

The second type of dilution is "tarnishment," which occurs when another party's unauthorized use degrades the mark.[136] Use of the trademark on shoddy goods or in an unwholesome or derogatory context may cause dilution through tarnishment.[137] Despite the recognition of tarnishment as a form of dilution by scholars, it is not clear that the FTDA authorizes a federal remedy against tarnishment. Some legislative history and application of the FTDA suggests that it does.[138] On the other hand, as the Supreme Court has noted, the language of the statute suggests otherwise.[139]

A literal interpretation of the "dilutive of" prong of the ACPA suggests that the plaintiff must prove all the elements of dilution merely to fulfill that prong.[140] But asking the plaintiff to meet the substantial hurdle of proving dilution simply as a "gateway" into the ACPA would render the ACPA essentially superfluous in these situations. After all, remedies for dilution already include surrendering the domain name,[141] the primary remedy authorized by the ACPA.[142] Further, prior to the passage of the ACPA, dilution was the primary cause of action against squatters.[143] As noted by Congress, the ACPA was enacted to catch squatters who fall

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135. *See* H.R. REP. NO. 104-374, at 3 (1995).

136. 4 MCCARTHY, *supra* note 58, § 24:69.

137. *Id.* § 24:104.

138. The FTDA was intended "to protect famous trademarks from subsequent uses that blur the distinctiveness of the mark or tarnish or disparage it . . . ." 141 CONG. REC. H1295 (daily ed. Dec. 12, 1995) (statement of Rep. Moorhead); *see also* Hormel Foods Corp. v. Jim Henson Prods., 73 F.3d 497, 507 (2d Cir. 1996); Dr. Seuss Enters., L.P. v. Penguin Book USA, Inc., 924 F. Supp. 1559, 1573 (S.D. Cal. 1996).

139. Moseley v. V Secret Catalogue, Inc., 537 U.S. 418, 432 (2003). State laws such as Massachusetts's, noted in *Moseley*, provide relief for "injury to business reputation." *Id.* at 430 (quoting 1947 Mass. Acts, p. 300, ch. 307). This would be tarnishment.

140. Proving dilution was made more difficult by the Supreme Court's holding that the FTDA requires proof of actual dilution, not merely the likelihood of dilution. *Moseley*, 537 U.S. at 432-33; *see also* Brian Paul Gearing, Note, Moseley v. V Secret Catalogue, Inc., 19 BERKELEY TECH. L.J. 221, 233-40 (2004) (discussing the effect of the decision on the difficulty of proving dilution).

141. *See* Panavision Int'l, L.P. v. Toeppen, 945 F. Supp. 1296, 1306 (C.D. Cal. 1996), *aff'd*, 141 F.3d 1316 (9th Cir. 1998).

142. *See* 15 U.S.C. § 1125(d)(1)(C) (2000).

143. *See, e.g.*, *Panavision*, 141 F.3d at 1324-27; Northland Ins. Cos. v. Blaylock, 115 F. Supp. 2d 1108 (D. Minn. 2000); Planned Parenthood Fed'n of Am., Inc. v. Bucci, No. 97 Civ. 0629 (KMW), 1997 U.S. Dist. LEXIS 3338 (S.D.N.Y. Mar. 24, 1997). *Northland* included a dilution claim as well as an ACPA claim.

through the cracks of a dilution claim.[144] The "gateway" interpretation is at odds with this goal.

b) Applying the "Dilutive of" Requirement

Assuming the ACPA requires dilution as a threshold inquiry for a domain name not "identical or confusingly similar to" the mark,[145] the court in *Bally Total Fitness Holding Corp. v. Faber* arguably held that a pejorative-suffix griper does not blur.[146] In *Bally*, the defendant established a gripe site at the URL <www.compupix.com/ballysucks>.[147] The court concluded that the griper's use was not a commercial use in commerce—an essential element of a dilution claim[148]—despite the fact that the defendant referred to the gripe site when promoting his web design skills elsewhere on his website.[149] That the BALLY mark appeared in a directory name on the web server, rather than in the domain name, is probably irrelevant because a holding of commercial use for a clean-hands pejorative-suffix griper would probably depend on a likelihood of diverting consumers.[150] <ballysucks.com> is no more likely to divert consumers seeking the official Bally site than <www.compupix.com/ballysucks>.

Similarly, a tarnishment claim against a pejorative-suffix gripe site would likely fail because of the commercial use in commerce element.[151] Even if the commercial use requirement were met, however, use of the plaintiff's mark "in the context of a consumer commentary" is a protected use "necessary to maintain broad opportunities for expression."[152]

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144. SENATE REPORT, *supra* note 2, at 16 ("'Warehous[ers]' . . . . have been largely successful in evading the case law developed under the Federal Trademark Dilution Act.").

145. 15 U.S.C. § 1125(d)(1)(A)(ii)(II).

146. 29 F. Supp. 2d 1161 (C.D. Cal. 1998).

147. *Id.* at 1162.

148. The primary elements relevant to our inquiry that a plaintiff must establish to prove blurring are: 1) defendant's use must cause dilution of the distinctive quality of plaintiff's mark; and 2) defendant's use of the mark must be a commercial use in commerce. *Northland*, 115 F. Supp. 2d at 1122. The other elements are: "plaintiff's mark must be famous;" "plaintiff's mark must be distinctive;" and "the use must have occurred after the plaintiff's mark . . . [became] famous." *Id.*

149. *Bally*, 29 F. Supp. 2d at 1167.

150. *See* People for the Ethical Treatment of Animals v. Doughney, 263 F.3d 359, 364-66 (4th Cir. 2001) (holding that the likelihood of diverting consumers contributed to rendering the defendant's use "in connection with" the sale of goods under a trademark infringement claim).

151. *See Bally*, 29 F. Supp. 2d at 1167.

152. *See id.*

c) An Alternate View of the "Dilutive of" Requirement

More likely, by placing "dilutive" domain names within reach of the ACPA, Congress merely meant to enable litigation against domain names that *might* blur or tarnish famous marks but for the commercial use requirement of the FTDA. In other words, <buickaspirin.com> and <buicksucks.com> would pass the identical, confusingly similar, or dilutive prong of the ACPA based on a prima facie inquiry. <buickaspirin.com> and <buicksucks.com> lessen the mental link between the BUICK mark and cars, or cast aspersions on the BUICK mark. Accordingly, the court could proceed to the bad-faith inquiry.

The court's inquiry into bad faith would be nearly identical to that for a same-name griper, with the exception of the fifth factor. This is because the only difference between a same-name griper and a pejorative-suffix griper is the domain name used. Yet the domain name used is only important under the first, second, and fifth factors. The other factors focus instead on extrinsic elements such as the registrant's behavior and the site's content.

Of the factors related to the domain name, as noted in Part III.A.1, only the fifth factor is likely to matter in a griper case. This factor, focusing on intent to divert consumers from the mark owner's official site, would automatically weigh in favor of the griper because <buicksucks.com> does not divert consumers seeking out <buick.com>. Moreover, because the fifth factor is rarely a determining element in an ACPA case, even if a court found that the fifth factor weighed against a pejorative-suffix griper, the fourth and sixth factors could still warrant a finding of no liability. Because the activities that may jeopardize the judicial safe harbor are also unrelated to the actual domain name used, the analysis of these activities, in Part III.A.2, applies here as well.

IV. CONCLUSION

Congress did not intend the ACPA to prohibit the use of a domain name for non-pretextual criticism or parody.[153] By creating a judicial safe harbor for cybergripers posting bona fide criticism or parody without commercial content, links to commercial sites, or offers to sell, the 2004 cybergriper decisions reflect the correct interpretation of the ACPA as to both same-name and pejorative-suffix gripers in light of congressional intent. This interpretation is probably not the best outcome from the perspective of mark owners and satisfied consumers who merely seek conven-

153. SENATE REPORT, *supra* note 2, at 9.

ience in using the Internet. Yet, in the absence of a change in the tide of judicial opinion, mark owners likely are stuck. They will have to rely on prompt registration of their trademarks or payoffs to irate consumers to keep savvy gripers shunted into obscure corners of the web.

PLAYBOY ENTERPRISES, INC. V. NETSCAPE COMMUNICATIONS CORP.: MAKING CONFUSION A REQUIREMENT FOR ONLINE INITIAL INTEREST CONFUSION

By Joseph V. Marra

The Internet enables advertisers to target consumers with unprecedented specificity and efficiency. Search engines rapidly take consumer input and match it to responsive ads, webpages, and other web-based services. The era of blanket information dissemination is giving way to one of exact, pinpoint consumer targeting. Advertisers no longer have to guess what a consumer wants: they now have that information waiting for them in search boxes and address bars throughout cyberspace. One consequence of this change is that Internet advertisers are putting trademarks to new uses. For example, metatags—code embedded in a webpage, invisible to users but detected by search engines—utilize trademarks to link users with specific online content. Advertisers also use trademarks in domain names and banner advertisements. These and other novel uses of trademarks continue to proliferate along with the Internet itself.

In response to the proliferation of online trademark uses, courts have expanded trademark doctrine to cover more trademark uses than ever before. For example, courts have recently turned to old-fashioned, brick-and-mortar doctrines to stem the flow of cutting-edge trademark uses. Specifically, initial interest confusion, a doctrine established before the Internet appeared,[1] is a favorite of courts intent on curbing the use of trademarks in a variety of Internet settings.

These two trends are on a collision course. Multi-billion dollar advertising enterprises, organized around aggressive advertising business models, are bent on using trademarks in myriad new ways to effectively target consumers and generate revenue. Courts and trademark owners show dedication in the opposite direction: they seek to protect trademarks and expand trademark law. With so much at stake, it is critical that courts apply the correct doctrines in the correct fashions. Unfortunately, some

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1. *See* 3 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 23:6 (4th ed. 2004) (citing Grotrian, Helfferich, Schulz, Th. Steinweg Nachf. v. Steinway & Sons, 365 F. Supp. 707 (S.D.N.Y. 1973), as one of the first cases to develop the doctrine of initial interest confusion).

courts are not getting it right, and the doctrine of initial interest confusion has been gravely misapplied in many cases.

The Ninth Circuit has been a hotbed of initial interest confusion decisions involving the Internet. However, at times its application of the doctrine works an abrupt severance of the doctrine from the consumer protection goal of trademark law, tending instead towards recognition of a property right in the trademark itself. Part I of this Note provides a background on trademark law and the initial interest confusion doctrine. The Note in Parts II and III juxtaposes two recent Ninth Circuit opinions: *Brookfield Communications, Inc. v. West Coast Entertainment Corp.*[2] and *Playboy Enterprises, Inc. v. Netscape Communications Corp.*[3] In Part IV, the Note advocates the *Playboy* approach over the *Brookfield* approach, and finally, suggests ways in which the *Playboy* approach might be improved.

I. TRADEMARK LAW AND THE INITIAL INTEREST CONFUSION DOCTRINE

The Lanham Act,[4] the United States' vanguard trademark protection system, serves two main functions. First, it protects consumers against confusion, and therefore reduces decision making costs.[5] Second, it protects an owner's interest in its mark, thereby ensuring an opportunity to reap the financial and goodwill benefits associated with desirable products.[6] Section 1125(c) furthers this latter goal by preventing the "dilution of the distinctive quality of the mark."[7] Although this second function has gained increasing attention since the recognition of trademark dilution,[8] preventing consumer confusion remains the focus of trademark law.[9] In fact, the leading treatise trumpets the likelihood of confusion test as the

2. 174 F.3d 1036 (9th Cir. 1999).

3. 354 F.3d 1020 (9th Cir. 2004).

4. 15 U.S.C. §§ 1051-1141(n) (2000).

5. *Brookfield*, 174 F.3d at 1053 (citing Qualitex v. Jacobsen Prods., 514 U.S. 159, 163-64 (1995)).

6. *Id.*

7. 15 U.S.C. § 1125(c).

8. DAVID S. WELKOWITZ, TRADEMARK DILUTION: FEDERAL, STATE AND INTERNATIONAL LAW 5 (2002) (contrasting dilution and traditional trademark infringement).

9. *But see* C.D.G. PICKERING, TRADE MARKS IN THEORY & PRACTICE 105 (1998) ("It must be recognized that trade mark law is so apparently producer-centered that it is unreal to suggest that consumer influence is anything greater than a secondary consideration."). It is worth noting that dilution theory protects just a particular set of trademarks.

"keystone" of infringement analysis,[10] and the Ninth Circuit recently referred to it as the "core" element of trademark infringement.[11]

Due to the myriad settings in which trademark disputes arise, courts have developed different species of actionable confusion. Traditional confusion describes a scenario where the consumer purchases a good, believing it to be from one producer, when in fact the good is produced by another producer using a confusingly similar mark. In this scenario, confusion occurs at the point of sale. However, in 1962, Congress deleted the word "purchasers" from the Lanham Act,[12] and by 1975, increasing numbers of courts were finding confusion prior to the point of sale.[13] Such presale confusion is commonly referred to as initial interest confusion.

In a brick-and-mortar setting, initial interest confusion is easily applied and appeals to common sense. One often heard example is that of a highway sign indicating that restaurant X is located at a particular exit, when in fact, X's competitor actually posted the sign in order to lead customers to its own restaurant. If would-be X customers are unwilling to get back on the highway and search for X, X's competitor has used confusion to generate initial interest in its own product.

McCarthy provides a second example by analogizing initial interest confusion to a situation where:

> [A] job-seeker who misrepresents [her] educational background on a resumé, obtains an interview and at the interview explains that the inflated resumé claim is a mistake or a "typo." The misrepresentation has enabled the job-seeker to obtain a coveted interview, a clear advantage over others with the same background who honestly stated their educational achievements on their resumes.[14]

This sort of outright deception is rightfully enjoined under trademark law principles.

As advertising competition on the Internet rages, firms are consistently pressing the boundaries of trademark law through enhanced technological means of targeting consumers. Courts have turned to the initial interest confusion doctrine to stop a variety of questionable trademark uses, such

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10. 3 MCCARTHY, *supra* note 1, § 23:6.

11. *Brookfield*, 174 F.3d at 1053.

12. Note, *Confusion in Cyberspace: Defending and Recalibrating the Initial Interest Confusion Doctrine*, 117 HARV. L. REV. 2387, 2392 (2004).

13. G. Gervaise Davis III & Eric B. Boustani, *Initial Interest Confusion and the Internet: A Confusion of Trademark Law Principles*, J. INTERNET L., Jan. 2002, at 2.

14. 3 MCCARTHY, *supra* note 1, § 23.6.

as those in metatagging,[15] domain name registration,[16] and most recently, keyword advertising.[17] However, complications arise when initial interest confusion is applied to online practices. For example, in *Brookfield Communications, Inc. v. West Coast Entertainment Corp.*, the Ninth Circuit applied initial interest confusion to metatags with disastrous effects.

II. *BROOKFIELD*: A CONFUSED COURT

A. The *Brookfield* Holding

"Metatagging" is the process by which words and phrases are embedded in the html code of a website, invisible to users but read by search engines.[18] Search engines sometimes consider these embedded words and phrases as if they actually appeared on screen, which leads to more frequent placement of the metatagged website in search results.[19] These search results, of course, are what the user finally sees.

In *Brookfield*, plaintiff Brookfield offered an entertainment industry database under the trademarked name "Moviebuff."[20] Defendant West Coast registered the domain name "moviebuff.com" to host a site containing a similar database.[21] The defendant also used moviebuff.com within its site's metatags.[22] In reversing the lower court's denial of a preliminary injunction for the plaintiff, the Ninth Circuit applied the initial interest confusion doctrine to the metatags issue.[23]

The court reasoned that, by using "MovieBuff" in the metatags of its website, West Coast was able to divert people looking for "Moviebuff" to its own website, thereby improperly benefiting from the goodwill that Brookfield developed in its mark.[24] The court followed up this statement by offering the familiar analogy of a competitor posting a sign for a trademark owner's store, leading initially confused customers to its own store instead.[25] Yet, the court's own example of initial interest confusion did not fit the facts before it. This is because the initial interest generated

15. *Brookfield*, 174 F.3d at 1043.
16. *Id.*
17. Playboy Enters., Inc. v. Netscape Communications Corp., 354 F.3d 1020, 1022 (9th Cir. 2004).
18. *Brookfield*, 174 F.3d at 1061 n.23.
19. 4 MCCARTHY, *supra* note 1, § 25:69.
20. *Brookfield*, 174 F.3d at 1041-42.
21. *Id.* at 1042.
22. *Id.* at 1043.
23. *Id.* at 1062.
24. *Id.*
25. *Id.* at 1064.

in the defendant's website was simply not the result of confusion, but rather of hidden metatags to which users were oblivious.[26] Interestingly, the court noted the absence of any actual consumer confusion and twice mentioned misappropriation of the plaintiff's goodwill.[27] In short, the court in *Brookfield* used the initial interest confusion doctrine to enjoin initial interest that was not generated by confusion. In doing so, it ignored trademark law's main function and instead treated trademarks like property.

B. *Brookfield*'s Aftermath

Brookfield has been widely cited and followed, spreading its property-rights rationale throughout the courts. For example, in *Promatek Industries, Ltd. v. Equitrac Corp.*,[28] the Seventh Circuit affirmed a preliminary injunction involving the use of trademarks as metatags.[29] In so holding, the *Promatek* court reasoned, "by Equitrac's placing the term Copitrack in its metatag, consumers are diverted to its website and Equitrac reaps the *goodwill* Promatek developed in the Copitrak mark."[30] Moreover, the court noted that "[w]hat is important is not the duration of the confusion, it is the misappropriation of Promatek's *goodwill*."[31] Thus, the Seventh Circuit seems to have subscribed to *Brookfield*'s goodwill analysis, downplaying the confusion facet of initial interest confusion.[32]

In *Bayer Healthcare LLC v. Nagrom, Inc.*,[33] the federal court in the district of Kansas permanently enjoined the defendant from using plain-

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26. *Contra* Chad J. Doellinger, *Trademarks, Metatags and Initial Interest Confusion: A Look into the Past to Reconceptualize the Future*, 41 IDEA 173, 221-24 (2001) (arguing that a web search engine is an extension of the user, so that when it is confused, the user is therefore also confused). Even if the user is not confused via the search engine's "confusion," the list such a search engine generates may confuse users. This is unlikely, however, since such search results usually contain short descriptions below their links, explaining to users the content of each site. *See* Playboy Enters., Inc. v. Netscape Communications Corp., 354 F.3d 1020, 1035 (9th Cir. 2004) (Berzon, J., concurring) ("I do not think it is reasonable to find initial interest confusion when a consumer is never confused as to source or affiliation, but instead knows, or should know, from the outset that a product or web link is not related to that of the trademark holder because *the list produced by the search engine so informs him*.") (emphasis added).

27. *Brookfield*, 174 F.3d at 1062, 1064.

28. 300 F.3d 808 (7th Cir. 2002).

29. *Id.* at 814.

30. *Id.* at 812 (emphasis added).

31. *Id.* at 812-13 (emphasis added).

32. Since the *Promatek* court was reviewing a preliminary injunction, it did not examine the merits of likelihood of confusion in any depth.

33. No. 03-2448-KHV, 2004 U.S. Dist. LEXIS 19454 (D. Kan. Sept. 7, 2004).

tiff's "Advantage" mark to market its pesticides.[34] The defendant used the plaintiff's mark in website titles, in the unauthorized portrayal of the distinctive packaging of the plaintiff's products, and in the metatags for its websites.[35] The *Bayer* court, relying heavily on the holding in *Brookfield*, held that the use of the plaintiff's marks on webpages and in metatags "constitutes an appropriation of goodwill and creates initial interest confusion."[36] The court's cursory treatment of initial interest confusion ended there,[37] thus creating the impression that the court equated an appropriation of goodwill with initial interest confusion.

In *Horphag Research Ltd. v. Pellegrini*, the Ninth Circuit considered another metatagging case, in which the defendant used plaintiff's mark "Pycnogenol" in the metatags of his website.[38] Citing only *Brookfield* for authority, the court held:

> [B]ecause [the defendant] admits to using Horphag's Pycnogenol trademark and specifically admits to using the Pycnogenol mark in the meta-tags for his websites, his use satisfies the terms of trademark infringement in the first instance. Thus, we must determine whether he adequately presents a defense to infringement under the Lanham Act.[39]

Hence, the *Horphag* court seemingly used *Brookfield* to propose that metatagging with a competitor's trademark is per se infringement,[40] at which point it disregarded the traditional infringement test and proceeded directly to an affirmative defense analysis.

The Third Circuit also subscribes to *Brookfield*'s analysis. In *Checkpoint Systems, Inc. v. Check Point Software Technologies, Inc.*,[41] the court considered whether defendant software manufacturer's use of the domain name "www.checkpoint.com" infringed plaintiff security control systems

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34. *Id.* at *17.

35. *Id.* at *5.

36. *Id.* at *15.

37. The *Bayer* court did not employ the likelihood of confusion test.

38. 337 F.3d 1036, 1039 (9th Cir. 2003). The court noted, "[Defendant] is an entrepreneur who has used the Internet site 'healthierlife.com,' among others, to advertise and sell various pharmaceutical products, including 'Pycnogenol' and 'Masquelier's: the original French Pycnogenol.' [Defendant], allegedly to compare his product to Horphag's, repeatedly used Horphag's trademark 'Pycnogenol' as a 'meta-tag.'" *Id.* at 1039.

39. *Id.* at 1040.

40. Judge Berzon's *Playboy* concurrence specifically draws attention to *Horphag*. *See* Playboy Enters., Inc. v. Netscape Communications, Corp., 354 F.3d 1020, 1036 (9th Cir. 2004) (Berzon, J., concurring).

41. 269 F.3d 270 (3d Cir. 2001).

manufacturer's registered "Checkpoint" mark.[42] In affirming the lower court's judgment for the defendant, the *Checkpoint* court found no likelihood of confusion.[43] Its holding explicitly recognized initial interest confusion as applicable within the Third Circuit; however, in the case before it, the Third Circuit found evidence of such confusion de minimis, and the products too disparate, for such confusion to be likely.[44] *Checkpoint* did not involve metatags; however, its reliance on *Brookfield* for examples of initial interest confusion raised the possibility that *Brookfield* applies beyond the metatags setting.[45]

Yet another application of *Brookfield* occurred recently in *Playboy Enterprises, Inc. v. Netscape Communications Corp.*[46] This is an especially significant case, because unlike *Checkpoint*, it clearly demonstrates that *Brookfield* applies to online trademark uses beyond metatags.

III. *PLAYBOY*: A LESS CONFUSED COURT

A. Background and Holding

"Keying" is the process by which keywords are linked to advertisements, so that searches that include the keywords produce specific advertisements on the user's results page.[47] For example, if a user entered "pornography" into a search engine, ads for various sites keyed to the term "pornography" would be displayed on the results page. Keying gives rise to legal problems when trademarks are used as keywords, as in the *Playboy* case.[48] There, when "Playboy" was entered into the search engine, links to Playboy's websites appeared. However, unmarked ads for Playboy's competitors who had keyed their ads to Playboy's mark also appeared along with the genuine Playboy links.[49]

Playboy Enterprises, Inc. ("PEI") brought suit against Netscape Communications Corp. and Excite, Inc. alleging trademark infringement and

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42. *Id.* at 278-79.
43. *Id.* at 300-01.
44. *Id.* at 298.
45. *Id.* at 293-94. The *Checkpoint* court echoed *Brookfield*'s goodwill rationale when citing it.
46. 354 F.3d 1020 (9th Cir. 2004).
47. *Id.* at 1022-23.
48. *Id.* at 1023.
49. The defendants, Internet service providers Netscape and Excite, *required* all adult-oriented companies to key their ads to a predetermined list of terms. Nothing in the case indicates that these companies had any input over which words were keyed to their advertisements. *Id.* at 1023.

dilution.[50] PEI claimed that by keying PEI's trademarks "Playboy" and "Playmate" to its competitors' advertising banners, the defendants were infringing PEI's marks.[51] The parties moved for summary judgment, which the district court granted for the defendants.[52] PEI appealed the grant of summary judgment, and the Ninth Circuit reversed.[53]

The Ninth Circuit found that PEI held the marks and that the defendants had used the marks in commerce,[54] making likelihood of confusion the heart of the infringement claim.[55] The specific type of confusion it examined was initial interest confusion, which the court described as the initial interest in a competitor's product created by the defendant's confusing use of plaintiff's mark.[56] The court reiterated that such infringing use was actionable, relying heavily on *Brookfield* for guidance.[57]

After indicating that *Brookfield* alone would be sufficient to defeat summary judgment, the court, in the interest of thoroughness, applied its well-known *Sleekcraft*[58] test for likelihood of confusion.[59] The court found that factor eight—likelihood of expansion of the product lines—did not apply in the Internet context and that factor four—evidence of actual confusion—was important enough to consider as a threshold matter.[60] Citing PEI's expert, the court found significant likelihood of consumer confusion

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50. *Id.*

51. *Id.* PEI filed suit in the Federal District Court for the Central District of California, and requested a preliminary injunction. The district court denied the request, and the Ninth Circuit affirmed in an unpublished disposition. *See* Playboy Enters., Inc. v. Netscape Communications Corp., 55 F. Supp. 2d 1070 (C.D. Cal.), *aff'd*, 202 F.3d 278 (9th Cir. 1999).

52. *See Playboy*, 354 F.3d at 1023.

53. *Id.*

54. The use in commerce issue has its own body of legal scholarship, and goes beyond the scope of this Note. Consequently, this Note does not address the use in commerce issue. For some discussion on the use in commerce issues of online trademark law, *see* Julieta Lerner, Note, *Trademark Infringement and Pop-up Ads: Tailoring the Likelihood of Confusion Analysis to Internet Uses of Trademarks*, 20 BERKELEY TECH. L.J. 229 (2005).

55. *Playboy*, 354 F.3d at 1024.

56. *Id.* at 1024-25.

57. *Id.* at 1025-26.

58. AMF v. Sleekcraft Boats, 599 F.2d 341 (9th Cir. 1979).

59. The *Sleekcraft* factors are: (1) strength of the mark; (2) proximity of the goods; (3) similarity of the marks; (4) evidence of actual confusion; (5) marketing channels used; (6) type of goods and the degree of care likely to be exercised by the publisher; (7) defendant's intent in selecting the mark; and (8) likelihood of expansion of the product lines. *Playboy*, 354 F.3d at 1026.

60. *Id.*

based on user surveys.[61] Although the defendants disputed this evidence, the court held that the existence of such a dispute demonstrated the inappropriateness of summary judgment.[62]

The court went on to hold that the strength of the mark, the proximity of the goods, the similarity of the marks, the type of goods and degree of care likely to be exercised by the publisher, and the defendants' intent all favored PEI, giving little merit to marketing channels used.[63] With the factors suggesting a likelihood of confusion heavily in PEI's favor, the court examined the defendants' affirmative defenses of fair use, nominative use, and functional use.[64] Fair use failed, because, in the court's view, "a fair use may not be a confusing use."[65] Nominative use also failed due to the defendants' lack of need for PEI's marks in conducting its advertising services.[66] Finally, the court rejected the functional use argument,[67] since it found nothing functional about the trademarks "Playboy" and "Playmate."[68] With the *Sleekcraft* test satisfied and the affirmative defenses rendered inapplicable, the court held that PEI had created a genuine issue of material fact sufficient to defeat summary judgment against its trademark infringement claim.[69]

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61. *Id.* at 1026-27. Playboy's expert, Dr. Ford, provided findings that:

> When study participants were shown search results for the term "playboy," 51% believed that PEI sponsored or was otherwise associated with the adult-content banner ad displayed. When shown results for the term "playmate," 31% held the same belief. Using control groups, Dr. Ford also concluded that for 29% of those participants viewing "playboy" searches and 22% of those viewing "playmate" searches, the confusion stemmed from the targeting of the banner advertisements. The individuals were not confused by random, untargeted advertisements.

Id. at 1026.

62. *Id.* at 1027.

63. *Id.* at 1028-29.

64. *Id.* at 1029.

65. *Id.*

66. *Id.* at 1030.

67. *Id.* at 1031.

68. The court remarked that the only functional aspect of the marks was their use as keywords for the defendants. *See Id.* at 1030-31.

69. *Id.* at 1031. On the dilution claim, the court found that, in light of the new standard announced in *Moseley v. V Secret Catalogue, Inc.*, 537 U.S. 418 (2003), it was necessary to reverse and remand for a determination of dilution under the *Moseley* standard. Playboy, 354 F.3d at 1033. *Moseley* set the new standard for defeating summary judgment as requiring a showing of *actual*, as opposed to *likely*, dilution. *Id.* at 1033 n.56.

B. Judge Berzon's Concurring Opinion

Although she agreed that the court's decision was consistent with *Brookfield*, Judge Berzon had serious reservations about *Brookfield*'s correctness.[70] The fundamental problem with it, she reasoned, was that when trademarks are used solely in the metatags of a competitor's website, there is no chance of confusion because the sites displayed on the search results page clearly demarcate the sponsors of the sites listed.[71] For example, if Toyota used "Chevrolet" as a metatag, all the consumer would see after searching for "Chevrolet" would be a listing of the Chevrolet and Toyota websites, with no possible confusion as to sponsorship. In that regard, Berzon noted there is not even initial interest confusion: when the consumer clicks on either the Chevrolet or Toyota link, the consumer knows exactly what he or she is clicking on. According to Judge Berzon, to the extent Toyota is trading on the "goodwill" of Chevrolet, it is no worse than asking a department store clerk where to find a specific brand of clothing and encountering other brands along the way.[72] Finding *Brookfield* to be unsupportable, Judge Berzon suggested the case be reconsidered en banc.[73]

Judge Berzon concurred, however, because in PEI's case, consumers could have been initially confused as to the sponsorship of the ads, and to that extent, she agreed with the court's holding.[74] She drew an important distinction between

> hijacking a customer to another website by making the customer think he or she is visiting the trademark holder's website (even if only briefly), which is what may be happening in this case when the banner advertisements are not labeled, and just distracting a potential customer with another *choice*, when it is clear that it is a choice.[75]

Judge Berzon cautioned that future cases, in which the keyed ads are clearly labeled, will present more troubling issues and could unjustifiably expand *Brookfield*.[76]

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70. *Playboy*, 354 F.3d at 1034 (Berzon, J., concurring).
71. *Id.* at 1035 (Berzon, J., concurring).
72. *Id.* (Berzon, J., concurring).
73. *Id.* at 1034 (Berzon, J., concurring).
74. *Id.* at 1034-35 (Berzon, J., concurring).
75. *Id.* at 1035 (Berzon, J., concurring). Judge Berzon's allusion to "what may be happening in this case" finds meaning in Playboy's expert testimony. See *supra* note 61 and accompanying text for an explanation of Playboy's confusion data.
76. *Playboy*, 354 F.3d at 1034-35 (Berzon, J., concurring).

C. *Playboy*'s Twin Analyses

1. *The Good Analysis*

Playboy's holding on initial interest confusion is supportable under the classic initial interest confusion doctrine. By keywording unmarked ads to PEI's trademarks, the defendants created a situation in which consumers could mistakenly assume that there was an affiliation between the unmarked ads and PEI. To the extent that consumers became interested in PEI's competitors' ads because of an assumed affiliation, the defendants' actions resulted in initial interest confusion. In sum, the *Playboy* court did not need *Brookfield* to hold as it did, since the court had sufficient evidence of confusion,[77] and its relationship to the initial interest thereby generated. Absent the references to *Brookfield*, *Playboy* does not raise any eyebrows.

2. *The Bad Analysis*

Unfortunately, the *Playboy* court did not squarely rest its holding on the likelihood of confusion analysis. Instead, it also analogized the defendants' keywords to *Brookfield*'s metatags. The consequences of this analogy are twofold. First, it means that *Brookfield* is viable in more contexts than just metatagging. This is troubling considering *Brookfield*'s reliance on a goodwill rationale, which signals a shift from consumer protection to owner protection. Second, it taints the good analysis of *Playboy*—the analysis based on confusion.

3. *Which Analysis Will Prevail in Future Cases?*

Playboy thus has twin rationales, one based on confusion and the other based merely on an analogy to the poorly reasoned *Brookfield*. As a result, it is unclear which rationale will govern future cases. Returning to Judge Berzon's concern, which analysis will control in the event that keyed ads clearly indicate that they are not those of the trademark owner? Under such circumstances, there would be no chance of confusion because the consumer would see the ad's source before clicking on it. Under the good analysis, the defendant should prevail. However, under the bad analysis, the plaintiff could still win, notwithstanding this absence of confusion. Non-confusing behavior will be enjoined in the name of preventing consumer confusion, and the initial interest confusion doctrine will become an unprincipled inroad to trademarks in gross.

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77. At least, sufficient evidence of confusion to defeat summary judgment.

IV. THE FUTURE OF ONLINE INITIAL INTEREST CONFUSION

Commentators advocate different approaches for online initial interest confusion. Dogan and Lemley criticize the expansion of a *Brookfield*-type analysis and argue for a test that requires competitive proximity between the parties.[78] Doellinger suggests that the initial interest confusion doctrine is "best viewed as a subspecies of likelihood of confusion."[79] At least one author suggests that the doctrine is superfluous and should be abandoned,[80] while counterarguments stress the need for the doctrine.[81] This Note does not attempt to reconcile the abundant scholarship over whether the doctrine should be abandoned. Instead, it assumes that the doctrine in its current form is not well-suited for online application, but with proper adjustments would be a potent and much needed facet of online trademark law. Using this final observation as a point of departure, the remainder of this Note suggests ways in which the doctrine can be tailored into a more useful tool for resolving online trademark disputes.

A. Back to Basics

Online initial interest confusion is currently at a fork in the road. To one side is the goodwill, property-centered approach laid down in *Brookfield* and spreading through the federal circuit courts. To the other side stands the familiar, consumer-centered approach honored in *Playboy* and rooted in the likelihood of confusion test. Assuming that the doctrine itself is here to stay, the courts inevitably must decide which path they will take.

It is easy to condemn the *Brookfield* approach as being divorced from the consumer protection justification of trademark law. The court's acknowledged absence of any confusion in *Brookfield* readily demonstrates as much. Dogan and Lemley suggest that the *Brookfield* approach thinly veils a judicial instinct to prevent unjust enrichment. This instinct, if blindly obeyed, "would argue in favor of a property right in gross for trademark holders—something courts have vigorously resisted in the past" in the context of infringement.[82] Another commentator has cautioned that *Brookfield*'s holding, as it stands, is "nothing more than an intuitive stan-

78. Stacey L. Dogan & Mark A. Lemley, *Trademarks and Consumer Search Costs on the Internet*, 41 HOUS. L. REV. 777, 826 (2004).

79. Doellinger, *supra* note 26, at 196.

80. Yelena Dunaevsky, Comment, *Don't Confuse Metatags with Initial Interest Confusion*, 29 FORDHAM URB. L.J. 1349, 1380 (2002).

81. Note, *supra* note 12, at 2404.

82. Dogan & Lemley, *supra* note 78, at 783 (citing numerous authorities).

dard that judges can apply at their whim,"[83] and Judge Berzon strongly suggested *Brookfield* has already spread too far.[84]

Cut loose from the consumer protection goals of trademark law, *Brookfield* has no consistent, grounding principle. Whether a disguised unjust enrichment instinct, a property right, or some still-unarticulated principle explains *Brookfield*, the case simply does not provide much guidance to courts or parties. For example, the concept of bad faith can vary so much from judge to judge, and the notion of goodwill is so fluid, that advertisers will be unlikely to gamble millions of dollars on finding a favorable judge. Moreover, inviting courts to "go with their gut" invites inconsistent rulings in similar scenarios. It would thus behoove courts to return to the main justification for trademark law, anchoring the initial interest confusion doctrine in the sound principles of consumer protection, and instructing parties as to exactly what governs this area of law. That is precisely what *Playboy* did, and it is the superior path for courts to take.

Playboy placed the initial interest confusion doctrine back within the traditional likelihood of confusion test.[85] Doellinger describes the initial interest confusion doctrine as a "subspecies" of likelihood of confusion, urging that initial interest confusion is not an alternative to likelihood of confusion, but rather another form of it.[86] The *Playboy* court took this important point for granted, while the *Brookfield* court missed it entirely. Concentrating only on the factors it found applicable to online initial interest confusion,[87] the *Playboy* court meticulously analyzed the *Sleekcraft* factors and found that *Playboy* raised a genuine issue of fact. In contrast, *Brookfield* seemed to push the *Sleekcraft* factors aside[88] and embark upon

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83. Doellinger, *supra* note 26, at 183.

84. Playboy Enters., Inc. v. Netscape Communications, Inc., 354 F.3d 1020, 1034-35 (9th Cir. 2004) (Berzon, J., concurring).

85. *Id.* at 1026.

86. Doellinger, *supra* note 26, at 196.

87. The court deemed these factors to be one through seven, excluding factor eight (likelihood of expansion of product lines). *Playboy*, 354 F.3d at 1026.

88. *Brookfield* did give the domain name part of the dispute a full *Sleekcraft* treatment. However, when reaching the metatags issue, the court noted:

> At first glance, our resolution of the infringement issues in the domain name context would appear to dictate a similar conclusion of likelihood of confusion with respect to West Coast's use of "moviebuff.com" in its metatags. Indeed all eight likelihood of confusion factors outlined [above] with the possible exception of purchaser care, which we discuss below—apply here as they did in our analysis of domain names; we are, after all, dealing with the same marks, the same products and services, the same consumers, etc. Disposing of the issue so readily, however, would ignore the fact that the likelihood of confusion in the

its own goodwill analysis of the defendant's metatags use.[89] *Playboy* rendered a carefully reasoned opinion grounded—at least in part—in the consumer protection justification of trademark law, offering valuable guidance to courts and potential litigants. As a result, *Playboy*'s likelihood of confusion analysis is superior to *Brookfield*'s goodwill analysis and should be followed instead of *Brookfield*. *Playboy*, however, can still be improved.

B. Improving the *Playboy* Approach

Playboy takes strides to bring initial interest confusion back within the parameters of the traditional likelihood of confusion test, but the case is only a first step towards a fully functioning online initial interest confusion test. Future courts must fine-tune the test for online use by considering the following factors: the competitive proximity of the parties and their products; the identity of the targeted consumers and their level of online sophistication; the proof of confusion required; and the nexus between the confusion and any initial interest it creates.

1. The Competitive Proximity Requirement

Several commentators have already stressed the need for competitive proximity as a requisite to online initial interest confusion. Dogan and Lemley maintain that courts like *Checkpoint* rightfully require competitive proximity between the plaintiff and defendant.[90] In support, they explain that unreasonable results would follow if non-competing parties could not divert some attention from trademark owners; for example, where a producer provides complementary products or a critic wishes to poke fun at a name brand.[91] Another author argues that:

> [C]ompetitive proximity is the sine qua non of initial interest confusion liability online. Without competitive proximity, there is little reason to fear a decrease in the quality of online service, because an Internet user's initial interest in the trademark origi-

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domain name context resulted largely from the associational confusion between West Coast's domain name "moviebuff.com" and Brookfield's trademark "MovieBuff." The question in the metatags context is quite different.

174 F.3d 1036, 1062 (9th Cir. 1999).

89. *Id.*

90. *See generally* Dogan & Lemley, *supra* note 78.

91. *Id.* at 827-28.

> nally sought will not easily be extinguished by a diversion to a noncompeting, completely unrelated website.[92]

Some courts have followed this common sense approach. For example, in *Bihari v. Gross*, the district court considered whether the defendant's use of plaintiff's trademark in metatags was actionable[93] in a situation where the defendant's website was critical of the plaintiff rather than in direct competition.[94] The court denied a preliminary injunction, based partly on the lack of competitive proximity between the parties.[95] The court explained "the [defendant's] websites cannot divert Internet users away from [the plaintiff's] website because [the plaintiff] does not have a competing website."[96] Courts and commentators are correct in placing significant weight on competitive proximity for a finding of initial interest confusion, and any suitable online initial interest confusion test must consider such proximity.

2. *The Reasonable Online User and Corresponding Level of Care*

While it is well established that trademark law is oriented toward the consumer of average intelligence, the initial interest confusion doctrine has been criticized by some for treating online consumers as having below average intelligence.[97] Dunaevsky contends that "[m]ost Internet users are familiar with the intricacies of the Internet shopping process, including the function of search engines. They know that when they type in their keywords, a number of possibly unrelated or competing links will be generated."[98] She continues by arguing that courts "cannot conclude definitively that the use of another's trademarks in metatags of a website causes initial interest confusion without first determining what the consumer's intent was when entering that particular trademark name into a search engine."[99] Thus, Dunaevsky views the doctrine as underestimating users' awareness,

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92. Note, *supra* note 12, at 2408-09.
93. 119 F. Supp. 2d 309, 311 (S.D.N.Y. 2000).
94. *Id.* at 313.
95. *Id.* at 327.
96. *Id.* at 320.
97. Todd B. Patterson & Peter L. Brewer, *"Initial Interest Confusion" Factors into Infringement Analysis*, N.J.L.J., Mar. 11, 2002, at 31 ("There is concern that the doctrine of initial interest confusion is contrary to the well-established principle that trademark law is oriented to the person of average intelligence, not the consumer of below-average intelligence.").
98. Dunaevsky, *supra* note 80, at 1383-84.
99. *Id.* at 1384.

while simultaneously failing to consider their motivations for using trademarked search terms.

Doellinger has defended this aspect of the doctrine, arguing that even sophisticated users can become confused and that, notwithstanding popular opinion, "the level of sophistication of Internet users is not as high as some might argue."[100] He points to the widespread proliferation of the Internet to dispel the impression that only sophisticated people use the Internet.[101] Combined with the low cost of clicking the back button to return to the previous page, even a sophisticated user may not exercise a high degree of care while searching for a specific site.

The reality is that while the Internet has become widespread and is used by people of all ages and sophistication levels, it is unclear how much the average user knows about search engine operation, metatags, keywording, and the like. Moreover, the dynamic nature of the Internet and its advertising methods ensure that what is understood today could be obsolete tomorrow. Given this fast-paced and widespread area of consumer-producer interaction, a reasonable standard cannot presume too much or too little in the way of user sophistication.

However, in light of the competitive proximity factor discussed above, courts would be well advised to cast the reasonable consumer in terms of the industry under consideration. For example, a determination of competitive proximity requires an examination of the industries involved; therefore, why not continue examining those same industries to determine who—and how sophisticated—its consumers are? The user searching for pornography on the Internet is unlikely to exercise the same level of sophistication shown by users shopping for cars, given the greater financial and time commitments inherent in buying a car.[102] Even then, the car shopper does not necessarily know more about the ways in which metatags and keywording operate behind the scenes. Some users are fully cognizant of the fact that searches can produce both related and unrelated results, while others are still oblivious. Ascertaining the knowledge base of consumers in a given online industry is critical, and might best be accomplished by surveys or other statistical endeavors.

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100. Doellinger, *supra* note 26, at 222.

101. *Id.*

102. *See, e.g.*, Brookfield Communications v. W. Coast Entm't Corp., 174 F.3d 1036, 1060 (9th Cir. 1999) ("[W]hen dealing with inexpensive products, customers are likely to exercise less care, making confusion more likely.").

3. *The Requisite Level of Confusion*

Given the fleeting duration of initial interest confusion online, it is unclear how much confusion is required to support a finding of infringement. In *Playboy*, the plaintiffs introduced an expert study concluding that some 51% of subjects were confused as to the sponsorship of the keyed banner ads.[103] The court noted that such surveys are commonly used as probative evidence of actual confusion, and it went on to find that the evidence created a genuine issue of material fact.[104] At the other end of the spectrum, the *Brookfield* court repeatedly stated that "it is difficult to say that a consumer is likely to be confused about whose site is has reached," and held for the plaintiff in the absence of any confusion.[105]

Doellinger has argued that requiring proof of actual consumer confusion would place an insurmountable burden on the plaintiff and essentially eliminate the doctrine of initial interest confusion.[106] Of course, the *Playboy* court never explicitly required actual proof. Rather, it afforded such proof considerable weight in the *Sleekcraft* analysis. Future courts should do the same, neither requiring nor ignoring such probative survey evidence. However, in those cases where proof of actual confusion is absent, courts can turn to the remaining *Sleekcraft* factors to rule on the likelihood of confusion, just as in a traditional infringement case.[107] This keeps initial interest confusion grounded in consumer protection principles. By allowing the *Sleekcraft* test to resolve the likelihood of confusion, courts can use the pliable middle ground between requiring proof of actual confusion, on the one hand, and completely ignoring a lack of confusion, on the other.

4. *A Requisite Nexus between Confusion and Initial Interest*

Just as the initial interest doctrine must require some level of confusion to avoid becoming a proxy for goodwill and property protection, that

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103. Playboy Enters., Inc. v. Netscape Communications Corp., 354 F.3d 1020, 1026 (9th Cir. 2004).

104. *Id.* at 1026 n.28.

105. *Brookfield*, 174 F.3d at 1062.

106. Doellinger, *supra* note 26, at 218.

107. *See* Herbko Int'l, Inc. v. Kappa Books, Inc., 308 F.3d 1156, 1165 (Fed. Cir. 2002) ("While evidence of actual confusion factors into the *DuPont* analysis, the test under § 1052(d) is likelihood of confusion, not actual confusion. Hence, a showing of actual confusion is not necessary to establish a likelihood of confusion."); *see also* Eclipse Assocs., Ltd. v. Data Gen. Corp., 894 F.2d 1114, 1118-19 (9th Cir. 1990) ("[P]roof of actual confusion is only one factor to be weighed in determining likelihood of confusion . . . . Although no actual confusion was proven by [plaintiff], the district court was not clearly erroneous in determining that 'likelihood of confusion' existed.").

same requisite confusion should also be the cause of the initial interest. In the situation where confusion generates initial interest, the court has before it a proper initial interest confusion case. However, where the confusion does not cause any initial interest, the plaintiff may have other theories of recovery, but initial interest confusion is not one of them. Similarly, where there is initial interest that is not the result of confusion,[108] the behavior causing such initial interest should not be enjoined in the name of the initial interest confusion doctrine.

C. A Proposed Test

When the approach taken in *Playboy* is enhanced by the above considerations, features of a practical test for online initial interest confusion come into focus. First, the core of such a test is the *Sleekcraft* likelihood of confusion test. This serves to keep the initial interest confusion doctrine anchored in the justification of consumer protection.[109] Second, no actual proof of confusion is required; however, such evidence is given its normal probative value. This enables the plaintiff to make a case without shouldering an insurmountable burden. Third, the competitive proximity of the goods is given significant, and in some cases even dispositive, weight. This serves to separate infringing uses from nominative and fair uses. Fourth, the court looks to the entirety of the *Sleekcraft* factors, as in traditional infringement cases, to determine the likelihood of confusion. This ensures that no single unchecked instinct—like that toward protecting goodwill in *Brookfield*—will control a case. Fifth, while evaluating the *Sleekcraft* factors, the court does so with the consumer of average intelligence in mind, exercising an average level of care and sophistication given the goods involved. This standard will most likely vary from case to case.

Once courts have determined whether the defendant's use confuses the relevant consumer, the final task is to decide whether that confusion caused any initial interest. Absent a finding of such causation, there can be no initial interest confusion. The trademark holder might be able to recover under other confusion-based theories;[110] however, initial interest confusion must be reserved for cases where confusion causes initial interest.

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108. This would include the scenario where initial interest precipitates confusion.

109. Although not all of the *Sleekcraft* factors may apply in the online context, most of the test is applicable in Internet cases. For example, the *Playboy* court applied seven of the eight factors, finding only likelihood of expansion of product lines inapplicable to the case before it. *Playboy*, 354 F.3d at 1026 n.26.

110. For example, the trademark owner might recover under traditional point-of-sale confusion.

D. What to do with Goodwill and *Brookfield*

This Note has argued that *Brookfield*'s goodwill analysis has no place in the initial interest confusion analysis. However, many courts find such an analysis appealing, and several have adopted the *Brookfield* approach entirely.[111] It may be possible to preserve some portion of goodwill analysis in the online initial interest confusion test sketched above. The first solution is to make the goodwill misappropriation analysis a factor in the *Sleekcraft* test. Courts recognize the malleable nature of the test, and might be willing to add factors with the same ease with which they eliminate factors.[112]

Another solution would be to set the goodwill analysis on a sliding scale with the *Sleekcraft* test. Rather than examining goodwill within the *Sleekcraft* test, courts could determine the likelihood of confusion under *Sleekcraft* and then weigh it against the misappropriation of goodwill. Weaker showings of likelihood of confusion could be salvaged upon a greater misappropriation of goodwill.

V. CONCLUSION

Online initial interest confusion doctrine is too often tainted with the type of simplistic goodwill analysis found in *Brookfield*. This type of analysis is removed from the foundation of trademark law and leads courts down an unpredictable road. The alternative analysis is grounded in consumer protection principles and manifest in the *Sleekcraft* factors as applied in *Playboy*.

Using *Playboy* as a starting point, the online initial interest confusion doctrine can be supplemented with Internet-specific considerations, and online initial interest confusion can be set on the right track. With a properly defined and applied online initial interest confusion doctrine, courts can more fairly and effectively protect trademarks in the promising online advertising frontier.

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111. *See* discussion *supra* Part II.B.

112. *See, e.g.*, *Playboy*, 354 F.3d at 1026 ("In the Internet context, courts must be flexible in applying the factors, as some may not apply.").

TRADEMARK INFRINGEMENT AND POP-UP ADS: TAILORING THE LIKELIHOOD OF CONFUSION ANALYSIS TO INTERNET USES OF TRADEMARKS

By Julieta L. Lerner

> In the 1950s—Surveys showed that people preferred their daughters not to marry advertising men.[1]

No surveys have been conducted, but one can confidently assert that most people prefer that their sons, daughters, and distant relatives not marry pop-up advertisers. Despite their negative public image, online marketing companies that use pop-up ads are profiting and working to establish themselves as reputable businesses that will revolutionize marketing. Recently, law suits brought by website-owning businesses have threatened to topple these companies. Thus far, trademark infringement is the only cause of action that may require pop-up advertisers to change their business methods. The district courts have been divided in their approach to the pop-up ad cases. While one court granted a preliminary injunction for trademark infringement,[2] two other courts declined to apply trademark law.[3] Foreclosing the possibility of applying trademark law would likely lead to confusion and thus higher consumer search costs, but an overly stringent application of trademark law would likely stifle novel marketing methods, thus also increasing consumer costs.

This Note first discusses pop-up ad technology and the use of pop-up ads in commerce by online contextual and behavioral marketing companies, looking beyond these companies' negative public images to their innovative Internet marketing models. Part II reviews trademark infringement law in the Internet context and its role in three recent pop-up ad cases. Part III concludes that while one court correctly decided that pop-up ads are a "use in commerce" under the Lanham Act, courts should not apply the "likelihood of confusion" test too stringently. Otherwise, trade-

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1. The statement continues, "Government economists threatened federal control of advertising. A book calling advertisers 'The Hidden Persuaders' was on the best-seller list for two years." Charles K. Ramond, *How Advertising Became Respectable*, 28 J. MKTG. 1, 2 (1964) (envisioning that by 1999—35 years into the future—advertising would become respectable).

2. 1-800 Contacts, Inc. v. WhenU.com, Inc., 309 F. Supp. 2d 467 (S.D.N.Y. 2003).

3. Wells Fargo & Co. v. WhenU.com, Inc., 293 F. Supp. 2d 734 (E.D. Mich. 2003); U-Haul Int'l, Inc. v. WhenU.com, Inc., 279 F. Supp. 2d 723 (E.D. Va. 2003).

mark law will stifle new marketing models and technologies. In particular, courts should examine branding, disclaimers, and license agreements when deciding whether the use of trademarks to trigger pop-up ads causes a likelihood of confusion. Finally, this Note argues that courts should examine an additional factor, the "degree of confusion," to assuage the harshness of the initial interest confusion doctrine.

I. POP-UP ADVERTISERS: NOVEL BUSINESS STRATEGIES AND TECHNOLOGIES

Pop-up ads are advertisements that appear in separate windows on a computer user's desktop while the user surfs the Internet. Typically, the window pops up without the user intentionally triggering the action.[4] The ads' subject matter ranges from pornography to home mortgages to contact lenses. Some pop-up ads are triggered by the host website without the user's explicit consent, as when the user visits a particular webpage. For example, a visit to www.nytimes.com can render a pop-up ad displaying the phrase: "appreciation, negotiation, innovation" followed by an ad stating, "the New York Times subscribe today." Other ads do not originate from the host site and are not triggered with the user's consent.[5] Some pop-up advertisers have been highly successful in providing pop-up ads with user consent.

In their short history, pop-up ads have acquired notoriety. *Wired News* recently noted, "[M]ost experienced web surfers will tell you that the most annoying aspects of life on the internet are pop-up ads and spam."[6] One legal article referred to pop-up advertisers as cyberswamp predators.[7] Even the trial judge in a recent pop-up ad case pondered: "Computer users, like this trial judge, may wonder what we have done to warrant the

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4. *See* 1-800 Contacts, Inc. v. WhenU.com, Inc., 309 F. Supp. 2d 467, 476 (S.D.N.Y. 2003).

5. A more menacing situation can occur when a user mistypes a web address and enters a "cybermaze," an often pornographic "maze of pop-up advertising . . . which sends up even more ads when surfers click the 'Back' button on browsers or try to close the windows altogether." Reuters, *Website Owner Nabbed in Porn Scam*, WIRED NEWS, Sept. 3, 2003 (reporting that federal authorities arrested a suspect for allegedly running "websites that use misspelled addresses to direct children looking for Disneyland or the Teletubbies to graphic sex instead"), *at* http://www.wired.com/news/politics/0,1283,60279,00.html.

6. Adam L. Penenberg, *Ads That Annoy Also Succeed*, WIRED NEWS, Sept. 8, 2004, http://www.wired.com/news/business/0,1367,64807,00.html.

7. Jason Allen Cody, *Just WhenU Thought It Was All Over, Gator's Kin Pops Up and Slides Out of Dangerous IP Waters (for the Most Part): A Review of 2 Online Pop-up Advertisers and 4 Internet Law Decisions*, 7 PGH J. TECH. L. & POL'Y 3 (2004).

punishment of seizure of our computer screens by pop-up advertisements for secret webcameras, insurance, travel values, and fad diets."[8]

Despite society's predominantly negative perception of them, pop-up advertisers use novel technologies. Unlike spammers, they rely on a user consent model that notifies consumers that they will receive pop-up ads. They also deserve credit for using two novel business concepts, contextual and behavior marketing, that promise to help companies provide ads only when consumers most need them. Pop-up advertisers, embodied by WhenU and Claria (formerly Gator), are profitable as well as innovative. Admittedly, pop-up advertisers must work to confront public image and legal problems, but they are hardly predators or instigators of punishment.

WhenU and Claria rely on user consent to provide pop-up ads.[9] The two advertisers rely on similar methods for matching ads to specific consumers. They provide consumers with cost-free, proprietary software; in exchange, consumers install software that generates pop-up ads. Examples include: WhenU's ClockSync, which synchronizes the Windows clock with the official standard time;[10] Claria's KaZaA, a multimedia search feature;[11] or Claria's ScreenScenes (nature-themed screensavers).[12] Claria and WhenU bundle their cost-free software with the pop-up ad software; a consumer cannot install one program without installing the other. Before downloading the bundled software package, consumers must agree to the terms of a licensing agreement. WhenU's licensing agreement explains that by accepting the free software, the user agrees to install software that generates contextually relevant pop-up ads and coupons.[13]

Claria and WhenU's pop-up ad software programs track a user's web-surfing activities and trigger pop-up ads at designated moments. WhenU's

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8. *U-Haul*, 279 F. Supp. 2d at 725.

9. Stefanie Olsen, *Adware Maker WhenU 'Exploring' Options*, CNET NEWS.COM, June 3, 2004 ("Industry analysts say WhenU and Claria are in the best position to capitalize on the burgeoning online ad market that specializes in targeting people based on their behavior."), *at* http://news.com.com/2102-1024_3-5226023.html. Other such companies include 180 Solutions, DirectRevenue, and Weatherbug. *See* Stefanie Olsen, *Adware Anxiety Gives Claria Cold Feet*, CNET NEWS.COM, Aug. 12, 2004 [hereinafter *Olsen, Adware Anxiety Gives Claria Cold Feet*], *at* http://news.com.com/2102-1024_3-5307545.html.

10. CLOCKSYNC, WhenU, *at* http://www.whenu.com/products_clocksync.html (last visited Mar. 12, 2005).

11. *How Can Kazaa Be Free?*, KaZaa, *at* http://www.kazaa.com/us/help/faq/howis_kazaa_free.htm (last visited Mar. 12, 2005).

12. Software, Claria, *at* http://www.claria.com/products/software (last visited Mar. 12, 2005).

13. Wells Fargo & Co. v. WhenU.com, Inc., 293 F. Supp. 2d 734, 739 (E.D. Mich. 2003).

SaveNow software collects URLs, website addresses, search terms, and webpage content and compares this information to the SaveNow directory using a matching algorithm. The algorithm then generates a content-appropriate pop-up ad. In a simple example, when a user types in "1800contacts.com," "the SaveNow software recognizes that the user is interested in the eye-care category, and retrieves from an Internet server a pop-up advertisement from that category."[14] The directory, housed on the user's computer, stays current because SaveNow automatically updates itself when the user is online. WhenU's software does not store individual user information.[15] In contrast, Claria's software tracks a user's long-term web-surfing habits by collecting and *storing* anonymous data.[16]

Such software makes highly-targeted contextual and behavioral marketing possible. On the Internet, contextual marketing is the targeting of users based on their *current* activity.[17] Avi Nader, Chief Executive Office of WhenU, touted contextual marketing as "delivering something" to consumers "when they need it."[18] Online contextual marketing delivers ads to consumers when they need it, because the software knows when a consumer is interested in traveling to Hawaii or buying a car and has a directory of ads matching those categories. The model is "revolutionary," because it tracks "actual interests."[19] The approach solves several problems inherent in traditional print and television marketing campaigns: it avoids the need for complex demographic studies and the high cost of advertising to a large group to reach a smaller target audience.

Claria takes contextual marketing a step further to behavioral marketing. Behavioral marketing involves the "targeting of consumers based on their Web site behavior, rather than purely by the content of the pages they visit."[20] Thus, Claria is theoretically even better than WhenU at tracking actual interests, because it refines its targeting based on a growing database of individualized information.

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14. 1-800 Contacts, Inc. v. WhenU.com, Inc., 309 F. Supp. 2d 467, 476 (S.D.N.Y. 2003).

15. The *1-800 Contacts* court found that SaveNow does not store individual user information or track the user's computer usage. *Id.* at 477.

16. Chang Yu, *Behavioral Marketing in Context*, CLICKZ, Aug. 11, 2004, *at* http://www.clickz.com/experts/media/behavioral_marketing/article.php/3392701.

17. *Id.*

18. *1-800 Contacts*, 309 F. Supp. 2d at 481.

19. Avi Nader testified that WhenU was conceived to "revolutionize marketing from implied interest, interests that are deducted [sic] based on who a consumer is and what their personal information is, to actual interests, when you shop, when you travel, when you invest. And that's why we named the company WhenU.com." *Id.*

20. Yu, *supra* note 16.

The ability to determine consumers' actual interests has led WhenU and Claria to great success. They are successful largely because targeted pop-up ads are far more effective than bulk e-mail or other Internet ads.[21] One company claimed, "Pop-ups generate roughly 5 to 10 times the response rate of standard banner units,"[22] and Claria claimed rates 20-40 times higher.[23] Claria has a customer base of over 400 advertisers, including mainstream companies such as American Express and Target.[24] Claria filed for an initial public offering on April 8, 2004, and reported profits in 2003 of about $35.6 million on revenue of about $90 million.[25] WhenU's customer base includes J.P. Morgan Chase, Verizon Communications, T-Mobile, and Merck.[26] In June 2004, WhenU confirmed that it had hired an investment bank to explore strategic partnerships and investment options.[27]

Despite pioneering successful Internet marketing models, WhenU and Claria have recently confronted legal and public image problems. WhenU and Claria have become enmeshed in numerous lawsuits. This Note focuses on three recent lawsuits, all brought against WhenU. In August, 2004, Claria postponed its initial public offering, reflecting a lack of investor confidence amid lawsuits and controversy about its behavior-tracking methods.[28] Previously Claria had changed its name from Gator to Claria to distance itself "from a name that ha[d] become synonymous with 'spyware'—that is, ad-tracking software that can be installed surreptitiously."[29] Although Claria and WhenU's business models center on user consent, the extent to which consumers have consented to install their pop-up ad software is debatable. One recent study found that 87% of WhenU users and 75% of Claria users were unaware they had installed pop-up ad

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21. Penenberg, *supra* note 6.

22. *Id.* (quoting Michael Bailey, interactive media supervisor at GSD&M Advertising).

23. *Claria as a Leader in Behavioral Marketing,* Claria, *at* http://www.claria.com/advertise (last visited Mar. 12, 2004).

24. Olsen, *Adware Anxiety Gives Claria Cold Feet, supra* note 9.

25. *Id.*

26. Declan McCullagh, *Adware's Going Mainstream, Report Says,* CNET NEWS.COM, June 30, 2004 (reviewing a study prepared by Ben Edelman, a Harvard University graduate student), *at* http://news.com.com/2102-1024_3-5253029.html.

27. Olsen, *Adware Anxiety Gives Claria Cold Feet, supra* note 9.

28. *Id.*

29. Stefanie Olsen, *Gator Sheds Skin, Renames Itself,* CNET NEWS.COM, Oct. 29, 2003, *at* http://news.com.com/Gator+sheds+skin,+renames+itself/2100-1024_35099212.html.

software.[30] The perception that Claria and WhenU swindle users into installing pop-up generating software has marred their public images.

II. POP-UP ADS AND TRADEMARK LAW

In the lawsuits led by online media companies and website-owning businesses, plaintiffs have used numerous legal theories against pop-up advertisers, including copyright infringement and contributory infringement, trademark dilution, unfair competition, and various state law claims. With one exception, the only theory capable of affecting the pop-up advertisers and their customers is trademark infringement.[31] Yet courts are divided on whether pop-up ads violate trademark laws. Much of the discussion has focused on trademark's "use in commerce" requirements. This Note first explains the requirements for trademark infringement and then discusses three recent cases: *U-Haul International v. WhenU.com*,[32] *Wells Fargo & Co. v. WhenU.com*,[33] and *1-800 Contacts, Inc. v. WhenU.com*.[34]

A. Trademark Infringement in the Internet Age

The Lanham Act, passed in 1946, protects trademarks used in commerce.[35] The Act serves two intertwining objectives: to prevent consumer confusion, thereby reducing search costs and promoting competition; and to protect trademark owners' goodwill, thereby creating incentives for such owners to maintain quality standards for the goods and services they offer.[36] The twin goals of trademark law are potentially harmonious. However, some scholars have suggested that when courts overemphasize the goodwill component, they stifle the goal of competition.[37]

The Lanham Act states that any person who, without permission, uses a mark in commerce "in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with

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30. *Eighty-Seven Percent of WhenU Users Are Unaware They Are Using It*, PC PITSTOP, *at* http://www.pcpitstop.com/spycheck/whenu.asp (last visited Mar. 12, 2005).

31. The exception to this was *Washingtonpost.newsweek Interactive Co. v. Gator Corp.*, which in a very brief opinion granted the plaintiff's motion for a preliminary injunction for various reasons, including copyright infringement. No. 02-909-A, 2002 U.S. Dist. LEXIS 20879, at *1-*2 (E.D. Va. July 16, 2002).

32. 279 F. Supp. 2d 273 (E.D. Va. 2003).

33. 293 F. Supp. 2d 734 (E.D. Mich. 2003).

34. 309 F. Supp. 2d 467 (S.D.N.Y. 2003).

35. 15 U.S.C. §§ 1051-1141 (2000).

36. ROBERT P. MERGES ET AL., INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGY AGE 529-30 (3d ed. 2003).

37. *See* Stacey L. Dogan & Mark A. Lemley, *Trademarks and Consumer Search Costs on the Internet*, 41 HOUS. L. REV. 777, 788 (2004).

which such use is likely to cause confusion, or to cause mistake, or to deceive" is liable for trademark infringement.[38] A party alleging trademark infringement bears the burden of proving that: 1) it possesses a mark; 2) the allegedly infringing party used the mark or a similar mark in connection with the sale, offering for sale, distribution, or advertising of goods or services; 3) such use of the mark occurred in commerce; and 4) the allegedly infringing party used the mark in a manner likely to confuse consumers.[39]

Although recent Internet cases have focused on the meaning of "use in commerce," the "likelihood of confusion" prong remains the "core" of a trademark infringement action.[40] An "appreciable number of ordinarily prudent purchasers" must be confused to invoke the Lanham Act.[41] The federal courts assess likelihood of confusion by examining various factors. Each circuit has its own list of factors, but these factors tend to overlap and are often identical.[42] For instance, the *1-800 Contacts* court applied the eight-factor *Polaroid* test.[43] The *Wells Fargo* court applied the similar

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38. Lanham Act § 32, 15 U.S.C. § 1051; *see also* Lanham Act § 2(d), 15 U.S.C. § 1052 (prohibiting the registration of a mark "which so resembles" a senior mark "as to be likely, when used on or in connection with the goods of the applicant, to cause confusion, or to cause mistake, or to deceive . . ."); Lanham Act § 43, 15 U.S.C. § 1125 (making liable in a civil action "any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or misleading representation of fact which (A) is likely to cause confusion, or to cause mistake, or to deceive . . .").

39. *See* U-Haul Int'l, Inc. v. WhenU.com, Inc., 279 F. Supp. 2d 723, 727 (E.D. Va. 2003).

40. Brookfield Communications, Inc. v. W. Coast Entm't Corp., 174 F.3d 1036, 1053 (9th Cir. 1999) ("The core element of trademark infringement is the likelihood of confusion, i.e., whether the similarity of the marks is likely to confuse customers about the source of the products." (citation omitted)); *accord* Nautilus Group, Inc. v. ICON Health & Fitness, Inc., 372 F.3d 1330, 1344 (quoting What-A-Burger, Inc. v. Whataburger, Inc., 357 F.3d 441, 450 (4th Cir. 2004) ("The keystone of infringement is the likelihood of confusion.") (internal quotation marks omitted); King of the Mountain Sports, Inc. v. Chrysler Corp., 185 F.3d 1084, 1089 (10th Cir. 1999) ("Likelihood of confusion forms the gravamen for a trademark infringement action."); E&J Gallo Winery v. Gallo Cattle Co., 967 F.2d 1280, 1290 (9th Cir. 1992)).

41. 1-800 Contacts, Inc. v. WhenU.com, Inc., 309 F. Supp. 2d 467, 490 (S.D.N.Y. 2003).

42. *See* 2-5 JEROME GILSON & ANNE GILSON, TRADEMARK PROTECTION AND PRACTICE § 5.01 n.19 (2004) (emphasizing the overlap between circuits and comparing the First, Second, Seventh, Ninth, and Eleventh Circuits).

43. *1-800 Contacts*, 309 F. Supp. 2d at 494. According to the *1-800 Contacts* court, the *Polaroid* factors are:

1) the strength of Plaintiff's Mark;

eight-factor *Frisch* test, which looks at "the marketing channel used," but not at the quality of the defendant's mark.[44] The circuits agree that these factors are not exhaustive.[45]

In proving likelihood of confusion, a plaintiff need not show actual confusion.[46] The absence of actual confusion does not necessarily prove that confusion is unlikely.[47] Nevertheless, evidence of actual confusion "is highly probative of the likelihood of consumer confusion."[48]

Likelihood of confusion can exist at the point of sale, or at a point prior or subsequent to the sale. Much of the controversy surrounding trademark use on the Internet has involved initial interest confusion.[49] The recent *PETA* case illustrates how the initial interest confusion doctrine has been applied in an Internet context.[50] A person entering "www.peta.org" and finding the "People Eating Tasty Animals" website could not mistake the site for the People for Ethical Treatment of Animals (PETA) website, yet the Fourth Circuit found that a likelihood of initial interest confusion

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2) the similarity between the plaintiff's and defendant's marks;
3) proximity of the parties' services;
4) the likelihood that one party will "bridge the gap" into the other's product line;
5) the existence of actual confusion between the marks;
6) the good faith of the Defendant in using the mark;
7) the quality of the Defendant's services;
8) the sophistication of the consumers.

Id. (quoting Polaroid Corp. v. Polarad Elecs. Corp., 287 F.2d 492, 495 (2d Cir. 1961)).

44. Wells Fargo & Co. v. WhenU.com, Inc., 293 F. Supp. 2d 734, 764 (E.D. Mich. 2003) (citing to the factors articulated in Frisch's Rest., Inc. v. Elby's Big Boy, Inc., 670 F.2d 642, 648 (6th Cir. 1982)).

45. *See 1-800 Contacts*, 309 F. Supp. 2d at 494 (explaining that the "*Polaroid* factors are not always dispositive" and courts "may consider other variables" and ignore "irrelevant factors"); *Wells Fargo*, 293 F. Supp. 2d at 764 ("These factors are not exhaustive and courts may consider some or none of them, or expand upon them.").

46. *See* Sara Lee Corp. v. Kayser-Roth Corp., 81 F.3d 455, 464 (4th Cir. 1996) ("Evidence of actual confusion is unnecessary.").

47. *See* PACCAR, Inc. v. TeleScan Techs., L.L.C., 319 F.3d 243, 252 (6th Cir. 2003) ("[T]he absence of actual confusion evidence is inconsequential.").

48. *See* Duncan McIntosh Co. v. Newport Dunes Marina, L.L.C., 324 F. Supp. 2d 1078, 1085 (C.D. Cal. 2004) (stating that any evidence of actual confusion is substantial evidence that confusion is likely); *1-800 Contacts*, 309 F. Supp. 2d at 499 ("Proof of actual confusion, in the form of [fair and relevant] market research survey evidence, is highly probative of the likelihood of consumer confusion.").

49. *See, e.g.*, Joseph Marra, Notes, Playboy Enterprises, Inc. v. Netscape Communications Corp.: *Making Confusion a Requirement for Online Initial Interest Confusion*, 20 BERKELEY TECH. L.J. 209 (2005).

50. People for the Ethical Treatment of Animals v. Doughney, 263 F.3d 359 (4th Cir. 2001).

existed.[51] The court found that the defendant's use of the mark in the domain name was "likely to prevent users from reaching" the plaintiff's website, because "prospective users . . . may fail to continue to search for PETA's own home page, due to anger, frustration, or the belief that PETA's home page does not exist."[52] The Fourth Circuit found that this initial interest confusion constituted trademark infringement under the Lanham Act.

Almost all the federal circuits recognize initial interest confusion in situations where the defendant uses the plaintiff's trademark or a similar mark to lure away consumers.[53] Notably, the First Circuit only recognizes confusion surrounding a consumer's purchase decision. The First Circuit declines to recognize initial interest confusion that does not result in a consumer purchasing the defendant's goods or services.[54] The Sixth Circuit has neither adopted nor acknowledged the initial interest confusion doctrine in recent Internet cases, instead focusing not on when the confusion occurred but on whether "there is a likelihood of confusion between the parties' goods and services."[55]

B. Pop-up Advertisers' Methods May Violate Trademark Law

At the end of 2003, three district courts considered the issue of whether WhenU's pop-up ads violate trademark law. Although two district court cases found that WhenU had not broken any laws, another district court issued a preliminary injunction for trademark infringement.[56] It remains to be seen which court's view will prevail.

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51. *Id.*

52. *Id.* (brackets omitted).

53. Most circuits have reasoned that when in 1962 Congress removed the "purchasers" from the Lanham Act, Congress meant to extend trademark protection to presale and post-sale confusion. Deborah F. Buckman, Annotation, *Initial Interest Confusion Doctrine Under Lanham Trademark Act*, 183 A.L.R. FED. 553, § 2 (2004).

54. *See* Hasbro, Inc. v. Clue Computing, Inc., 232 F.3d 1, 2 (1st Cir. 2000) ("Certainly in a case involving such disparate products and services as this, the court's refusal to enter the 'initial interest confusion' thicket is well taken given the unlikelihood of 'legally significant' confusion."). *But see* EMC Corp. v. Hewlett-Packard Co., 59 F. Supp. 2d 147, 151 (D. Mass. 1999) (asserting that the First Circuit does not reject the initial interest doctrine, because had it rejected it the First Circuit would likely have more thoroughly discussed it).

55. Wells Fargo & Co. v. WhenU.com, Inc., 293 F. Supp. 2d 734, 764 (E.D. Mich. 2003).

56. The plaintiffs in these lawsuits also asserted various other causes of actions, with little success. For instance, U-Haul sued WhenU and others on nine counts that included trademark infringement, unfair competition, and trademark dilution under the Lanham Act, copyright infringement, misappropriation, interference with a prospective

1. U-Haul Int'l, Inc. v. WhenU.com, Inc.: *WhenU Prevails on All Counts*

U-Haul International (U-Haul) learned that consumers running WhenU's SaveNow software sometimes found more than U-Haul trucks, moving boxes, and services when visiting U-Haul's website. These consumers also found pop-up ads featuring Budget Rent-A-Car, Moversbay.com, and Door-to-Door Storage.[57] U-Haul sued WhenU and its customers (collectively WhenU for this Subsection) in the United States District Court for the Eastern District of Virginia, alleging, among other counts, trademark infringement. Both U-Haul and WhenU moved for summary judgment.[58] On September 5, 2003, the court granted WhenU's motion for summary judgment on the trademark infringement claim.[59]

The court found that U-Haul failed to meet the "use in commerce" element of the trademark infringement analysis.[60] U-Haul contended that WhenU used its mark in commerce in two ways. First, WhenU used U-Haul's trademark when its pop-up ads appeared in close proximity to the window containing U-Haul's website. Second, WhenU used the mark to trigger the pop-up ads.[61] U-Haul also argued that WhenU's system interfered with consumers' use of the U-Haul website.[62]

The court rejected WhenU's arguments. First, it found that the WhenU ad appeared in a branded window that was separate and distinct from the U-Haul window. It emphasized that use in commerce "is not established merely because trademarks are simultaneously visible to a consumer."[63] Second, it found that WhenU's inclusion of U-Haul's URL and mark into the SaveNow directory was not a use in commerce. Also, it found that WhenU's scheme did not interfere with a consumer's use of U-Haul's website, since SaveNow did not affect U-Haul's computer servers and the consumers had agreed to install the SaveNow software.[64] Having found that U-Haul failed to show a "use in commerce," the court granted the de-

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business advantage, unjust enrichment, and violations of the Virginia Conspiracy Act. However, when U-Haul and WhenU moved for summary judgment, the court dismissed all the claims. U-Haul Int'l, Inc. v. WhenU.com, Inc., 279 F. Supp. 2d 723, 726 (E.D. Va. 2003).

57. Plaintiff's Complaint, U-Haul Int'l, Inc. v. WhenU.com, Inc., 279 F. Supp. 2d 723 (E.D. Va. 2003) (No. 02-1469).

58. *U-Haul*, 279 F. Supp. 2d at 726.

59. *Id.* at 726.

60. *Id.*

61. *Id.* at 727.

62. *Id.*

63. *Id.* at 728.

64. *Id.* at 727-28.

fendants' motion for summary judgment on the trademark infringement claim.[65]

2. Wells Fargo & Co. v. WhenU.com, Inc.: *WhenU Prevails Again*

WhenU won a second victory in the United States District Court for the Eastern District of Michigan. Wells Fargo[66] and Quicken Loans, Inc. (Quicken Loans) sought a preliminary injunction, claiming irreparable harm from trademark and copyright infringement.[67] Since a preliminary injunction is an "extraordinary" and "drastic" remedy,[68] the *Wells Fargo* plaintiffs faced a heavy burden. In deciding whether to issue a preliminary injunction, a court considers whether: 1) the movant has shown a strong likelihood of success on the merits; 2) the movant will suffer irreparable harm if the court fails to issue the injunction; 3) the issuance would cause substantial harm to others; and 4) issuing the injunction would serve the public interest.[69] The *Wells Fargo* court determined that all four factors favored WhenU. Thus, on November 19, 2004, the court denied the injunction, finding that: the plaintiffs were unlikely to prevail on the merits of the trademark infringement and copyright claims; that they had not suffered irreparable harm; and that the issuance of a preliminary injunction would harm WhenU, WhenU's customers, and consumers.[70]

The court began its analysis by finding that the plaintiffs failed to demonstrate a strong likelihood of success on the merits of their trademark infringement claim.[71] Like the *U-Haul* court, the *Wells Fargo* court found that WhenU had not used the plaintiffs' marks in commerce.[72] The court rejected the plaintiffs' arguments, which essentially reiterated U-Haul's "use in commerce" arguments.[73] First, the court reasoned that WhenU did not hinder access to plaintiffs' sites. Second, the court found that simulta-

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65. *Id.* at 729. For the same reason, the court granted summary judgment on the trademark dilution and unfair competition claims. To prove trademark dilution, the plaintiff must show that the defendant is making a commercial use of the mark in commerce. The unfair competition claim also required a showing of use in commerce as defined by the Lanham Act. *Id.* at 729.

66. Wells Fargo here is used to denote WFC Holding Corp. and Wells Fargo & Co.

67. Wells Fargo & Co. v. WhenU.com, Inc., 293 F. Supp. 2d 734, 757, 769 (E.D. Mich. 2003).

68. *Id.* at 757.

69. *Id.* at 756-57.

70. *Id.* at 756-73.

71. Likewise, the court found that plaintiffs failed to show a likelihood of success on the copyright claims. *Id.* at 769.

72. *Id.* at 757-58.

73. *Id.* at 758.

neous visibility of trademarks in separate windows did not establish a use in commerce of the plaintiffs' marks. The court distinguished *Hard Rock Cafe International, Inc. v. Morton*, because in that case the Hard Rock Hotel logo bordered another webpage.[74] The court reasoned that, in contrast to *Hard Rock Cafe*, in this case there was no seamless presentation between the well-marked WhenU ads and the plaintiffs' webpages.[75] Third, it found that WhenU engaged in legitimate comparative advertising.[76] Lastly, the court found that the inclusion of trademark-containing URLs into the SaveNow directory did not violate the Lanham Act, because WhenU did not use the plaintiffs' marks to indicate anything about the source of the products and services it advertises.[77]

Though it was unnecessary to delve into the likelihood of confusion question, the *Wells Fargo* court explored the issue in dicta.[78] The court applied the *Frisch* test, but discussed only three factors that remained in dispute: evidence of actual confusion, marketing channels used, and likely degree of purchaser care.[79] The court found that the plaintiffs had relied on unconvincing survey evidence that weakened all three factors. Moreover, it found that the record suggested a relatively high degree of consumer sophistication, since even the plaintiffs' expert acknowledged that, "people who decide to obtain a mortgage online may be more knowledgeable about the Internet than ordinary users" and that consumers are likely to be attentive to financial affairs.[80] Additionally, the court found "good reason to believe that the typical SaveNow user" would not be confused, because these users were accustomed to receiving competing ads, WhenU branded its ads and displayed a prominent disclaimer, and the ads appeared in distinct windows.[81]

Having failed to prove a likelihood of success on the merits, the plaintiffs were not entitled to a presumption of irreparable harm.[82] The court then found that the plaintiffs had not "demonstrated irreparable or even substantial injury," because the fact that the plaintiffs waited a long time to seek an injunction indicated that there was no such threat.[83] Lastly, the

74. *Id.* at 760-61.
75. *Id.*
76. *Id.* at 761-62.
77. *Id.* at 762-64.
78. *See id.* at 764.
79. *Id.* at 765.
80. *Id.* at 750, 767.
81. *Id.* at 749-50.
82. *Id.* at 771 (citing Ronald Mayott & Assocs. v. MGC Bldg. Co., 885 F. Supp. 148, 153 (E.D. Mich. 1994)).
83. *Id.* at 771.

court found that a preliminary injunction would harm WhenU through loss of clients and staff, harm WhenU customers by preventing them from competing, and harm consumers by threatening comparative advertising.[84] Having prevailed on all the preliminary injunction elements, WhenU scored a clear victory.

3. 1-800 Contacts, Inc. v. WhenU.com, Inc.: *WhenU's Good Fortune Changes*

The third of the WhenU lawsuits marked an important shift in the fortunes of plaintiffs hoping to stop WhenU. In *1-800 Contacts, Inc. v. WhenU.com, Inc.* 1-800 Contacts, Inc. sought a preliminary injunction against its competitor, Vision Direct, and WhenU, alleging eight claims under the Lanham Act and Copyright Act and two state laws claims.[85] On December 22, 2003, the Southern District of New York granted a preliminary injunction enjoining WhenU from including the 1-800 Contacts mark in the SaveNow directory and from causing Vision Direct ads to appear when a user types the 1-800 Contacts mark into the URL bar or a search engine.[86]

Expressly stating that it disagreed with the *U-Haul* and *Wells Fargo* decisions,[87] the *1-800 Contacts* court found that WhenU had used the plaintiff's mark in commerce. The court found that two activities constituted "use in commerce": 1) a use in the SaveNow directory to trigger the pop-up ads, and 2) a use in causing competitors' ads to appear when consumers seeking another site enter a mark into a URL bar or search engine.[88] First, citing domain name cases, the court reasoned that inclusion of the defendant's mark in the directory of terms together with the purpose to advertise directly competing goods was a use in commerce.[89] Under the court's reasoning, the use of a trademark in a directory without more would not constitute a use in commerce, similar to the domain name cases, where registration, without more, does not constitute a use in commerce.[90] However, the added purpose of exhibiting directly competing goods made it trademark use. Second, the court reasoned that using a consumer's prior

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84. *Id.* at 772-73.

85. 1-800 Contacts, Inc. v. WhenU.com, Inc., 309 F. Supp. 2d 467, 471-73 (S.D.N.Y. 2003).

86. *Id.* at 509-10.

87. *Id.* at 490 n.43 (stating that the court was not bound by the *Wells Fargo* and *U-Haul* findings that inclusion of the plaintiff's trademark in the SaveNow directory was not a "use").

88. *Id.* at 489.

89. *Id.*

90. *See id.* at 489-90.

knowledge of the plaintiff's trademark to exhibit its own directly competing goods or services constituted trademark use.[91] Further, the court emphasized that the defendant was capitalizing on the plaintiff's "reputation and goodwill."[92]

The court found a likelihood of source and initial interest confusion.[93] Having found a likelihood of success on the trademark infringement claim, the court presumed irreparable harm.[94] Thus, the court granted a preliminary injunction against the defendants.

III. A BETTER APPROACH TO THE TRADEMARK INFRINGEMENT ANALYSIS FOR POP-UP ADS

Courts should continue to apply the use in commerce requirement broadly so as extend to Internet uses of trademarks. Likelihood of confusion should be the focus of the Internet cases. In applying the likelihood of confusion factors, courts should examine "other factors," specifically the existence of disclaimers and branding. Further, this Note suggests that courts should examine an additional factor, the "degree of confusion."

A. A Flexible "Use" Requirement

Contrary to commentary by scholars and the courts in the recent *Wells Fargo* and *U-Haul* cases, the use in commerce requirement is not an appropriate gatekeeping device to prevent trademark infringement law from reaching into pop-up ads.[95] Since the Internet's advent, most courts have applied the "use in commerce" concept flexibly. In contrast, *Wells Fargo* and *U-Haul* took a rigid view of use in commerce. One can envision many possibilities where such a rigid approach to use in commerce would allow competitors to confuse consumers. Rather, the focus of the analysis should reside in likelihood of confusion, the keystone of trademark infringement.

1. *Courts Have Applied "Use in Commerce" Flexibly to Internet Cases*

When Congress passed the Lanham Act in 1946, it could not have foreseen today's Internet society. However, courts have found the statute's language sufficiently broad to permit applying the statute to Internet uses of trademarks. As new technologies have emerged, many federal courts

91. *Id.*
92. *Id.*
93. *Id.* at 504-05.
94. *Id.*
95. *See* Dogan & Lemley, *supra* note 37, at 805-12.

have flexibly interpreted "use in commerce" as defined by the Lanham Act.

Courts have generally found that using another's trademark name in a second-level domain name (the name before the ".com" or ".edu," etc.) is a use in commerce.[96] While registration alone is insufficient for commercial use,[97] using a domain name can be infringing when the registrant also capitalizes on the domain name to promote his own ends. For example, in *Planned Parenthood Federation of America v. Bucci*, the court found a use in commerce where the defendant registered the domain name "plannedparenthood.com," used it as the site address to promote his anti-abortion book, and used it in a way "likely to prevent some Internet users from reaching plaintiff's own Internet site."[98] Similarly, courts have found that "use in commerce" encompasses the use of trademarks in metatags, embedded software code that describes webpage content.[99]

2. 1-800 Contacts *Provides the Right Approach to "Use in Commerce"*

The *1-800 Contacts* court applied a well-reasoned approach in holding that the defendants used 1-800 Contacts' mark in commerce. Its approach is flexible yet reasonable. In contrast, the *U-Haul* and *Wells Fargo* courts rigidly approached trademark use. The plaintiffs in both cases presented similar rationales. They argued that the defendants used the mark by hindering Internet users from access to the plaintiffs' websites by positioning the pop-up ads in close proximity to the plaintiffs' websites and by using

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96. *See, e.g.*, OBH, Inc. v. Spotlight Mag., Inc., 86 F. Supp. 2d 176, 186 n.8 (W.D.N.Y. 2000).

97. Lockheed Martin Corp. v. Network Solutions, Inc., 985 F. Supp. 949 (C.D. Cal 1997), *aff'd*, 194 F.3d 980 (9th Cir. 1999).

98. No. 97 Civ. 0629, 1997 WL 133313, at *4 (S.D.N.Y. Mar. 24, 1997), *aff'd*, 152 F.3d 920 (2d Cir. 1998).

99. Metatags are HTML code intended to describe the contents of the website. There are different types of metatags, but those of principal concern to us are the "description" and "keyword" metatags. The description metatags are intended to describe the website; the keyword metatags, at least in theory, contain keywords relating to the contents of the website. The more often a term appears in the metatags and in the text of the web page, the more likely it is that the web page will be "hit" in a search for that keyword and the higher on the list of "hits" the web page will appear.

Brookfield Communications, Inc. v. W. Coast Entm't Corp., 174 F.3d 1036, 1045 (9th Cir. 1999).

their marks to trigger pop-up ads.[100] The courts separately examined each activity that might constitute a use in commerce. In *U-Haul*, the court reasoned that proximity was insufficient because WhenU used separate windows and simultaneously visible windows did not establish use. WhenU's inclusion of the marks in the SaveNow directory was not a trademark use, because WhenU did not sell the mark to customers or display the mark in pop-up ads. Lastly, the court reasoned that the pop-up scheme did not interfere with consumer use as in *PETA*, because here consumers had consented to install such a software program.[101] The *Wells Fargo* court made similar argument as to the first two points, but instead of focusing on consumer consent, the court reasoned that WhenU did not hinder access to the plaintiffs' websites because unlike in *PETA*, consumers still had access to the plaintiffs' webpages—to fully view the plaintiffs' websites, consumers needed only to close or minimize the pop-up window.[102]

Taking each reason separately, the *U-Haul* and *Wells Fargo* courts make persuasive arguments, but the courts failed to consider the entire scheme. WhenU did not randomly trigger an ad that was in close proximity to a competitor's website, nor did it place the plaintiff's mark and domain name in the SaveNow directory for any purpose other than to trigger directly competitive ads. WhenU combined these two uses of the plaintiffs' trademarks in a manner potentially confusing to consumers and with a scheme that potentially interferes with consumers' use of the plaintiff's website. If a consumer had believed that the ad was affiliated or sponsored by the desired website, then the consumer might have clicked on the link in the pop-up ad and found himself in another website, an experience that could discourage him from returning to the defendant's website. *U-Haul* and *Wells Fargo* took a narrow view of use in commerce, possibly to avoid the difficult case-by-case determination that the likelihood of confusion analysis requires.

B. Likelihood of Confusion is the Keystone of the Analysis

Likelihood of confusion, not use in commerce, is the keystone of the trademark infringement analysis. Stacey L. Dogan and Mark Lemley suggest that the use in commerce doctrine furthers the "fundamental goal of lowering search costs."[103] A better way to lower consumer search costs,

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100. *See* Wells Fargo & Co. v. WhenU.com, Inc., 293 F. Supp. 2d 734, 757-58 (E.D. Mich. 2003); U-Haul Int'l, Inc. v. WhenU.com, Inc., 279 F. Supp. 2d 723, 727 (E.D. Va. 2003).

101. *U-Haul*, 279 F. Supp. 2d at 727-29.

102. *Wells Fargo*, 293 F. Supp. 2d at 757-61.

103. Dogan & Lemley, *supra* note 37, at 810.

however, is through a stricter application of likelihood of confusion analysis. It would be unfair to trademark holders and consumers to interpret "use in commerce" so narrowly as to forgo the use of trademark law in situations where the defendant has made some use of the mark that may cause confusion.

1. 1-800 Contacts *Wrongly Found a Likelihood of Confusion*

Instead of employing "use in commerce" as a gate-keeping function, the *1-800 Contacts* court should have found that 1-800 Contacts failed to show a likelihood of succeeding on trademark infringement.[104] Several factors require discussion.

The *1-800 Contacts* court found that the "similarity between Plaintiff's and Defendant's mark" was great, because "[t]he website address, www.1800contacts.com, used by Defendants in the SaveNow proprietary directory of terms incorporates completely the Plaintiff's trademark 1-800 CONTACTS" and "[a]s used in the WhenU.com directory, Plaintiff's address, www.1800Contacts.com, differs from Plaintiff's trademark only in the omission of spaces and grammatical marks, and in the addition of the 'www' and '.com.'"[105] In traditional cases—where, for example, a handbag manufacturer incorporates a mark very similar to the mark of a luxury handbag manufacturer—this factor makes sense. In pop-up ad cases, the use of the mark is more subtle, since the mark does not appear on the pop-up ad itself—it is hidden in the directory or appears in a separate window. Thus, the court's finding that the mark used by the defendants was "extremely similar" to the plaintiff's mark is not very relevant. This factor should only weigh slightly for the plaintiff, since in this situation the similarity of the marks itself does not cause confusion. Rather, it is the circumstances surrounding the use of this similar, if not exact, mark that might cause confusion.

The *1-800 Contacts* court cited numerous sources holding that the "sophistication of consumers does not mitigate initial interest confusion, since sophisticated consumers are as likely to be initially confused as unsophis-

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104. *The 1-800 Contacts* court found a likelihood of confusion, even though it was insufficient to meet the plaintiff's burden. Since 1-800 Contacts was seeking the "drastic" remedy of a preliminary injunction, it needed to show a strong likelihood of success on the merits. The court found the eight-factor *Polaroid* test weighed in favor of 1-800 Contacts. Specifically it found that 1) strength of the mark; 2) similarity between plaintiff's and defendant's mark; 3) proximity of the parties' services; 4) bad faith of the defendant in using the mark; and 5) consumer sophistication weighed in favor of the plaintiff. The court also rejected WhenU's arguments that branding and consent weighed in its favor. 1-800 Contacts, Inc. v. WhenU.com, Inc., 309 F. Supp. 2d 467, 495-504 (S.D.N.Y. 2003).

105. *Id.* at 497.

ticated consumers."[106] In the context of pop-up ads, however, this rationale does not apply. Sophisticated users likely know that pop-up ads do not always originate from the website they are visiting. Moreover, the court never looked at what type of Internet users buy contact lenses.

Lastly, the *1-800 Contacts* court too easily dismissed the "other factors": branding and disclaimers.[107] Branding and disclaimers can greatly reduce or eliminate the likelihood of confusion. The WhenU pop-up ads were branded with a green "$" and the text "SaveNow!",[108] and also contained a disclaimer stating, "A WhenU offer—click? for info."[109] The court failed to discuss the clearest disclaimer of all: the software licensing agreement to which the user consented. Although the burden on the defendant to "come forward with evidence sufficient to demonstrate that its disclaimers would significantly reduce the likelihood of consumer confusion is a heavy one,"[110] it would be inequitable to require the defendant to show actual effectiveness when the plaintiff need not show actual confusion. Branding and disclaimers, if conspicuous, should weigh in the defendant's favor.

Moreover, the *1-800 Contacts* court stated, "Even if Defendants had offered evidence of the effect of its branding and disclaimers, such evidence would do little to counter Plaintiff's showing of the likelihood of initial interest confusion."[111] To support its argument, the court cited metatag cases where consumers could not read disclaimers until they arrived at the defendant's website.[112] Here, the SaveNow users received the information before arriving at the defendant's website and while they still had the plaintiff's website in view. Thus, WhenU's branding and disclaimers should have countered the plaintiff's showing of the likelihood of initial interest confusion.

The *1-800 Contacts* court's notion that WhenU and Vision Direct were bad actors may have influenced the court's application of the *Polaroid*

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106. *Id.* at 503 (quoting N.Y. State Soc'y of Certified Pub. Accountants v. Eric Louis Assocs., Inc., 79 F. Supp. 2d 331, 341-42 (S.D.N.Y. 1999)).

107. *Id.* at 504.

108. *Id.*

109. *Id.* After the lawsuit commenced, WhenU added a more thorough disclaimer; however, the court considered only the disclaimer used at the time the lawsuit was filed. *Id.* at 504 n.55.

110. *Id.* at 504 (internal citations omitted).

111. *Id.* (citing OBH, Inc. v. Spotlight Magazine Inc., 86 F. Supp. 2d 176, 190 (W.D.N.Y. 2000); N.Y. State Soc'y of Certified Publ. Accountants v. Eric Louis Assocs., 79 F. Supp. 2d 331 (S.D.N.Y. 1999); Planned Parenthood Fed'n of Am., Inc. v. Bucci, No. 97 Civ. 0629, 1997 1997 WL 133313 (S.D.N.Y. Mar. 24, 1997)).

112. *Id.*

test. The court found that the "bad faith" factor weighed in favor of 1-800 Contacts, since the defendants intentionally capitalized on Vision Direct's "reputation and goodwill," by purposely selecting 1-800 Contacts' mark for its SaveNow directory.[113] Additionally, the court found that 1-800 Contacts had a likelihood of success for its cybersquatting claim against Vision Direct, which had registered and maintained the "www.1800Contacts.com" domain name with bad faith—a name "almost identical" to 1-800 Contact's "www.1-800Contacts.com" domain name.[114]

2. Wells Fargo *Better Applied the Likelihood of Confusion Factors*

On very similar facts, the *Wells Fargo* court reached a different result for likelihood of confusion when evaluating the plaintiff's request for a preliminary injunction. Although it noted that its finding of no "use in commerce" made it unnecessary to reach the issue of likelihood of confusion, the *Wells Fargo* court proceeded with the analysis.[115] Applying the *Frisch* test, the court found that Wells Fargo failed to show a likelihood of confusion. The court stated that the only factors in dispute were actual confusion, marketing channels used, and likely degree of purchaser care. For each of those factors, *Wells Fargo* had relied on survey evidence, the same evidence that appeared in *1-800 Contacts*. The *Wells Fargo* and *1-800 Contacts* courts agreed that the survey evidence was unpersuasive.

More importantly, *Wells Fargo* approached the sophistication factor differently than in *1-800 Contacts*. Noting that "there are obvious differences between conducting financial transactions online and buying contact lenses online," the court found the record suggested "a relatively high degree of sophistication on the part of plaintiffs' customers, both with respect to the Internet and financial services."[116] Although the court questioned the sophistication of contact lenses buyers, it at least considered the sophistication of the consumer group and relied on evidence rather than supposition.

3. *The Solution: Other Factors for Internet Cases*

The circuits agree that the factors of the "likelihood of confusion" tests are not dispositive. The *1-800 Contacts* court did not reject that disclaimers and branding may factor into the analysis, but did not find strong evi-

113. *Id.* at 501-02.
114. *Id.* at 505-07.
115. Wells Fargo & Co. v. WhenU.com, Inc., 293 F. Supp. 2d 734, 764 (E.D. Mich. 2003).
116. *Id.* at 767.

dence that they weighed in the defendants' favor, possibly because it felt defendants were bad actors. However, disclaimers and branding, when used effectively, should weigh heavily in favor of the defendants. In finding effectiveness of disclaimers or branding, the courts should not require defendants to show survey evidence, because they do not require that of the plaintiffs who bear the ultimate burden of showing confusion. Moreover, in the context of pop-up ads and similar online tools, disclaimers and branding can reduce the likelihood of initial interest confusion because these devices inform consumers of the ad's source before they enter a competing website.

Another factor, which the courts have not considered, may help solve a problem inherent in the current likelihood of confusion analysis. Although a person's attention span is shorter on the Internet, the proposition that one second's worth of initial interest confusion is sufficient is problematic. The problem arises because the plaintiff has suffered little damage, and consumers have incurred minimal additional search costs. Dogan and Lemley explain the rationale underlying the likelihood of confusion analysis: "[C]onfusion diverts customers to a competitor of the trademark holder and 'switching costs' keep them there, uncertainty enters the trademark-product connection, which ultimately increases consumer search costs."[117] They correctly point out that in the online context, "switching costs are minimal, confusion is frequently speculative, and many defendants have persuasive arguments that their uses bring benefits to consumers."[118] One of their main solutions, requiring competitive proximity, is not helpful in the pop-up ad cases, because in these cases competitive proximity exists yet the switching costs remain low.[119]

A more workable approach to the problem would be to limit initial interest confusion by evaluating the "degree of confusion." This factor would involve looking at the diversion's length of time, the difficulty in returning to one's target website, and the likelihood that the same person would be confused again. This factor would weigh heavily in favor of pop-up advertisers, because the diversion might be a fraction-of-a-second glance at the pop-up window. This factor would be less favorable to defendants in domain name or metatag cases, since consumers might spend more time dispelling the confusion, especially since these situations are less predictable. A consumer usually expects that entering the business's name into the web address will lead to that business's site. In contrast, as

117. Dogan & Lemley, *supra* note 37, at 814.
118. *Id.* at 815.
119. *Id.* at 826-27.

competitive advertising through pop-up ads becomes more common, consumers will know that pop-up ads do not always originate from the underlying website. A "degree of confusion" factor would inject common sense into the initial interest confusion analysis, because it would take into account the "switching costs" that motivate the initial interest confusion doctrine.

4. *A "Degree of Confusion" Factor Would Preserve Innovative New Technologies and Business Methods that Foster Competition*

Already, courts have developed a doctrine that permits at least some confusion. As the *Wells Fargo* court emphasized, WhenU is engaged in legitimate comparative advertising. The court stated, "In accusing WhenU of 'free riding' on their trademarks, plaintiffs ignore the fact that trademark laws are concerned with source identification. They are not meant to protect consumer good will [sic] created through extensive, skillful, and costly advertising."[120] Further, comparative advertisers may make use of the trademark holder's mark.[121] The Seventh Circuit even held that some confusion is acceptable when the defendant is engaged in competitive advertising, explaining that "some [consumers] are bound to misunderstand no matter how careful a producer is."[122] Likewise, some SaveNow users are bound to misunderstand no matter how careful WhenU is, but many users will benefit from ads and coupons that appear right at the moment they are searching for them. This is especially true because the technology that SaveNow employs is still nascent.

Allowing some confusion invites some free-riding. One scholar suggests that the cost of decreased "producers' incentives to conduct business online and to provide customers with high-quality online services . . . militates in favor of applying the initial interest confusion doctrine" broadly on the Internet.[123] Arguably, the benefit of increased competition outweighs the negative economic costs.[124] The cost-benefit analy-

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120. *Wells Fargo*, 293 F. Supp. 2d at 761 (internal citations omitted and alteration in original).

121. *Id.*

122. *Id.* (quoting August Storck K.G. v. Nabisco, Inc., 59 F.3d 616, 618 (7th Cir. 1995)).

123. Note, *Confusion in Cyberspace: Defending and Recalibrating the Initial Interest Confusion Doctrine*, 117 HARV. L. REV. 2387, 2401 (2004).

124. Further, trademark law has permitted some free-riding in the marketplace. With little fear of the trademark laws, an aspiring restaurateur can open an Italian restaurant next door to a trendy Italian restaurant. Trademark law stops free-riding of a competitor's goodwill only when there is a likelihood of confusion.

sis indicates that if switching costs are low, there will be little economic effect to the competitor. Moreover, the online business will benefit from offering high-quality Internet services, since it is precisely this type of better service that will motivate the consumer to click back to the trademark holder's page.

A "degree of confusion" factor would further prevent courts from crushing technologies and business methods in their infancy. In *1-800 Contacts*, WhenU's expert, Harvard Professor John Deighton, testified that a preliminary injunction in the case would have long-term chilling impacts.[125] This August, Claria put its initial public offering on hold, and other companies may soon feel a chilling effect on their efforts.

Moreover, the legal holdings of these pop-up ad cases will likely have implications far beyond pop-up ads. The recent *Government Employees Insurance Co. (GEICO) v. Google, Inc.* decision demonstrates the possibility of widespread effects.[126] The *GEICO* court relied on *1-800 Contacts* in determining that GEICO sufficiently alleged that the defendants used its protected marks in commerce.[127] The court noted that *1-800 Contacts* was better reasoned than *WhenU* and *Wells Fargo*.[128] The court found that Google's use of the trademarks in its internal computer coding together with its use of GEICO's trademarks to sell advertising and then to link that advertising to results of searches constituted a "use in commerce."[129] Thus, the implications of the use in commerce test have already been felt in an important keyword advertising case.

IV. CONCLUSION

Although WhenU and Claria specialize in marketing, they have a public image problem. Web surfers generally find pop-up ads annoying, scholars paint WhenU and Claria as predators, and one court finding in favor of WhenU even questioned what society had done to warrant such punishment. One can tell a different story about these companies. In this story, their online behavioral and contextual marketing models are revolutionary, lowering costs for advertisers and allowing consumers to receive ads when they most want them.[130] These online marketing companies are

125. 1-800 Contacts, Inc. v. WhenU.com, Inc., 309 F. Supp. 2d 467, 482 (S.D.N.Y. 2003).

126. No. 1:04CV507, 2004 U.S. Dist. LEXIS 18415 (E.D. Va. Aug. 25, 2004).

127. *Id.* at *8-*9.

128. *Id.* at *9.

129. *Id.* at *10.

130. The *Wells Fargo* court even found that Quicken Loans "actually benefited from SaveNow." Wells Fargo & Co. v. WhenU.com, Inc., 293 F. Supp. 2d 734, 755 (E.D.

profitable and help spur competition, thus lowering costs for consumers. A 1964 article envisioned that traditional marketing companies would be respectable by 1999, and they are.[131] A 2004 note envisions that online behavioral and contextual marketers might be respectable in the future, an outcome which is only feasible if the legal system properly balances society's interest in maintaining competition with its interest in preventing consumer confusion.

Mich. 2003) (finding Quicken Loan's parent company owns TurboTax, a WhenU customer, and that Quicken Loans has been involved in joint marketing campaigns with TurboTax).

131. Ramond, *supra* note 1.

ADDITIONAL DEVELOPMENTS—TRADEMARK

RULES OF PRACTICE FOR TRADEMARK-RELATED FILINGS UNDER THE MADRID PROTOCOL IMPLEMENTATION ACT

68 FED REG. 55, 748 (Sept. 26, 2003) (codified at 37 C.F.R. § 7.1 to .41 (2004))

The United States Patent and Trademark Office (USPTO) promulgated new regulations to implement the Madrid Protocol Implementation Act of 2002 ("the Act"). The Act amended the Trademark Act of 1946, and authorizes owners of a United States trademark to seek protection of marks in any country that is a party to the Madrid Protocol by submitting an application to the International Bureau ("IB") of the World Intellectual Property Organization (WIPO). The Act also enables owners of foreign trademarks to seek protection in the United States. .

To apply for international registration under the Act, a United States applicant must prepare an application based on a registered trademark or pending trademark application in the United States. An application must be submitted to the USPTO, which certifies the application and forwards it to the IB for review. If the application is approved, the IB registers the marks, publishes the international registration in the WIPO Gazette of International marks, sends a certificate to the holder, and notifies the offices of state in the countries in which an extension of protection is sought. Registration by the IB does not automatically grant protection in the designated foreign jurisdiction—the mark must be reviewed by the foreign office from which protection is sought.

Part 7 of 37 C.F.R. provides the regulations and procedures by which the USPTO will implement this scheme. 37 C.F.R. § 7.11 to .24 set out the requirements for international applications based on United States trademarks, including guidelines for identifying goods and services, correcting errors and irregularities in applications, and extending protection to additional jurisdictions. International applications can be based on more than one U.S. application or registration if the marks are all the same and have a common owner.

37 C.F.R. § 7.25 to .40 provide rules for requests by owners of internationally registered trademarks for extension of protection to the United States. These sections describe the requirements for asserting a priority claim under the Paris Convention for the Protection of Industrial Property, replacement of domestic registration by international registration, effects of a cancellation of international registration, and the requirements for transformation of an international application into a U.S. application.

Under § 66(a) of the Act, a request for extension of protection to the United States must be accompanied by a declaration of an intention to use the mark in commerce that the U.S. Congress has authority to regulate. The specific declarations that must be made at registration can be found in 37 C.F.R. § 2.33(e). Requirements for declarations of use of the trademark in commerce, and excusable nonuse between the fifth and sixth year after registration and every ten years after registration, can be found at 37 C.F.R. § 7.36 to .40.

Finally, 37 C.F.R. § 7.41 describes the process of renewal of registration. The initial term of international registration is ten years, which can be renewed for up to twenty additional years upon payment of a renewal fee. Renewal of international registration and its extension of protection to the United States must be made directly with the IB.

ADDITIONAL DEVELOPMENTS—TRADE SECRET

DVD COPY CONTROL ASS'N, INC. V. BUNNER

10 Cal. Rptr. 3d 185 (Ct. App. 2004)

A California court of appeal reversed a preliminary injunction that barred the defendant from posting, disclosing, or distributing plaintiff's alleged trade secrets and held that the evidence was insufficient to justify the injunction under the Uniform Trade Secrets Act (UTSA).

The motion picture industry adopted a content scrambling system (CSS) to prevent unauthorized reproduction of motion pictures on DVDs by encrypting the film data. The industry agreed upon a restrictive licensing scheme to keep CSS secret, with DVD Copy Control Association (DVD CCA) as the sole licensing agent. Despite these efforts, software decrypting CSS (DeCSS) appeared on the Internet in October 1999. The industry sent cease-and-desist letters to website operators offering DeCSS or links to the program. DVD CCA filed suit seeking a preliminary injunction in December 1999, naming Bunner as a defendant even though Bunner had not received a cease-and-desist letter. DVD CCA alleged that DeCSS contained CSS trade secret information, and that DeCSS was created by reverse engineering CSS in breach of a license agreement. Therefore, DVD CCA reasoned that the website operators misappropriated trade secrets by posting DeCSS with the knowledge that it had originated through improper means. The trial court issued the preliminary injunction and Bunner appealed, claiming that the injunction violated his free speech rights; the appellate court agreed and reversed. The California Supreme Court granted review and held that the injunction did not violate free speech, as long as the trial court properly issued the injunction under California's trade secret law.

On remand, the California court of appeal determined whether the injunction was warranted by considering the likelihood that the moving party would prevail on the merits and the relative harm to the parties vis-à-vis the injunction. The court stated that the plaintiff's first burden is to show that the information it seeks to preserve is a trade secret. The court noted that online publication will not destroy the trade secret as long as the publication is "sufficiently obscure or transient or otherwise limited" so that the information is not generally disclosed to economically interested parties. However, the court held that information in the public domain cannot be subjected to trade secret protection. The court ruled that the plaintiff was unlikely to prevail on the merits, since DeCSS was widely distributed over the Internet and the record was unclear as to when Bunner posted the program. With respect to the allegations of reverse engineering, the court held that even if the information was acquired improperly with everyone's knowledge thereof, third party publication is not automatically illegal if the information becomes publicly available. Because the court concluded that the facts demonstrated the information entered the public domain at some time after the initial publication, the court ruled that if the online distribution of DeCSS disclosed CSS to the public domain before Bunner posted, then no trade secret existed for Bunner to misappropriate.

Even if Bunner posted before the widespread dissemination, the court held that if the information became general knowledge before the trial, a preliminary injunction would be improper because DVD CCA would not be able to demonstrate interim harm. The court ruled that the injunction would be ineffective in prohibiting future disclosures, given the existing availability of the information online, and therefore DVD CCA would

not be able to satisfy the interim harm requirement. Furthermore, the court held that the preliminary injunction burdened more speech than was necessary to protect DVD CCA's property interest. Therefore, the court found the injunction to be an unlawful prior restraint on Bunner's free speech rights and subsequently reversed the lower court's grant of preliminary injunction.

LEJEUNE V. COIN ACCEPTORS, INC.

849 A.2d 451 (Md. 2004)

The Maryland Court of Appeals vacated a preliminary injunction against an ex-employee and rejected application of the trade secret doctrine of inevitable disclosure.

Coin Acceptors, Inc. ("Coinco") was in the currency acceptor industry. LeJeune was an employee for Coinco for ten years, during which time LeJeune never entered into a noncompete or confidentiality agreement. Coinco's primary competitor, Mars, subsequently hired LeJeune. Before leaving, LeJeune transferred numerous Coinco files onto a CD and retained hard copies of a number of files, including pricing and cost information. Coinco filed suit, claiming misappropriation of trade secrets under the Maryland Uniform Trade Secrets Act (MUTSA).

The trial court found that Coinco was likely to succeed on the merits of its claims of misappropriation of trade secrets, and granted Coinco a preliminary injunction against LeJeune that prohibited him from using or disclosing any of Coinco's trade secrets, and from "working for Mars in any area in which he would have to use or disclose Coinco's confidential and trade secret information." This grant of injunctive relief was based on the theory of inevitable disclosure, which had been applied in courts outside of Maryland but never relied on in an action under the MUTSA.

The court of appeals agreed with the trial court that the information copied and taken by LeJeune qualified as trade secrets and that LeJeune had misappropriated this information, but rejected the inevitable disclosure doctrine and thus vacated the preliminary injunction. The court first noted that an injunction is only appropriate to prevent future acquisition or disclosure of trade secrets, not as a remedy for past misappropriation, and furthermore that Coinco had presented no proof of threat of future acquisition or disclosure of trade secrets. The court then reasoned that allowing a company to obtain an injunction based on the inevitable disclosure theory would be unfair, in that it would allow a company to effectively obtain an after-the-fact noncompetition or nondisclosure agreement where one had not been expressly negotiated as part of the employment contract. A company could still, under the MUTSA, obtain an injunction by presenting actual proof of threatened acquisition or disclosure of trade secrets.

BERKELEY TECHNOLOGY LAW JOURNAL
ANNUAL REVIEW OF LAW AND TECHNOLOGY

CYBERLAW

IDENTITY THEFT IN CYBERSPACE: CRIME CONTROL METHODS AND THEIR EFFECTIVENESS IN COMBATING PHISHING ATTACKS

By Jennifer Lynch

> Dear Paypal valued member, It has come to our attention that your account information needs to be updated due to inactive members, frauds and spoof reports. If you could please take 5-10 minutes out of your online experience and renew your records you will not run into any future problems. However, failure to update your records will result in account suspension Please follow the link below and login to your account and renew your account information . . . .[1]

The above communication may appear, at first glance, to be a legitimate request from PayPal to update the accountholder's information. Instead, this e-mail is an example of the most recent form of identity fraud occurring on the Internet—"phishing."[2]

In the most common phishing scam, the "phisher" sends an e-mail disguised to look like it is from a financial institution or e-commerce site.[3] To appear credible and to attract the recipient's attention, the e-mail uses the company's logos and trademarks and employs "scare tactics" such as threats of account closure. The phishing e-mail typically tells the recipient she needs to update her account information "to avoid fraud" or for "security reasons" and directs her, through a link in the e-mail, to a fake site de-

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1. I received this e-mail, conveniently, while working on this Note. It is reprinted exactly as I received it and includes the e-mail's punctuation and grammatical errors, which were much less glaring when viewed in the context of PayPal's logos and design. This e-mail made it through two spam filters, and caught my attention because I am a PayPal account holder.

2. The word "phishing" comes from an analogy to fishing; the e-mail is bait used to lure in "fish" from the "sea" of Internet users. The "f" is changed to "ph" in keeping with computer hacking tradition. Anita Ramasastry, *Hooking Phishermen*, CNN.COM, Aug. 16, 2004, *at* http://www.cnn.com/2004/LAW/08/16/ramasastry.phishing.

3. Although phishers generally use the guise of banks and retailers as "bait," recent phishing scams used the lure of donating to the John Kerry presidential campaign and the chance to buy an advance electronic copy of an upcoming Harry Potter book. *See* John Borland, *Con Artists 'Phish' for Campaign Donors*, CNET NEWS.COM, Aug. 3, 2004, *at* http://news.com.com/Con+artists+'phish'+for+campaign+donors/2100-1028_3-5295764.html; Lawrence Van Gelder, *J.K. Rowling Warns Fans*, N.Y. TIMES, Feb. 3, 2005, at E2.

signed to look exactly like the site of the business mentioned in the e-mail.[4] Once there, she is asked to enter her personal information and update her password. However, if she does, this information will be used not to "update" her account, but to steal her identity.

The terms "identity theft" and "identity fraud" describe the theft for fraudulent purposes of personal information, such as account numbers, social security numbers (SSNs), and other personal identifiers such as a mother's maiden name.[5] Victims of identity theft and phishing attacks primarily suffer financial losses. However, these crimes also exact a price on the victim in time and money spent trying to rebuild her credit and good name, and a price on society in business losses, generally passed on to consumers through higher costs for goods and credit. Phishing imposes an additional societal cost—loss of consumer confidence in conducting business online.[6]

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4. Ramasastry, *supra* note 2; *see also* Internet Fraud Complaint Center, *'Spoofed' E-Mails & Websites—A Gateway to Identity Theft and Credit Card Fraud* 2 (2002) [hereinafter IFCC Intelligence Note], *at* http://www1.ifccfbi.gov/strategy/63003SpoofNote.pdf.

5. Most people define "identity theft" as the theft of personal identifying information for some kind of fraudulent purpose. However, some qualify this definition in two different ways. First, some limit identity theft to the theft of non-account information such as a social security number, driver's license number, or date of birth. *See e.g.*, 18 U.S.C.S. § 1028(d)(7) (LEXIS Supp. 2004); IDENTITY THEFT at vii (Claudia L. Hayward ed., 2004). Others may use a broader definition of identifying information to include the information just listed as well as account numbers, PINs, mother's maiden name, etc., but may limit the purpose of use to financial crimes such as account-takeovers or fraudulent account applications. *See* Richard M. Stana, *Identity Theft: Prevalence and Cost Appear to be Growing*, *in* IDENTITY THEFT, *supra*, 17, 49 [hereinafter Stana, *Identity Theft: Prevalence and Cost*]. This Note will use the broadest definition of identity theft; as such it will include the theft of any type of personal identifying information used for any purpose. However, the primary focus will be on the theft of personal information used for financial fraud, because this is the most common outcome of phishing attacks.

6. *See Introduction of the "Anti-Phishing Act Of 2004"*, 150 CONG. REC. S7897 (July 9, 2004) [hereinafter Senator Leahy Statement] (statement of Sen. Leahy), *available at* http://leahy.senate.gov/press/200407/070904c.html; *see also* Bob Tedeschi, *E-Commerce Report; Growing Concern About Fraud is Pushing the Online World into Action. The Task Looms Large, Though.*, N.Y. TIMES, Sept. 8, 2003, at C9 (discussing a 2003 Forrester Research poll of 39,000 Internet users that found that almost one-third were pessimistic about security on the Internet—the highest figure since the company began taking the poll in 1998). Tedeschi also quoted a Nielsen NetRatings Analyst who believes online retailers have lost "billions" due to customer wariness of buying online. Another recent article quoted an Internet-based security firm as stating that 29% of its survey respondents would avoid online shopping during the Christmas 2004 season due to e-mail scams. Bob Sullivan, *'Tis the Season for Phishing Scams*, MSNBC.COM, Nov.

This Note discusses the growing identity theft problem in cyberspace, focusing specifically on phishing attacks. Part I presents an overview of identity theft through a discussion of associated costs, laws, and stakeholders. Part II provides facts and statistics on the phishing problem. Part III sets up a structure for analyzing identity theft crime control methods based on primary, secondary, and tertiary responses to crime. The primary level includes victim self-help measures, the secondary level involves private-party architecture solutions, and the tertiary level includes public law enforcement efforts. Part III then discusses recent developments in fighting identity theft at each level, focusing on new laws and services that help consumers secure their identity, advances in private-party methods to detect and prevent fraud, and new and proposed changes to criminal laws used in the battle against identity theft. It also discusses the effectiveness of these new developments on phishing attacks, and critically examines who is best equipped to combat the phishing problem. The Note concludes that no single crime control method alone will be enough to combat phishing. Only a combined approach, incorporating strategies from each level, will diminish the phishing problem.

I. OVERVIEW OF THE IDENTITY THEFT PROBLEM IN THE DIGITAL AGE

Identity theft is one of the fastest growing crimes in the United States. A broad survey commissioned by the Federal Trade Commission (FTC) in September 2003, estimated that 9.9 million Americans had had their personal information stolen in the prior year,[7] collectively costing businesses $47.6 billion and consumers $5.0 billion.[8] The FTC Identity Theft Survey

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24, 2004 (citing a survey conducted by MailFrontier, Inc.), *at* http://www.msnbc.msn.com/id/6560652.

7. FED. TRADE COMM'N, IDENTITY THEFT SURVEY REPORT 7 (2003) [hereinafter FTC SURVEY REPORT], *at* http://www.ftc.gov/os/2003/09/synovatereport.pdf. The FTC estimated these figures by extrapolating from the percentage of survey respondents who stated they had had their identity stolen. *Id.* at 3. This figure is much higher than previously expected. Based on self-reporting figures at private and federal consumer protection agencies, many thought, prior to this report, that the number of victims of identity theft was closer to 750,000. Timothy L. O'Brien, *Identity Theft Is Epidemic. Can It Be Stopped?*, N.Y.TIMES, Oct. 24, 2004, § 3 (SundayBusiness), at 1 (quoting the executive director at the consumer advocacy group Identity Theft Resource Center); *see also* Stana, *Identity Theft: Prevalence and Cost*, *supra* note 5, at 19 (noting that as of 2002, the date of the article, there were no comprehensive statistics on how many people had been victims of identity theft).

8. FTC SURVEY REPORT, *supra* note 7, at 7.

revealed an exponential increase in identity theft, with the number of victims nearly doubling each year for the previous 2-3 years.[9]

Identity theft is not a new crime. Long before the Internet, thieves used low-tech methods to obtain and misuse people's credit and identification documents.[10] Current offline identity theft techniques include simple pickpocketing, "dumpster diving" for discarded financial records and credit card statements, stealing pre-approved credit card applications from mailboxes, completing "change of address" forms through the Post Office to divert a victim's mail, and securing low-level employment with an organization to gain access to and steal consumers' SSNs, credit reports, and financial records.[11] These techniques still account for the majority of identity theft cases,[12] but the Internet and the increased use of databases for storing consumer information has allowed thieves easier access to greater quantities of individual information at one time.[13] In close to the same

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9. *Protecting Privacy of Social Security Numbers: Hearing Before the Subcomm. on Commerce, Trade, and Consumer Protection of the House Comm. on Energy and Commerce*, 108th Cong. (2004) [hereinafter *FTC Statement 9/28/04*] (statement of Thomas B. Leary, Comm'r, FTC), *available at* http://www.ftc.gov/os/testimony/040928 test.htm. The number of victims falling prey to account theft (where the thief uses a victim's existing accounts to make fraudulent purchases) has increased 71% over the last year. FTC SURVEY REPORT, *supra* note 7, at 18.

10. Brian F. Caminer, *Credit Card Fraud: The Neglected Crime*, 76 J. CRIM. L. & CRIMINOLOGY 746, 746 n.5 (1985) (noting that in 1982, "credit card fraud [was] the fastest growing crime against business" and fraud perpetrated against Visa and MasterCard amounted to $125.8 million—"two and a half times greater than the amount of money stolen in bank robberies"); *see also* Katrina Brooker, *Just One Word: Plastic; How the Rise of the Credit Card Changed Life for the FORTUNE 500—And for the Rest of Us*, FORTUNE , Feb. 23, 2004, at 125 (discussing early forms of credit card fraud).

11. Kurt M. Saunders & Bruce Zucker, *Counteracting Identity Fraud in the Information Age: The Identity Theft and Assumption Deterrence Act*, 8 CORNELL J.L. & PUB. POL'Y 661, 663 (1999); O'Brien, *supra* note 7; FTC, *ID Theft: What's It All About*, *at* http://www.ftc.gov/bcp/conline/pubs/credit/idtheftmini.htm.

12. *See* FTC SURVEY REPORT, *supra* note 7, at 9.

13. *See* PETER GRABOSKY ET AL., ELECTRONIC THEFT: UNLAWFUL ACQUISITION IN CYBERSPACE 2 (2001) ("The fundamental principle of criminology is that crime follows opportunity, and opportunities for theft abound in the Digital Age."). In a 2000 Congressional Hearing, the FTC reported:

> The Internet has dramatically altered the potential occurrence and impact of identity theft. First, the Internet provides access to identifying information through both illicit and legal means. The global publication of identifying details that previously were available only to a select few increases the potential for misuse of that information. Second, the ability of the identity thief to purchase goods and services from innumerable e-merchants expands the potential harm to the victim through numerous purchases. The explosion of financial services offered on-line,

amount of time it would take for a thief to monitor a physical mailbox and steal one individual's new credit card, the thief can now set up a phishing scam and potentially steal hundreds or thousands of individuals' personal identifying information.

Once a thief has obtained a person's information, he may change the address on existing accounts and run up bills, open a new credit card account, obtain a home or car loan in the victim's name, obtain counterfeit checks to drain a person's bank account, or use a person's information when arrested for a crime.[14] Losses average $10,200 per identity theft case for businesses and $1,180 for consumers;[15] however, these costs fail to depict the full scope of the problem. In addition to monetary losses, victims report suffering non-monetary harm including emotional distress from feeling personally violated by the theft, being harassed by creditors and collection agencies for debts they did not incur, being turned down for a loan or new account, or even being arrested for crimes committed by

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> such as mortgages, credit cards, bank accounts and loans, provides a sense of anonymity to those potential thieves who would not risk committing identity theft in a face-to-face transaction.

Stana, *Identity Theft: Prevalence and Cost*, *supra* note 5, at 58; *see also* Bob Sullivan, *Database Giant Gives Access to Fake Firms*, MSNBC.COM, Feb. 14, 2004 (noting that Choicepoint, a company that maintains databases of personal information on virtually all U.S. citizens, recently warned 30,000 California residents that criminals posing as legitimate businesses had used its databases to access the residents' personal information), *at* http://www.msnbc.msn.com/id/6969799.

14. *See* FTC SURVEY REPORT, *supra* note 7, at 6 (noting that in 15% of cases, the victim's information was used for non-financial purposes, such as when the thief presented the victim's information to law enforcement when arrested for a crime or used it to obtain government documents); *see also* Saunders & Zucker, *supra* note 11, at 666-67. Saunders and Zucker present a particularly bad case discussed in *Rogan v. Los Angeles*, 668 F. Supp. 1384 (C.D. Cal. 1987), where a prison escapee who had stolen Rogan's birth certificate and used it to obtain a California driver's license also used Rogan's name when he was arrested on suspicion of murder and robbery. The identity thief was released, but the Los Angeles Police Department later issued an arrest warrant, charging Rogan with two robbery-murders. Rogan, who lived in Michigan and had no idea what was going on, was arrested at gunpoint multiple times over three years because the LAPD did not remove the warrant, even after it discovered that Rogan's fingerprints did not match those of the criminal who had used his name. Rogan won his Section 1983 civil rights action against the City of Los Angeles.

15. Jennifer Lee, *Identity Theft Victimizes Millions, Costs Billions*, N.Y. TIMES, Sept. 4, 2003, at A20. These figures are lower when the thief uses the victim's current account rather than setting up a new account in the victim's name. The FTC Identity Theft Survey also noted that many victims do not incur any out-of-pocket losses. FTC SURVEY REPORT, *supra* note 7, at 41–43. Under the Truth in Lending Act, most victims are not liable for fraudulent credit card purchases over $50, so these losses are borne by their credit issuers. *See* 15 U.S.C. § 1643(a)(1) (2000).

someone else in their name.[16] In some cases, the thief may destroy a victim's credit rating such that the victim is no longer able to obtain a loan, mortgage, or credit card. Victims average thirty or sixty hours per case trying to repair their credit history,[17] but the longer it takes victims to discover the crime, the greater the cost in terms of both financial losses and hours spent resolving the problem.[18] In the worst cases victims report spending up to 200 hours dealing with the problem, and it can take months or even years of agonizing effort for a person to clear her name and correct her credit history.[19]

Many laws criminalize identity theft and offer protection for consumers. At the federal level, laws against credit card fraud,[20] wire fraud,[21] bank fraud,[22] and identity theft[23] can be used against identity thieves. Consumers are also protected by the Truth in Lending Act,[24] which among

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16. FTC SURVEY REPORT, *supra* note 7, at 47; *see also* Stana, *Identity Theft: Prevalence and Cost*, *supra* note 5, at 23 (discussing how victims feel "personally violated" by identity theft and suffer emotional harm); Harry A. Valetk, *Mastering the Dark Arts of Cyberspace: A Quest for Sound Internet Safety Policies*, 2004 STAN. TECH. L. REV. 2, ¶¶ 29–32 (discussing a case of criminal identity theft), *at* http://stlr.stanford.edu/STLR/Articles/04_STLR_2. Many victims also report that their problems stem from their dealings with credit reporting agencies. *See, e.g.*, Jeff Sovern, *The Jewel of Their Souls: Preventing Identity Theft Through Loss Allocation Rules*, 64 U. PITT. L. REV. 343, 361 n.67 (2003) (discussing the extensive procedures and requirements that credit reporting agencies (CRAs) subject victims to before removing fraudulent information from their accounts, procedures to which the thieves were never subjected). Local police officers can also be less than supportive. Many do not understand their role in combating identity theft and fail to even provide victims with the police report necessary to convince CRAs to take fraudulent information off victims' accounts. *See Identity Theft: How It Happens, Its Impact on Victims, and Legislative Solutions: Hearing Before Sen. Judiciary Subcomm. on Tech., Terrorism and Gov't Info.* (2000) (statement of Beth Givens, Director, Privacy Rights Clearinghouse), *available at* http://www.privacyrights.org/ar/id_theft.htm.

17. FTC SURVEY REPORT, *supra* note 7, at 6. The lower figure reflects average time spent clearing up theft that involved misuse of existing accounts, while the higher figure represents "new account" theft.

18. *Id.* at 8, 43; *see also Nowhere to Turn: Victims Speak Out on Identity Theft*, Privacy Rights Clearinghouse (May 2000) (noting that victims surveyed by the organization averaged 175 hours dealing with the theft, although seven respondents spent between 500 and 1500 hours), *at* http://www.privacyrights.org/ar/idtheft2000.htm.

19. Stana, *Identity Theft: Prevalence and Cost*, *supra* note 5, at 64-65; *see also Identity Theft and Assumption Deterrence Act of 1998*, 144 CONG. REC. S9501, 9503 (1998) (statement of Sen. Leahy).

20. 18 U.S.C. § 1029 (2000 & Supp. II 2002).

21. *Id.* § 1343.

22. 18 U.S.C. § 1344 (2000).

23. *Id.* § 1028.

24. 15 U.S.C. § 1643(a)(1) (2000).

other things limits their losses to $50 for unauthorized credit card use, and the Gramm-Leach-Bliley Act (GLB Act),[25] which prohibits a person from using false pretenses to obtain financial information from a customer. In addition, almost every state has its own criminal and consumer protection laws that deal with identity theft.[26]

There are also many stakeholders, in addition to victims and identity thieves, involved in identity theft. Federal agencies such as the FBI, Justice Department, Secret Service, and Postal Service work together and with local, state, and international law enforcement agencies to catch and prosecute identity thieves. The Social Security Administration, FTC, and state consumer protection agencies study the problem; educate consumers, law enforcement agencies, and businesses; and help consumers after their identity has been stolen. Many nonprofit organizations also help identity theft victims and work to pass tougher identity theft and consumer protection laws. The credit and financial industries, including banks, credit card issuers, and credit reporting agencies (CRAs, also called "consumer reporting agencies")[27] also play a role, as do merchants, healthcare organizations, universities, and any other organization that might be a repository for personal information.

II. PHISHING

Phishing is a particularly pernicious form of identity theft because it exacts a price on both the individual consumer and on Internet use in general. Phishing victims are subject to the same emotional and financial

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25. *Id.* § 6821(b). The Gramm-Leach-Bliley Act predominantly relates to consumer privacy and financial institutions; however, the FTC has used it in civil cases against identity thieves. *See* Complaint for Permanent Injunction and Other Equitable Relief, FTC v. Hill (S.D. Tex. 2004) (No. H 03 5537) [hereinafter FTC Complaint], *available at* http://www.ftc.gov/os/caselist/0323102/0323102zkhill.htm; Press Release, Federal Trade Commission, Justice Department Halt Identity Theft Scam (Mar. 22, 2004) [hereinafter Hill Press Release], *at* http://www.ftc.gov/opa/2004/03/phishinghilljoint.htm.

26. *See* Holly K. Towle, *Identity Theft: Myths, Methods, and New Law*, 30 RUTGERS COMPUTER & TECH. L.J. 237, 302-305 (2004) (providing an overview of state identity theft laws, including specific code sections). This Note will discuss a few California laws as examples because California has a very high prevalence of identity theft cases relative to other states. Richard M. Stana, *Awareness and Use of Existing Data on Identity Theft* [hereinafter Stana, *Awareness and Use*], *in* IDENTITY THEFT, *supra* note 5, at 95, 104, 120. However, the sheer quantity of state laws makes a full discussion impossible in a Note of this length and breadth. In addition, some of these laws may now be preempted by the Fair and Accurate Credit Transactions Act. *See* 15 U.S.C.S. § 1681t (LEXIS Supp. 2004).

27. There are three major CRAs: TransUnion, Equifax, and Experian.

harms and damage to reputation suffered by other identity theft victims, but risk more extensive losses both financially and in time spent dealing with the problem. Merchant and credit card issuers may also suffer more extensive financial losses.[28] This is because phishing victims may not discover the theft until long after it occurs.[29]

Phishing affects the Internet in general by undermining consumers' trust in secured online transactions, which in turn leads to reduced activity online.[30] Because the fraudulent e-mails and websites look incredibly similar to official e-mails and sites, these scams call into question any electronic communication received from an online business. Consumers start to doubt the veracity of any unsolicited e-mail they receive, which could force organizations to return to more expensive offline methods to communicate with their customers.[31] In fact, research indicates that phishing and other online scams are already affecting online business. A recent survey of Internet users conducted by an e-mail security provider found that 29% of respondents stated they would avoid online shopping during Christmas 2004 due to e-mail scams.[32] A study of 39,000 Internet users in fall 2003 found that almost one-third were pessimistic about security on the Internet, in part due to online fraud—the highest figure since the company began taking the poll in 1998.[33]

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28. The Truth in Lending Act limits consumer liability for unauthorized credit card purchases, so merchants and credit card issuers shoulder almost all of the financial losses due to fraudulent purchases. 15 U.S.C. § 1643(a)(1) (2000).

29. Because the phishing scams look so real, victims may never realize that they have been duped. Compare this to a lost or stolen wallet, where the victim knows about the theft almost immediately and can alert her credit card issuers and the CRAs before much harm has occurred. The FTC Report indicated that victims who took longer to discover that their personal information had been stolen suffered greater monetary and non-monetary losses and were at a greater risk of having new accounts opened in their name. FTC SURVEY REPORT, *supra* note 7, at 8.

30. Senator Leahy Statement, *supra* note 6; David McGuire, *Senate Bill Targets 'Phishers'*, WASH. POST., July 12, 2004, *available at* http://www.washingtonpost.com/wp-dyn/articles/A44826-2004Jul12.html.

31. *See* Brian Krebs, *Companies Forced to Fight Phishing*, WASH. POST., Nov. 19, 2004 [hereinafter Krebs, *Companies Forced to Fight Phishing*] (noting that phishing has forced businesses to change how they communicate with their customers), *available at* http://www.washingtonpost.com/wp-dyn/articles/A61916-2004Nov19.html.

32. Sullivan, *supra* note 6. *See generally supra* note 6.

33. Tedeschi, *supra* note 6 (discussing a 2003 Forrester Research poll); *see also The War on ID Theft*, RED HERRING, Oct. 29, 2004 (quoting Gartner Research analyst Avivah Litan who noted that "62 percent [of the 47 percent of adults who bank online] said they felt very nervous about security and privacy of information" and that "[e]ighty percent of that group said they'd bank and keep more money online if more security was offered by

A. Overview of Past and Present Phishing Techniques

Phishing scams involve a spoofed e-mail and a spoofed website,[34] both of which use company trademarks and logos to appear to represent a legitimate financial institution or Internet Service Provider (ISP) with which the consumer has an account. Phishing scams focus almost exclusively on banks and online shopping sites: 30% are linked to eBay or PayPal, while almost 60% target US Bank or CitiBank.[35]

Phishers use scare tactics to catch a recipient off guard. E-mails state that the recipient's account may have been compromised or will be shut down if she does not respond.[36] In the most basic phishing scams, the e-mail states that the recipient needs to update her account by clicking on a link and entering her personal and financial information in the website to which she is directed. The e-mail contains a "link alteration" that directs the recipient to a URL that looks like it should belong to the financial institution but in fact links to the phisher's website. After the recipient has entered her personal and financial information on the fraudulent website, she will then be redirected to the actual financial institution's website, to make the experience seem authentic.[37] However, by that point the victim's information has already been automatically sent to the phisher.[38] Because the whole process looks so real, a victim may not know that her identity has been stolen, and she may never trace fraudulent uses of her financial information to the phishing attack. This makes phishers particularly difficult to trace and catch.

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service providers"), *at* http://www.redherring.com/Article.aspx?a=10938&sector=Industries&subsector=SecurityAndDefense.

34. Spoofing involves reproducing the look and feel of a website to another server owned and operated by someone else. *Spoofing Attacks*, WIKIPEDIA: THE FREE DICTIONARY, *at* http://en.wikipedia.org/wiki/Spoofing_attacks (last modified Mar. 4, 2005).

35. Krebs, *Companies Forced to Fight Phishing*, *supra* note 31; Brian Krebs, *Phishing Feeds Internet Black Markets*, WASH. POST., Nov. 18, 2004 [hereinafter Krebs, *Phishing Feeds Internet Black Markets*], *available at* http://www.washingtonpost.com/wp-dyn/articles/A59347-2004Nov18.html.

36. Saul Hansell, *Online Swindlers, Called 'Phishers,' Lure the Unwary*, N.Y. TIMES, Mar. 24, 2004, at A1 (also noting that some phishing e-mails have stated the recipient was about to be charged with child pornography).

37. Press Release, U.S. Department of Justice, Operation Web Snare 8 (Aug. 26, 2004) [hereinafter Operation Websnare Report], *formerly available at* http://www.fbi.gov/cyberinvest/websnare/websnare.pdf (on file with author).

38. *Id.* at 7.

Phishers rely almost entirely on the Internet for the ways and means of their scams. E-mail addresses are readily available online,[39] and phishers can purchase do-it-yourself phishing "starter kits" online that contain all the necessary graphics, code, text, and scripts to complete the scam.[40] Phishers then use the stolen financial information to purchase goods on the Internet.[41] Once they have stolen a victim's financial and personal information, they can sell or trade that information online as well, through news groups, chatrooms, message boards, and other covert locations.[42]

Early phishing attempts were crude and designed mainly to obtain passwords to access the Internet for free.[43] Later scams involved eBay's auction site, where thieves would use the account holder's information to set up fraudulent auctions.[44] Other early phishing attacks involving simple credit card theft were committed mainly by amateurs, including teenagers, and were relatively easy to detect.[45]

These early attacks were linked mainly to servers within the United States, but law enforcement agencies now trace the source of attacks to parts of Europe, Eastern Europe, and Asia.[46] Law enforcement agencies

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39. *See* Operation Websnare Report, *supra* note 37, at 10 (discussing one phisher in Georgia who purchased e-mail addresses through IRC chatrooms). A Google search will turn up many websites offering e-mail addresses for sale.

40. *See* John Leyden, *DIY Phishing Kits Hit the Net*, REGISTER, Aug. 19, 2004, *at* http://www.theregister.co.uk/2004/08/19/diy_phishing.

41. Operation Websnare Report, *supra* note 37, at 10 (noting also that phishers often have these goods delivered to vacant houses or to individuals recruited for this purpose).

42. *See* Michael Cohn, *Phishing Attacks Linked to Organized Crime: Tactics Growing More Sophisticated*, SECURITY PIPELINE, July 7, 2004, *at* http://www.securitypipeline.com/22104197; Beth Cox, *The Great Credit Card Bazaar*, INTERNETNEWS.COM, Sept. 20, 2002, *at* http://www.internetnews.com/ec-news/article.php/1467331. Many of these sites have recently been shut down as part of a Secret Service operation to nab identity thieves. *See* Jim Wagner, *Feds Charge 28 in ID Theft Ring*, INTERNETNEWS.COM, Oct. 29, 2004, *at* http://www.internetnews.com/security/article.php/3429101. However, a quick Google search for the names "Carderplanet" and "ShadowCrew" revealed cached pages where users were openly selling credit card and social security numbers, both singly and in bulk, in addition to fake IDs from around the world.

43. Ramasastry, *supra* note 2; *see also* Hansell, *supra* note 36 (noting that phishing originated 10 years ago when AOL charged users by the hour. Phishers sent fraudulent e-mails to obtain AOL users' account and password information so they could access the Internet at the user's expense).

44. IFCC Intelligence Note, *supra* note 4, at 2; Krebs, *Phishing Feeds Internet Black Markets*, *supra* note 35.

45. Hansell, *supra* note 36. One set of phishing attacks was conducted by a 55-year-old woman operating out of her home in Akron, Ohio.

46. IFCC Intelligence Note, *supra* note 4, at 2; Hansell, *supra* note 36; *see also* Operation Websnare Report, *supra* note 37, at 2 (noting that "illegally obtained funds have been identified as flowing to parts of the world where [terrorist groups] have been known

also believe current attacks are linked to organized crime both inside and outside of the United States.[47] Criminals located in foreign countries are able to complete their scams with the help of individuals recruited inside the United States to receive money and merchandise.[48] These individuals re-ship the merchandise to locations outside the country and launder the money through United States and foreign bank accounts.[49]

Current attacks have become more prevalent and more sophisticated. They use spyware, take advantage of software security flaws, and are able to avoid fraud and spam filters. In one attack that uses spyware, the scam replaces the "Address" bar at the top of the victim's browser with an appropriately-designed working fake.[50] The fake address bar remains installed even after the consumer leaves the fraudulent site and allows the phisher to track the consumer's Internet movement as well as all of the information the victim sends and receives.[51] In another advanced attack, the e-mail directs the recipient to a site that appears to be under construction, but which instead takes advantage of a Microsoft Internet Explorer security flaw to install a key-logger on the victim's computer.[52] This device records a victim's keystrokes, including logins, passwords, and PINs. The key-logger also compromises the victim's computer by allowing a hacker to use it as a mail proxy for spam and by giving the hacker the ability to control the computer remotely. While Microsoft has fixed the flaw, many users do not update regularly and could still be vulnerable. In another scam, the e-mail avoids fraud and spam filters by using an image

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to operate"). In one recent case, a thief operating out of Romania used a targeted phishing scam to bilk United States eBay purchasers out of $500,000. He was caught through a coordinated effort between the Secret Service, eBay, and the Romanian General Directorate for Combating Organized Crime. Press Release, U.S. Department of Homeland Security and U.S. Secret Service, United States Secret Service and Romanian Police Work Together to Solve Major Computer Fraud Investigation (Sept. 11, 2003), *available at* http://www.secretservice.gov/press/pub2503.pdf.

47. Cohn, *supra* note 42; Hansell, *supra* note 36.

48. Operation Websnare Report, *supra* note 37, at 8.

49. *Id.* at 9.

50. APWG Threat Advisory Alert, *Phishing Technique Replaces Web Browser Address Bar with Malicious JavaScript Fake* (Mar. 31, 2004) (noting that unlike similar attacks in 2003 that took advantage of a bug in Microsoft's Internet Explorer and thus were limited to that browser, this scam can replicate any browser), *formerly at* http://www.antiphishing.org/news/03-31-04_Alert-FakeAddressBar.html; *see also* Matthew Broersma, *Barclays Scam E-mail Exploits New IE Flaw*, ZDNET UK, Jan. 12, 2004 (discussing the flaw in Internet Explorer), *at* http://news.zdnet.co.uk/internet/security/0,39020375,39119033,00.htm.

51. APWG Threat Advisory Alert, *supra* note 50.

52. Andy McCue, *'Trojan' Emails Conceal Theft Tools*, ZDNET.COM UK, Aug. 13, 2004, *at* http://news.zdnet.co.uk/internet/security/0,39020375,39163517,00.htm.

instead of text in the body of the spoofed e-mail.[53] Other scams link to a legitimate financial institution's true site but use a "Secure Confirmation" popup screen, operated by the phisher, for the victim to enter her information.[54] In a final new attack—the worst of the recent variations—recipients are at risk even if they do not click on a link in the e-mail. If the recipient opens the e-mail, it changes her "host file," a local file on her computer that links easy-to-remember web addresses, such as www.CitiBank.com, with their IP addresses, so that whenever the consumer types in her bank's web address she is automatically directed to the phisher's IP address rather than the bank's.[55] Fortunately, this variation is not yet widespread.

These attacks are on the rise; the Anti-Phishing Working Group estimates there were over 500 unique phishing attacks per week in July 2004 alone.[56] Brightmail, an e-mail filter provider, identified 2.3 billion phishing messages in February 2004.[57] This figure represents 4% of all e-mail the company processed that month and was an increase from the 1% detected in September 2003. Although no one knows the exact cost of phishing attacks or how much money has been stolen,[58] Senator Patrick Leahy, who researched phishing to support his recent Anti-Phishing Bill, has estimated that approximately 1 million Americans have already been victims of these scams, at a cost of over $2 billion between mid-2003 and mid-2004.[59] Phishers have been able to convince up to 5% of recipients to respond to these e-mails,[60] and as the costs of running a scam are low, a 5% return rate for phishers may yield high results.[61]

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53. Operation Websnare Report, *supra* note 37, at 8–9.

54. *Id.* at 9.

55. Bob Sullivan, *A New, More Sneaky Phishing Attack, Victim Computers Hijacked, Sent to Fake Bank Sites*, MSNBC.COM, Nov. 5, 2004, *at* http://www.msnbc.msn.com/id/6416723.

56. Anti-Phishing Working Group, http://www.antiphishing.org (last visited Feb. 3, 2005). The Anti-Phishing Working Group (APWG) is an industry association that teams software makers, banks, ISPs, and law enforcement to study and combat phishing.

57. Hansell, *supra* note 36. Brightmail was recently acquired by Symantec.

58. *Id.*

59. Senator Leahy Statement, *supra* note 6. *But cf.* Press Release, TRUSTe, U.S. Consumer Loss of Phishing Fraud to Reach $500 Million (Sept. 29, 2004) (noting that a recent report sponsored by TRUSTe estimated that "the nation's total monetary loss to victims of [phishing scams is] approximately $500 million"), *at* http://www.truste.org/about/press_release/09_29_04.php.

60. Ramasastry, *supra* note 2 (citing a study by the Anti-Phishing Working Group).

61. Most organizations, including the FBI's Internet Fraud Complaint Center (IFCC), recognize that the majority of people who receive phishing e-mails ignore or delete them, and banks think losses attributable to phishing are relatively small compared with losses due to stolen credit cards. *See* IFCC Intelligence Note, *supra* note 4; Hansell,

B. Difficulties in Deterring and Catching Phishers

Like other forms of computer crime, phishing is difficult to deter because normal barriers to offline crime do not apply.[62] Computer crime's effective anonymity means that social norms that might deter offline criminals are inapplicable to cybercriminals.[63] This anonymity also means that the chance of getting caught is significantly lower. In addition, cybercrimes such as phishing attacks are much less expensive to commit, in part because the thief's computer substitutes for the accomplices who would be needed to commit a similar crime offline.[64]

Existing federal civil and criminal laws mentioned in Part II[65] can be and have been used against phishing.[66] However, a phisher's risk of getting caught is still very low. Most consumers who enter their personal information on a fraudulent site do so because they believe the site is authentic. By the time they realize what has happened and report the scam to law enforcement, the phisher has likely disappeared without a trace. The phishers' sites are generally online for no more than 54 hours, so the spoofed site will disappear before law enforcement has even received

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supra note 36. However, IFCC has also noted that the recent rise in identity theft and credit card fraud can be attributed, in part, to the lack of technical sophistication in new Internet users. IFCC Intelligence Note, *supra* note 4, at 1. Therefore, many are still at risk.

62. Neal Kumar Katyal, *Criminal Law in Cyberspace*, 149 U. PA. L. REV. 1003, 1011 (2001).

63. *Id.* Katyal also notes, however, that the fact that there is not more cybercrime may indicate that social norms do play some role. *Id.* at 1108.

64. *Id.* at 1042. Katyal notes that crimes committed with computers are effectively subsidized because offline criminals would need help from others and would then be criminally liable for both the underlying offense and the conspiracy, whereas criminals who work with a computer are subject only to the underlying offense. He proposes, for this reason, treating computer crime as a conspiracy, with the computer filling in as a quasi-conspirator.

65. *See supra* notes 20-25. The FTC Act, 15 U.S.C. § 45 (2000), which gives the FTC the authority to initiate federal court proceedings to protect consumers from unfair and deceptive acts, also benefits identity theft victims. Both the FTC Act and the GLB Act were used successfully in a 2004 civil case brought by the FTC against a small-scale phisher who was responsible for defrauding victims of approximately $47,000. *See* FTC Complaint, *supra* note 25; *see also* Criminal Information, United States v. Hill (E.D. Va. 2004) [hereinafter Hill Criminal Information], *available at* http://www.ftc.gov/os/caselist/0323102/0323102zkhill.htm; Plea Agreement, United States v. Hill (E.D. Va. 2004) [hereinafter Hill Plea Agreement], *available at* http://www.ftc.gov/os/caselist/0323102/0323102zkhill.htm; Hill Press Release, *supra* note 25.

66. Ramasastry, *supra* note 2.

workable information about the attack.[67] In addition, although a phisher's server information is revealed during the spoof, catching phishers is still difficult because they use multiple ISPs, redirect services, and hijacked third-party computers located in the United States and abroad.[68]

The FBI and the Secret Service have had some success catching phishers and other cyber-identity thieves. In Fall 2004, the government announced two recent investigations, "Operation Firewall" and "Operation Websnare," in which federal agencies collaborated with state and foreign law enforcement and business alliances to catch American and foreign cybercriminals.[69] Operation Websnare involved 150 investigations into crimes such as "criminal spam," identity theft, credit card fraud, intellectual property rights, and computer hacking. According to the FBI, more than 870,000 victims lost more than $210 million through these scams.[70] Operation Firewall focused on three Internet websites that provided a forum for buying and selling personal identification information and identity theft tutorials online. The Secret Service arrested 28 suspects from eight states and six foreign countries who were involved in stealing more than 1.7 million credit card numbers and other financial information costing more than $4.3 million.[71]

Although these operations involved many suspects, thousands of victims, and millions of dollars, even the FBI has stated that the investigations "represented only a fraction of the Cyber crime problem."[72] An analyst with Gartner Research, commenting on the success of Operation Firewall, noted: "It's good news when everyone works together, they can

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67. IFCC Intelligence Note, *supra* note 4, at 2 (noting that even when victims report the attacks, they often do not include pertinent information from the e-mail, such as full header information, that would enable law enforcement to track the phisher); Ramasastry *supra* note 2.

68. Operation Websnare Report, *supra* note 37, at 7; *see also* Katyal, *supra* note 62, at 1071-74 (discussing the difficulties involved in tracing cybercriminals); Saul Hansell, *E-Mail's Backdoor Open to Spammers*, N.Y. TIMES, May 20, 2003, at A1 (discussing spammers' use of proxy servers and software to cover their tracks); Ramasastry, *supra* note 2 (discussing one scam in which the phishers moved their fraudulent website among seven different servers located all over the world over a period of just twelve days).

69. Operation Websnare Report, *supra* note 37; Wagner, *supra* note 42. The FBI is currently working with other organizations in another investigation specifically targeting phishers called "Digital Phishnet." Krebs, *Companies Forced to Fight Phishing*, *supra* note 31.

70. Operation Websnare Report, *supra* note 37, at 2.

71. Robert Lemos, *Secret Service Busts Suspected ID Fraud Ring*, CNET NEWS.COM, Oct. 28, 2004, *at* http://news.com.com/Secret+Service+busts+suspected+ID+fraud+ring/2100-7348_3-5431419.html.

72. Operation Websnare Report, *supra* note 37, at 2.

really catch the crooks. The bad news is [the criminals] are like cockroaches—you kill one and 20 pop up."[73] These investigations are unlikely to make much of a dent in the phishing problem.

III. RECENT DEVELOPMENTS IN COMBATING IDENTITY THEFT AND HOW THEY STAND UP TO PHISHING ATTACKS

This Part presents a framework for analyzing various crime control methods employed by stakeholders involved in phishing attacks. It will then use that framework to analyze recent developments in combating identity theft in general and phishing scams in particular.

A. A Framework for Phishing Crime Control

Many federal agencies, including the FTC, Justice Department, FBI, and Secret Service, are involved in efforts to protect consumers against identity theft and in prosecuting criminals who have committed theft. But the federal government cannot operate alone. Most commentators recognize that government must work with other constituents, including private business entities and potential victims, for crime control to be effective. Some even see law enforcement as having only a narrow role today because "[c]ode, market forces, and to a lesser extent social norms, have eclipsed law as the major institutions of social control in cyberspace."[74] As eBay's vice president for security noted, "Technology can solve 60 percent of the problem . . . [e]ducation and awareness can solve 20 percent, and no matter how good the industry is, there will be people who fall victims so 20 percent will have to be handled by law enforcement."[75]

Crime control, both in the physical world and in cyberspace, can be seen as occurring on three levels: primary, which includes "self-help" steps the potential victim can take to educate herself about and insulate herself from the initial crime and resulting harms; secondary, which includes architecture and fraud prevention mechanisms that private parties can institute to prevent crime and lessen the harms associated with it; and tertiary, which includes public law enforcement efforts to deter crime and

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73. *The War on ID Theft*, *supra* note 33 (quoting Gartner Research analyst Avivah Litan).

74. GRABOSKY ET AL., *supra* note 13, at 8. Grabosky calls this approach "legal pluralism" and quotes Michel Foucault for the idea that crime control is a "web of constraint" in which government is but one strand. *Id.* at 6.

75. Hansell, *supra* note 36.

track down and prosecute criminals.[76] Depending on the type of crime involved and the situation, constituents at one or more of the levels may play a greater or lesser role in dealing with the crime.[77] Identity theft stakeholders who play a role at the primary level include the potential victims themselves, state and federal consumer protection agencies, and others who provide education to consumers. Insurers are also increasingly playing a role. At the secondary level are financial institutions, CRAs, and merchants. Software manufacturers and ISPs also play a role in preventing phishing attacks. Finally, the tertiary level includes local, state, and federal public law enforcement agencies. State and federal legislatures also play a role at both the secondary and tertiary levels by enacting consumer protection and criminal laws.

The past year has seen advances by constituents at each level. The rest of this Part discusses recent developments in fighting identity theft at each level, including new laws and services that help consumers secure their identity, advances in private party methods to detect and prevent fraud, and new and proposed changes to criminal laws. It also discusses the effect of these new developments on phishing attacks, analyzing which are the best methods for dealing with phishing by looking critically at which constituents are best equipped to combat this problem.

B. Primary-Level Strategies—Self-Help

We are all potential victims of identity theft, no matter how computer savvy we are and no matter how much we guard our personal information and credit card numbers.[78] This is due, in large part, to the fact that our

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76. The following is an example of each of these levels in a car theft situation in the physical world. At the primary level, a potential car theft victim protects herself by purchasing insurance, parking in a lighted lot, and locking her car. At the secondary level, the car manufacturer protects the potential victim by installing a good locking device on the car, and the parking lot owner helps by designing the lot so that it is well lit and patrolled regularly. Finally, if both primary- and secondary-level measures fail and the victim's car is stolen, law enforcement—working at the tertiary level—properly investigates the theft, catches the thief, and uses appropriate laws to punish him for his actions and prevent him from stealing other cars in the future.

77. In the example in note 76, the potential victim can take greater responsibility for protecting herself from a car theft, whereas in a situation over which she has less control (e.g., a bank heist) she might need to be more reliant on the bank's security system (secondary level) and a quick response from law enforcement (tertiary level).

78. The greatest losses attributable to identity theft may come from corporate employees who use their insider access to steal and sell thousands of identities without the consumer ever knowing. *See* O'Brien, *supra* note 7 (discussing the "biggest case of identity theft ever" victimizing 30,000 people and perpetrated by just two individuals, one of whom worked at a software company as a help desk clerk). O'Brien also notes that the

personal information is already out in the world, beyond our control. However, there are still steps that we as potential victims can take, both to protect ourselves from theft before it happens and to insulate ourselves from its costs after it does.

Three main self-help remedies include education, insurance, and civil litigation. The first two are available to potential phishing and other identity theft victims, and the following sections will discuss them further. The third common self-help remedy—civil litigation through tort law—is less prevalent in identity theft crimes. Consumers generally do not bring lawsuits directly against identity thieves for the obvious reason that thieves are almost never caught. However, even if a thief were caught, a victim might not have recourse through civil litigation because phishing attacks probably fall under the CAN-SPAM Act, which states that the FTC is the exclusive enforcement agency and prohibits individuals from filing suit directly.[79] Consumers also do not have much recourse against organizations, such as CRAs, law enforcement, ISPs, and credit issuers, that may propagate identity theft by issuing credit or accounts to thieves under the victim's name and by refusing to remove fraudulent information from a victim's files. This gap is due in part to several laws limiting the liability of these organizations.[80] In addition, since consumers are no longer fully liable for most unauthorized purchases on their credit card, in the eyes of the law they suffer little "real" harm and often are not considered the "victim" of the fraud.[81] Although consumers suffer significant loss of time,

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FDIC has warned that the outsourcing of corporate call centers and other high access jobs has heightened the risk of identity theft, and that even babies and the deceased have had their identities stolen. *Id.*

79. Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (CAN-SPAM Act of 2003), Pub. L. No. 108-187, 117 Stat. 2699 (amending scattered sections of 15 U.S.C., 18 U.S.C., 28 U.S.C., and 47 U.S.C.); Michael L. Rustad, *Punitive Damages in Cyberspace: Where in the World is the Consumer?*, 7 CHAP. L. REV. 39, 73 (2004); *see also* Lily Zhang, *The CAN-SPAM Act: An Insufficient Response to the Growing Spam Problem*, 20 BERKELEY TECH. L.J. 301 (2005) (discussing the CAN-SPAM Act in more detail).

80. *See* 17 U.S.C. § 512 (2000) (limiting ISPs' liability for their customers' copyright infringement); 47 U.S.C. § 230 (2000) (limiting ISPs' liability for defamatory content published by their customers); *see also* 15 U.S.C. § 1681e(b) (2000) (requiring CRAs to maintain "reasonable procedures" to protect the accuracy of consumer records). Cases have held the standard set forth in 15 U.S.C. § 1681e(b) limits CRAs' liability. *See, e.g.*, TRW Inc. v. Andrews, 534 U.S. 19 (2001); Rustad, *supra* note 79. Rustad argues that punitive damages should be available for cybercrimes and notes that in the last 10 years "not a single consumer prevailed in a cyberlaw case in which punitive damages were awarded." Rustad, *supra* note 79, at 50.

81. *See, e.g.*, United States v. Blake, 81 F.3d 498 (4th Cir. 1996) (holding that a person whose credit card was stolen in violation of 18 U.S.C. § 1029 did not qualify as

emotional harm, and damage to reputation, the law has not been able to quantify the value of these harms and does not provide much of a remedy to identity theft victims through civil litigation.

Consumers do have other self-help remedies through education and insurance. In the last year, Congress, federal agencies, the states, and private parties have made further efforts to help consumers deal directly with identity theft by offering information and identity-theft-specific insurance policies, and by mandating and enacting procedures by which consumers may better protect their personal information before it is stolen.

1. Education

The FTC Identity Theft Survey showed that many victims of identity theft, no matter how the theft occurred, felt that the most helpful tool they could have had in dealing with the crime would have been "better awareness on their own part of how to prevent and respond to identity theft."[82] Education and awareness are especially important for phishing attacks, and may be the most effective strategies against traditional phishing[83] at any of the three levels. Unlike other forms of identity theft that occur without the victim's knowledge and in which the victim could really do nothing to protect herself,[84] identity theft through phishing is preventable if the victim knows what to look for. Phishers rely on some kind of alarming "hook," such as threat of account closure or unauthorized charges or even identity theft, to elicit an emotional reaction from recipients. But if the recipient is forewarned of this trick, she will look at the correspondence critically and not fall into the trap. Unless a recipient takes the bait and enters her personal information on the fraudulent site, the phisher cannot steal anything from her. Therefore, many losses attributable to phishing could be prevented through greater consumer awareness of the phisher's techniques.

Information on identity theft and phishing scams and how to protect oneself against them is readily available to consumers—as long as they know where to look and what to look for. Many public and private consumer groups provide this information online, and major newspapers have

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the "victim" for purposes of restitution); *see also* Kurt M. Saunders & Zucker, *supra* note 11, at 668. Saunder and Zucker state that "no court has ever classified an individual's identity as tangible personal property." Saunder & Zucker, *supra* note 11, at 668.

82. FTC SURVEY REPORT, *supra* note 7, at 62.

83. As discussed further in this Part, education may not do much to prevent recent, more sophisticated attacks that rely less on the victim's actions and more on technology such as spyware and key-logging software.

84. *See supra* note 78 and accompanying text.

recently carried articles on identity theft.[85] The FTC has a website, hotline number, and in-depth publications that educate consumers on identity theft and phishing attacks, and how to prevent them and deal with associated problems after they happen.[86]

However, further education may not be the entire answer for many potential phishing victims. Many consumers still lack the experience to even know where to look for information on preventing identity theft and phishing, or to know what to do with the information once they learn of it. Although the FTC has tried since 1998 to be a central repository for information on identity theft and for victim complaints, its own survey in Fall 2003 revealed that only 3% of identity theft victims contacted the FTC, and only 5% contacted other federal agencies such as the Postal Service or Social Security Administration that might have directed them to the FTC website.[87] In addition, a recent survey of consumer online behavior related to identity theft suggested that even though the FTC and other organizations provided information on how to safeguard personal information online, most respondents did not follow their suggestions.[88]

Another somewhat obvious problem is that the term "phishing" is so obscure that many consumers would not associate it with a suspect e-mail purporting to be from their bank and asking for their personal information. Therefore, consumers face a Catch-22—they could prevent a successful phishing attack if they knew what to look for, but without knowing what to look for (i.e., that the scam is called "phishing"), consumers may be hard-pressed to educate themselves about the attacks.[89] This is exacerbated by the fact that the most obvious source for information—the bank or retailer that purportedly sent the fake e-mail—may not help the consumer. If the consumer tries to reach her bank via telephone, she could be in for a very long wait on hold, and if she tries to find information online, she may have a hard time locating this on the bank's website (especially if she tries to find this information by clicking on the link in the fraudulent e-mail).[90]

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85. *See, e.g.*, O'Brien, *supra* note 7; Identity Theft Resource Center, http://www.idtheftcenter.org (last visited Mar. 7, 2005); Privacy Right Clearinghouse, http://www.privacyrights.org (last visited Feb. 3, 2005). A recent search on Google News turned up about 3,500 articles on identity theft.

86. *See* FTC, *ID Theft Home*, *at* http://www.consumer.gov/idtheft (last visited Mar. 7, 2005).

87. FTC SURVEY REPORT, *supra* note 7, at 50.

88. George R. Milne et al., *Consumers' Protection of Online Privacy and Identity*, 38 J. CONSUMER AFF. 217, 223-224 (2004).

89. How does one "Google" something if one does not know what it is called?

90. Banks and other financial services providers such as PayPal have improved in this area. Now many providers have links to information about phishing on their home

The banking industry has so far declined to fund a recent campaign by a privacy organization, TRUSTe, that would sponsor alternate forms of education on phishing, such as radio or television public service ads.[91]

Finally, recent phishing attacks have become more sophisticated and involve technological devices that may be beyond the ken of even relatively savvy consumers. Some of these attacks, such as those that automatically change a recipient's hostfile,[92] do not even require any action to be taken by the consumer, so she would be hard-pressed to educate herself on how best to protect herself from this type of attack. For all these reasons, even though education and awareness are important strategies in preventing phishing, other resources at each of the three levels are also required.

2. *Consumer Assistance—Recent Legislative Developments*

a) The Fair and Accurate Credit Transactions Act

In December 2003, Congress passed the Fair and Accurate Credit Transactions Act (FACTA),[93] which amends the Fair Credit Reporting Act and provides measures that can help consumers correct mistakes on their credit record and protect themselves from identity theft.[94] It also mandates changes in how the credit industry takes care of a consumer's credit, although these will be discussed under secondary-level solutions below. While this new law was intended to offer more general protections against identity theft, it could also benefit phishing victims.

The FACTA was enacted to "prevent identity theft, improve resolution of consumer disputes, improve the accuracy of consumer records, [and] make improvements in the use of, and consumer access to, credit informa-

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pages. However, last year it was difficult to find this information, even though by then phishing attacks had become relatively common. This suggests that many institutions will still not be ready when the next version of online identity fraud hits.

91. Krebs, *Companies Forced to Fight Phishing*, *supra* note 31 (noting that TRUSTe, a nonprofit privacy group in San Francisco, has tried to convince financial institutions to fund a $10 million ad campaign to educate consumers about phishing, but as of the date of the article, none had pledged any funding).

92. *See supra* Part II.A.

93. Pub. L. No. 108-159, 117 Stat. 1952 (2003) (amending 15 U.S.C. § 1681 *et. seq.* (2000)).

94. A full analysis of this extensive piece of legislation is beyond the scope of this Note. For further information, see Gail Hillebrand, *After the FACTA: State Power to Prevent Identity Theft*, 17 LOY. CONSUMER L. REV. 53 (2004); Stefan Linnhoff & Jeff Langenderfer, *Identity Theft Legislation: The Fair and Accurate Credit Transactions Act of 2003 and the Road Not Taken*, 38 J. CONSUMER AFF. 204 (2004).

tion."[95] The Act provides that consumers have the right to request a free consumer report annually from the major CRAs.[96] It also allows consumers to put a fraud alert on their credit file if they think they have been the victim of identity theft, and establishes a national fraud alert system or a "joint fraud alert" so that once a consumer files a fraud alert with one of the three CRAs, that agency will share the request with the other two, lessening the burden on the consumer.[97] The Act also requires that CRAs block, or cease reporting, fraudulent or allegedly fraudulent information on a consumer's record when the consumer submits a police report and appropriate identifying information.[98] Some of these provisions went into effect in 2004, while others will be phased in throughout 2005.[99]

The FTC believes these new requirements will provide a large benefit to consumers by helping consumers to verify their credit information more

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95. Pub. L. No. 108-159.

96. *Id.* § 211. Under The Fair Credit Reporting Act, the precursor to FACTA, a consumer was only entitled to a free report when he or she "suffered adverse action, believed that fraudulent information may be in his or her credit file, was unemployed, or was receiving welfare benefits." *Identity Theft: Prevention and Victim Assistance: Hearing Before the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce*, 107th Cong. 13 n.25 (2003) [hereinafter *FTC Statement 12/15/03*] (statement of Betsy Broder, Assistant Director, Division of Planning and Information Bureau of Consumer Protection, FTC), *available at* http://www.ftc.gov/os/2003/12/031215idtheft testimony.pdf. However, some states, including Massachusetts and New Jersey, already required that the CRAs provide consumers with free annual reports. *See* FTC, Facts for Consumers: Your Access to Free Credit Reports (Nov. 2004), *at* http://www.ftc.gov/bcp/conline/pubs/credit/freereports.htm.

97. *FTC Statement 9/28/04*, *supra* note 9. A fraud alert "is simply a statement that some information in the report may be based on identity theft." Linnhoff & Langenderfer, *supra* note 94, at 205. Linhoff and Langenderfer note that a fraud alert may prevent further damage due to identity theft because it would likely "motivate potential creditors to verify identification prior to extending credit." *Id.* at 206.

98. FACTA, Pub. L. No. 108-159 § 152. Since many police reports are automated and do not require proof of identification, the statute requires that the identity theft victim provide CRAs with additional identification, both to prevent further identity theft from fraudulently filed police reports and to prevent consumers from removing negative, but accurate, information from their reports. *See* 16 C.F.R. 603.3 (2004) (including new rules regarding proof of identity required to block fraudulent reporting); Press Release, FTC, FTC Issues Final Rules on FACTA Identity Theft Definitions, Active Duty Alert Duration, and Appropriate Proof of Identity (Oct. 29, 2004) (discussing the new rules), *at* http://www.ftc.gov/opa/2004/10/facataidtheft.htm.

99. 16 C.F.R. § 602.1; *see also Social Security Numbers and Identity Theft: Hearing Before the Subcomm. on Soc. Sec. of the House Comm. on Ways and* Means, 108th Cong. 5-6 (June 15, 2004) (statement of J. Howard Beales, III, Director, Bureau of Consumer Protection, FTC), *available at* http://www.ftc.gov/os/testimony/040615idtheftssntest.pdf.

often and learn of possible identity theft earlier.[100] FACTA will also benefit potential victims of identity theft, including people who fall for phishing attacks, by simplifying the hoops a consumer has to go through to take care of the mess in her financial records after the theft occurs.

However, FACTA's weaknesses may outweigh its benefits. FACTA continues to place the primary burden of detecting and cleaning up identity theft on the victim. It does not provide credit reports automatically and only provides them for free once a year, which may not be often enough to detect fraud.[101] This is especially problematic for phishing victims who may think that the e-mail they received from their "bank" was authentic and may not realize until much later that they have been the victim of identity theft. A phishing victim would be unlikely to seek out a credit report until she notices suspect charges on her account. If the thief has, instead, used her identity to open a new account or take out a loan in her name, she may not realize the theft has occurred until she is turned down for a loan herself. The FTC Identity Theft Survey revealed that the longer it takes for a consumer to realize that her identity has been compromised, the greater the potential damage to her credit and good name.[102] Therefore, making credit reports available for free only once a year may not provide much help for the phishing victim. If, instead, the reports were provided more often and on an automatic basis, the consumer would have a better chance of discovering the theft in time to prevent many of the worst losses.

There are other problems with FACTA. For example, while the new "joint fraud alert" system may be helpful—having a fraud alert on one's account is certainly a red flag to credit issuers—it will not necessarily prevent them from issuing credit in the victim's name to others.[103] In addition, FACTA preempts many state laws that may have offered further pro-

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100. *FTC Statement 12/15/03*, *supra* note 96, at 13.

101. Although the annual reports are free, the law does not prevent the CRAs from trying to get consumers to purchase add-on services for a fee when they try to obtain their free report. When I obtained all three of my reports in December 2004, each agency asked me first if I would like to purchase various services ranging from my FICA score at $5.95 to an automatic identity theft detection service for $9.95 per month. Shortly after I requested my reports, I also received mail correspondence from my banks and credit card companies offering a similar monthly identity theft detection service for a fee.

102. FTC SURVEY REPORT, *supra* note 7, at 8.

103. *See* Brian Bergstein, *Anti-Identity Theft Freeze Gaining Momentum*, CNN.COM, Aug. 3, 2004 (noting that creditors may still issue instant credit despite a fraud alert); *at* http://www.cnn.com/2004/TECH/biztech/08/03/security.freeze.ap; *see also* Sovern, *supra* note 16, at 352 n.37 (noting multiple examples of this).

tection to consumers.[104] Not only would these state laws fill in the gaps in FACTA, but they would also provide an opportunity for experimentation to find the best balance between benefiting consumers and limiting the burden on the credit industry. Finally, some commentators fear that Congress may believe it has already addressed the identity theft problem and "will consider the job done and turn its attention to other matters, leaving serious gaps in the statutory matrix."[105] Therefore, while the FACTA provides some help to potential phishing victims, it is not a large change from the status quo, and it does not do much if anything to prevent identity theft before it happens.[106]

b) The "Anti-Identity Theft Freeze"

California and a few other states now offer consumers the option to put an "anti-identity theft freeze" or "security freeze" on their credit record that would prevent organizations from looking at their credit history and offering credit based on their record.[107] While the new FACTA provides identity theft victims with the ability to place a fraud alert on their credit accounts, this may not always prevent merchants and other creditors from issuing on-the-spot credit for big-item purchases.[108] The security freeze provides greater protection by completely preventing any creditor from accessing any part of a consumer's credit history—and without access, the creditor cannot offer credit. In California, this service is free for identity theft victims, although for everyone else, the initial freeze costs $10. It costs an additional $8 to lift the freeze temporarily if, for example, a consumer wants to obtain a loan or buy a car, or if she knows that someone such as a landlord will be requesting access to her account for a background check. But this cost is multiplied by three because the freeze must be performed with each of the three CRAs. The system uses a personal

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104. *See* 15 U.S.C.S. § 1681t (LEXIS Supp. 2004); Hillebrand, *supra* note 94 (analyzing FACTA's preemptive effects). *But see* Robert F. Brennan, *Erroneous Federal District Court Decisions on California's Consumer Credit Reporting Agencies Act Need to be Overruled: Faith And Credit*, 27 L.A. LAW. 36 (2004) (arguing that California's identity theft laws should not be preempted by FACTA). A full analysis of FACTA's preemptive effect on state laws is outside the scope of this article.

105. Linnhoff & Langenderfer, *supra* note 94, at 215; *see also supra* note 96.

106. *See* Francis J. Menton, Jr., *Can You Protect Yourself From Identity Theft?*, N.Y.L.J., Apr. 29, 2002, at 1. Menton believes that viewing your credit report annually does nothing to prevent identity theft before it happens.

107. Bergstein, *supra* note 103. California Senate Bill 168 amended California Civil Code Section 1785.1 *et seq.*, and went into effect on January 1, 2003. *See also* LA. REV. STAT. ANN. § 9:3571.1 (West 2004); TEX. BUS. & COM. CODE § 20.034 (Vernon 2002 & Supp. 2004-2005); VT. STAT. ANN. tit. 9, § 2480h (1993 & Supp. 2004).

108. Bergstein, *supra* note 103.

identification number (PIN), and the only way to lift a freeze is by calling each of the three CRAs and providing them with the PIN.[109]

Many in the credit industry think this law is over-kill and will unnecessarily prevent easy access to credit such as quick mortgage approval—perks that consumers have come to expect.[110] In fact, only 2,000 people have taken advantage of this option in California, in part because it has not been well-publicized, and in part because it costs money and enacts a procedure that many may feel is unnecessary unless their identity has already been stolen.[111] However, victims of identity theft feel the freeze is necessary because current federal laws and practices instituted by the credit industry do not offer enough protection.[112] In addition, the law offers those who suffer damages because of a violation of the freeze to sue for injunctive relief, court costs, attorney's fees, loss of wages, and pain and suffering, when applicable, which could be beneficial, given the lack of similar remedies in the federal scheme.[113]

The freeze may be a good option for people who are more likely to be potential phishing victims. These people, who may be less savvy about identity theft or who may not want the responsibility of continually trying to educate themselves about the latest scam, could place a freeze on their records and protect themselves from inadvertent disclosure. However, for many people whose lives are more in flux—who may change jobs, residences, or accounts more frequently—the procedural hoops and financial costs required to lift a freeze could be more of an annoyance than a help.

3. *Insurance*

There are three main types of identify theft "insurance" now offered to consumers. Two are more like notification services than traditional insurance, and claim to deal with identity theft before it happens. The third is

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109. Presumably, there could be some risk that a consumer's PIN would be stolen; however, as this is a unique number issued directly by the CRAs, there is less of a chance of misuse than with a commonly-used identifier such as a SSN.

110. Bergstein, *supra* note 103 (quoting a lobbyist for the Consumer Data Industry Association as calling freezes a "draconian alteration" to the credit reporting system and comparing them to "using a machine gun to get at a fly").

111. *Id.*

112. *Id.*

113. *See California Law S.B. 168 (Debra Bowen) Identity Theft Prevention*, *at* http://www.fightidentitytheft.com/legislation_california_sb168.html (last updated Sept. 14, 2004) (discussing California Law S.B. 168 and remedies provided in CAL. CIV. CODE § 1785.31 (West. Supp. 2004)). It is unclear whether these remedies are now preempted by FACTA. *See* 15 U.S.C.S. § 1681t (LEXIS Supp. 2004); Towle, *supra* note 26.

more like traditional theft insurance and covers costs incurred after a consumer's identity has been stolen.

The first type of insurance is generally offered through a consumer's bank or credit card company and may be free or may cost as much as $120 per year. The service monitors a consumer's credit activity on a daily basis and provides the consumer with regular credit reports.[114] While these services are not new, they are now being offered by more companies for less money, and consumer interest in them has grown.[115] However, many of these services do not monitor credit activity at all three CRAs, and thus could miss some fraudulent activity.[116] Furthermore, this type of insurance only protects against identity theft involving credit fraud, so it would not protect or alert a consumer against an imposter who is using her name to commit a crime. Thus, this insurance might give consumers a false sense of security that they are thoroughly insulated from identity theft.

A second type of insurance monitors the Internet for the consumer's personal identifying information and credit card numbers.[117] The service, offered by CardCops, uses a "proprietary search bot" to scan websites and chat rooms for a consumer's information, and also checks against its own list of known merchant vulnerabilities. By searching areas where identity thieves commonly buy and sell personal and financial information, the service claims to find consumer's information before it has been used for fraudulent purchases and to alert the consumer while she still has time to block her accounts.[118]

The third type of identity theft insurance operates after a consumer's information has been stolen and used fraudulently, and offers to reimburse a victim for the costs associated with restoring her good name. Coverage includes lost wages, phone bills, notary services, and sometimes attorney's fees. Some companies are now including this as part of homeowner's insurance, others are offering it as a stand-alone or add-on policy, and some

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114. Towle, *supra* note 26. U.S. Bank offers a similar but more extensive service that not only checks consumers' credit daily with the three CRAs but also gives them access to their Social Security records and their data on file with the Medical Information Bureau, a clearinghouse that supplies medical records to insurance companies.

115. About 150,000-170,000 subscribers had signed up for Credit Watch, a service offered by Equifax, by April 2002. Sovern, *supra* note 16, at 363 n.72.

116. *See* Laura Bruce, *Is Identity Theft Protection Worth the Money?*, BANKRATE.COM, Aug. 4, 2004 (quoting Linda Foley, of the nonprofit Identity Theft Resource Center, who says, "Some check all three the first time and then monitor just one or two"), *at* http://www.bankrate.com/brm/news/advice/scams/20040804a1.asp.

117. *See generally* CardCops, *at* http://www.cardcops.com/idprotect.htm (last visited Feb. 3, 2005).

118. *Id.*

banks are offering it to all accountholders.[119] Generally these policies cost between $25 and $50 for $15,000 to $25,000 worth of coverage.[120]

These services could benefit potential phishing victims, just as they could benefit all victims of identity theft. Whether or not a consumer should purchase one of these services depends on the cost of the insurance and the person's aversion to risk. The biggest criticism of these services is not that they do not benefit the consumer, but that the banks and CRAs that offer them are capitalizing on risks they make possible, and therefore the services should be offered for free.[121] Many consumer advocates also argue that instead of providing these back-end services, banks should be instituting procedures that make these services unnecessary—such as making access to consumer files and applying for credit more difficult.[122] A final criticism is that the services do little to alert a consumer to or protect a consumer from criminal identity theft, which, although infrequent, is especially damaging to the victim. For each of these reasons, insurance alone will not solve the phishing problem.

C. Secondary-Level Strategies—Architecture and Private Party Controls

As phishing attacks become more technologically sophisticated, primary level strategies cannot be the entire answer.[123] For example, scams that covertly install spyware on a victim's computer are beyond what most consumers can be expected to understand. In addition, behavioral studies have shown that consumers are not now instituting practices recommended by the FTC to protect themselves from online fraud, possibly because they are not technically savvy.[124] Consumers will need help from private parties that have greater technological expertise and the ability to

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119. Washington Mutual offers this service to customers with a deposit account; however, consumers must still sign up for it. There are two options. One is free and offers $5,000 in insurance to off-set recovery costs. The other costs $10 but offers $15,000 in coverage, gives consumers a copy of their credit reports, monitors consumers' credit with each of the three CRAs, and alerts consumers to any problems. Other banks offer similar products. Bruce, *supra* note 116.

120. *See Identity Theft Insurance*, Insurance Information Institute, *at* http://www.iii.org/individuals/other/insurance/identitytheft (last visited Mar. 3, 2005).

121. Sovern, *supra* note 16, at 362-363; *see id.* at 382 n.165 for further criticism of identity theft insurance; *see also* Bruce, *supra* note 116 ("[I]t should be free. It's not the consumer that has allowed identity theft to grow so explosively." (quoting Linda Foley, Internet Theft Resource Center)).

122. Bruce, *supra* note 116.

123. Ramasastry, *supra* note 2.

124. Milne et al., *supra* note 88, at 223-224 (noting that these strategies include using anonymizer software and encrypting e-mails).

make architectural changes that will prevent most of these attacks or discover them before they do too much harm.

Many commentators now believe that those who control the architecture may be in the best position to control cybercrime. Professor Lawrence Lessig has argued that architecture or "code" is better than traditional law in cyberspace because law regulates "through the threat of ex post sanction, while code, in constructing a social world, regulates immediately."[125] Relying on code rather than law may be the best way to combat other cybercrimes such as computer viruses. Even though laws criminalize the propagation of viruses, and the FBI sometimes catches these criminals, society is better protected from viruses by widespread use of virus-protection software and vigilant Information Technology (IT) professionals who discover and fix software weaknesses before they can be compromised, than by waiting for law enforcement to catch and prosecute virus propagators. This may turn out to be an effective method for preventing cyber identity theft as well.

The computer and financial industries have a vested interest in counteracting identity theft and phishing attacks. They want consumers to remain confident in doing business online,[126] and they want to protect their bottom line.[127] These organizations have the ability to make system-wide changes that could protect consumers from identity theft, and also the knowledge, financial backing and nimbleness to make these changes quickly and in direct response to real-world problems.[128]

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125. Lawrence Lessig, *The Constitution of Code: Limitations on Choice-Based Critiques of Cyberspace Regulation*, 5 COMMLAW CONSPECTUS 181, 184 (1997); *see also* Neal Kumar Katyal, *Digital Architecture as Crime Control*, 112 YALE L.J. 2261 (2003).

126. Companies that are listed in the phishing e-mails, such as banks and merchants, are, themselves, negatively affected by these attacks. The scams use the companies' trademarks to convince the consumer the e-mail is in fact from her bank. In so doing, they are, in some senses, diluting the value of the mark, because consumers are less likely in the future to trust that the mark actually represents the product they think it does. Amazon has used this trademark argument to fight phishers. It is suing unnamed defendants under Washington state's unfair practices statute, as well as under the Lanham Act for trademark violation. *See* Amazon.com, Stop Spoofing, *at* http://www.amazon.com/exec/obidos/tg/browse/-/4060771/103-1910307-0728623 (last visited Mar. 7, 2005) (listing legal actions in which Amazon.com is a party.

127. Hansell, *supra* note 36 (quoting Earthlink's Chief Executive, Garry Betty, as saying, "We get 20,000 phone calls every time one of those [phishing e-mails] goes out, and it costs us 100 grand").

128. As an example of this capability in a different area, Katyal notes that in 2000 eBay was able to counteract denial of service attacks within 90 minutes of discovering them. Katyal, *supra* note 62, at 1092.

The Anti-Phishing Working Group has partnered with the Financial Services Technology Consortium (FSTC), an association made up of leading North American-based banks, financial institutions, research organizations and government agencies to identify and evaluate solutions to phishing.[129] The federal government, through FACTA, has instituted some changes in how the credit industry handles consumer information and is considering proposed e-mail handling changes that could affect the computer industry.[130] However, many think these groups have not done as much as they could to protect consumers.

1. *Software Manufacturers and ISPs*

There are two main ways to fight phishing via technology at the consumer level:[131] detect fraudulent e-mail or detect fraudulent websites. WholeSecurity, an Internet security firm in Texas, has developed software that detects fraudulent sites by analyzing web addresses and domain name registration.[132] eBay uses the WholeSecurity software, called "Web Caller-ID," in its Internet toolbar to detect fake sites purporting to be connected to either eBay or its subsidiary, PayPal. The software automatically notifies users that they are entering a fraudulent site, and it has a 98% accu-

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129. Anti-Phishing Working Group, APWG and FSTC Partner on Counter-Phishing Initiative, *at* http://www.antiphishing.org/fstc-project.htm (last visited Mar. 7, 2005); Financial Services Technology Consortium, About FSTC, *at* http://www.fstc.org/about (last visited Mar. 7, 2005).

130. The FTC recently hosted an "EMail Authentication Summit" that addressed technological changes, such as domain-level authentication, that could prevent the proliferation of spam. Any development that limits spam would necessarily also reduce the amount of phishing scams, since phishers rely on spam to distribute their communications. See FTC, Email Authentication Summit, *at* http://www.ftc.gov/bcp/workshops/e-authentication/index.htm (last visited Mar. 7, 2005), for further information on the meeting and public comments on the technology from many consumer, financial, and privacy-related organizations. *See also* Zhang, *supra* note 79.

131. This Note will not discuss back-end technological developments used by credit organizations to protect personal information in their databases, nor will it discuss technological developments used by these organizations to detect fraud. Merchants and banks use software that looks for "red flags" to alert the vendor to possible credit card fraud. For example, BestBuy has software that can be programmed to automatically reject any online orders that originate from countries with high fraud rates. Brian Hansen, *Cyber-Crime*, CQ RESEARCHER, Apr. 12, 2002, at 311. The FTC, through FACTA, will be working with the financial industry to develop these indicators. *FTC Statement 9/28/04*, *supra* note 9, at 3. This kind of fraud detection brings its own privacy concerns—the only way a bank can tell whether a person trying to impersonate you is really not you is if the bank knows a lot about you and your habits.

132. Alorie Gilbert, *Catching 'Phishers' a WholeSecurity Sport*, CNET NEWS.COM, Aug. 16, 2004, *at* http://news.zdnet.com/2100-1009-5312105.html.

racy rate.[133] Earthlink also offers a downloadable toolbar that alerts a user before she visits a fraudulent site by comparing the URL against the toolbar's list of known fraudulent sites and by analyzing unknown sites for fraudulent tactics.[134] This service seems to have been successful; Earthlink has been able to reduce its costs in customer support calls, even though it remains among the top-ten companies most targeted by phishing attacks.[135]

Other companies have developed software that detects fraudulent e-mails. Microsoft has developed e-mail authentication technology called "SenderID" to combat "spoofed" return addresses on e-mails.[136] SenderID validates the sender's server IP address to "assure an e-mail recipient that a message claiming to be from a credit card company actually is."[137] However, like many Microsoft products, this technology has come under fire recently. The Apache Foundation, an open-source development group, claims that Microsoft's licensing requirement is too strict. The group thinks the license is "incompatible with open source [and] contrary to the practice of open Internet standards."[138] In part due to the rejection of SenderID by the open-source community, AOL has decided not to use the product.[139]

These technologies have additional drawbacks. Microsoft's SenderID raises privacy concerns because it would require mail service providers to tell Microsoft about customers using SenderID.[140] In addition, consumer organizations such as the Electronic Frontier Foundation (EFF) and the Electronic Privacy Information Center fear that e-mails that identify the sender could lead to even greater data collection by private marketers and

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133. *Id.*

134. Earthlink, *at* http://www.earthlink.net/home/software/toolbar (last visited Mar. 7, 2005).

135. Krebs, *Companies Forced to Fight Phishing*, *supra* note 31. EarthLink now receives about 300 phone calls and spends just under $5,000 per incident, a big reduction from an earlier per-incident figure of 20,000 calls at $100,000. *Id.*; *see also* Hansell, *supra* note 127.

136. Dawn Kawamoto, *Microsoft Touts 'Sender ID' to Fight Spam, Scams*, CNET NEWS.COM, Aug. 12, 2004, *at* http://news.com.com/Microsoft+touts+%27Sender+ID%27+to+fight+spam%2C+scams/2100-1029_3-5307339.html.

137. *Id.*

138. Robert Lemos, *Apache, Open-Source Groups Wary of Sender ID*, CNET NEWS.COM, Sept. 2, 2004, *at* http://news.com.com/2100-1013_3-5345317.html.

139. David F. Gallagher, *Users Find Too Many Phish in the Internet Sea*, N.Y. TIMES, Sept. 20, 2004, at C4.

140. Lemos, *supra* note 138.

surveillance by law enforcement.[141] Sender identification also impacts free expression and anonymity, core principles in the United States.[142] Software that targets fraudulent sites could also be problematic if it is not subtle enough to discern the difference between a scam and a parody.

These issues should be balanced against a decision to institute technological changes, especially if the benefits of the changes are minor compared to the threats to privacy and free expression. If the technology allows consumers to have some control over which sites they see or e-mails they receive (like spam filters do), then it could be a welcome addition to the potential phishing victim's arsenal. However, if it forces a consumer to choose between relinquishing privacy in her e-mail or online actions and being subjected to further phishing scams, which she could combat using less intrusive strategies, she should choose the latter.

2. *The Credit Industry: Credit Card Issuers, Merchants, and CRAs*

Laws at the state and federal level require credit organizations to institute practices that protect consumers' identifying information[143] and also limit consumer liability for fraudulent charges.[144] This Section discusses a few recent legal developments that affect the credit industry and that could benefit potential phishing victims.

Banks, merchants, and credit card vendors are the most common organizations contacted by consumers after they have been victims of identity theft.[145] FACTA, in addition to providing consumers with new tools to

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141. *See, e.g.*, EFF Comment to FTC Summit, *at* http://www.ftc.gov/os/comments/emailauthentication/512447-0043.pdf (last visited Mar. 7, 2005); Electronic Privacy Information Center, *Privacy*, *at* http://epic.org/privacy (last modified Jan. 11, 2005). EFF distinguishes between e-mail authentication and e-mail identification; it supports the former but does not support the latter.

142. *See generally* Peter J. Dugan, *National Security Checks Are in the Mail: A First Amendment Analysis of Intelligent Mail and Sender Identification*, 12 COMMLAW CONSPECTUS 265 (2004).

143. *See* Fair Credit Reporting Act, 15 U.S.C. § 1681 *et. seq.* (Supp. II 2002); *see also* Towle, *supra* note 26, at 308-310 (discussing some of these state laws).

144. 15 U.S.C. § 1643(a)(1) (2000) (limiting consumer liability for fraudulent credit card purchases to $50); *see also id.* § 1693 (providing consumer protection for all transactions using a debit card or electronic means to debit or credit an account). For interesting discussions of the history of credit cards and laws that affect them, see David G. Adams & Marlene Feigin Schwartz, *Consumer Protection*, 1976 ANN. SURV. AM. L. 257, 302 (criticizing the law for not affecting the majority of credit card transactions because the typical purchase in the 1970s was less than $50); Brooker, *supra* note 10.

145. FTC SURVEY REPORT, *supra* note 7, at 50 (noting that 43% of identity theft victims contacted these organizations while 22% contacted CRAs).

help themselves fight identity theft, mandates several changes in how credit bureaus and merchants handle consumers' credit. It requires CRAs to institute account blocking when a consumer submits a police report of identity theft, requires businesses to truncate credit card numbers on receipts, and mandates that FTC and banking regulators work together to develop red-flag indicators of ID theft.[146]

State laws provide further protections. For example, California law requires companies that maintain an unencrypted database of personal information to notify their customers if their information has been acquired by an unauthorized person.[147] California also requires organizations to limit their dissemination of SSNs[148] and requires lenders who discover that the personal information offered in a credit application does not match the information on a consumer's credit report to take reasonable steps to verify the information, including informing the consumer.[149] Consumers who are damaged by a violation of these statutes may recover actual damages, attorney's fees, and punitive damages up to $30,000.[150] However, FACTA has extensive and specific preemption provisions,[151] so it is unclear where these state laws now stand.

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146. *FTC Statement 12/15/03*, *supra* note 96, at 13-14; *see also supra* note 131. Banks already develop these indicators on their own. *See* Sovern, *supra* note 16, at 372 n.116.

147. CAL CIV. CODE §§ 1798.29, 1798.82-.84 (West Supp. 2004); *Identity Theft: Hearing Before the House Subcomm. on Tech., Info. Policy, Intergov't Relations, and Census of the Comm. on Gov't Reform*, 108th Cong. 13 n.9 (2004) (statement of Orson Swindle, Commissioner, FTC), *available at* http://www.ftc.gov/os/2004/09/040922infosecidthefttest.pdf; Jaikumar Vijayan, *One Year Later, California Identity Theft Law Remains Low-Key*, COMPUTERWORLD, June 7, 2004 (discussing the effectiveness of the new law), *at* http://www.computerworld.com/managementtopics/ebusiness/story/0,10801,93667,00.html; *see also* Sullivan, *supra* note 13 (noting that when Choicepoint's databases were breached it complied with this law and alerted 30,000 California residents whose information had been accessed fraudulently; although Choicepoint has information on almost every U.S. citizen, no other state's residents were contacted).

148. CAL. CIV. CODE § 1798.85. This law prevents a "person or entity" from publicly posting or displaying an individual's SSN, printing it on a card, or requiring it to be transmitted over an unsecure Internet connection. It also restricts organizations from printing SSNs on some information mailed to individuals. *Id.*

149. *Id.* § 1785.20.3(a); Dan Verton, *Regulatory Requirements Place New Burdens on IT: Calif. Privacy Law to Debut; Panic Emerging*, COMPUTERWORLD, June 30, 2003, *at* http://www.computerworld.com/governmenttopics/government/legalissues/story/0,10801,82600,00.html.

150. CAL. CIV. CODE § 1785.20.3(c).

151. *See* 15 U.S.C.S. § 1681t (LEXIS Supp. 2004).

Many commentators and victims of identity theft do not believe these laws meaningfully protect personal information from identity theft.[152] For example, despite lobbying efforts by consumer groups, FACTA does not include any provisions that address the widespread overuse of SSNs as identifiers, which many see as the biggest reason for the current identity theft problem.[153] Often credit issuers will issue credit based almost completely on a SSN. If the thief has this number correct, he can still receive credit despite misspelling the victim's name and using a different address.[154]

Without strict regulation, the credit industry is doing little on its own to prevent identity theft. Banks, credit card companies, and other vendors noticed "suspicious account activity" in only 25% of cases reported in the FTC Survey.[155] Moreover, CRAs, which generally are not liable for reporting inaccurate information and bear no financial liability for fraudulent purchases,[156] do not search for or disclose potential fraud to consumers unless the consumer requests her credit report or pays for a notification service. Most consumers do not discover that their identifying information has been compromised until *they* take steps to access their credit, such as monitoring their own account activity or attempting to obtain credit, at which point it may be too late to prevent much of the damage.[157]

Many think this is a poor record for companies that have most of the control over access to consumers' information.[158] Banks, merchants, and credit card vendors admit that they are in the best position to develop efficient fraud prevention measures,[159] yet many financial services firms that collect personal information online do not use security features to protect that information.[160] Banks also contribute directly to the phishing problem

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152. *See generally* Linnhoff & Langenderfer, *supra* note 94; Sovern, *supra* note 16.

153. Linnhoff & Langenderfer, *supra* note 94, at 215; Valetk, *supra* note 16, ¶ 21.

154. Valetk, *supra* note 16, ¶ 22.

155. FTC SURVEY REPORT, *supra* note 7, at 39.

156. 15 U.S.C.S. § 1681e(b) (LEXIS Supp. 2004) (requiring CRAs to maintain "reasonable procedures" to protect the accuracy of consumer records). Sovern argues this accuracy standard is inadequate to protect consumer information, and the cases he cites support his point. Sovern, *supra* note 16, at 390-93 & n.191.

157. FTC SURVEY REPORT, *supra* note 7, at 39-40.

158. *See also* O'Brien, *supra* note 7 (discussing a Gartner Research survey criticizing the financial industry for "not putting into effect more rigorous computer screening procedures to protect customer accounts" which has, in turn, "forced identity theft victims to bear most of the crime's social and economic costs"). *See generally* Sovern, *supra* note 16.

159. Sovern, *supra* note 16, at 374 n.119.

160. Jane Black, *Basic Hygiene for Sensitive Data*, BUSINESS WK. ONLINE, Nov. 14, 2003, *at* http://www.businessweek.com/technology/content/nov2003.

by sending out e-mail messages that look similar to phishing scams: offering deals on balance transfers and requiring customers to click on a link in the e-mail to access the deal.[161]

Banks argue that they are doing what they can and have a financial incentive to prevent identity theft—under the Truth in Lending Act, they are liable for fraudulent credit card purchases over $50.[162] The losses associated with identity theft support their argument. The FTC Identity Theft Survey revealed that last year identity theft cost businesses $47.6 billion.[163] However, MasterCard and Visa estimated that annual total fraud losses due to identity theft represented only 1/10th of one percent of annual sales volume, which belies the argument that credit issuers have a financial incentive to prevent identity theft.[164] Credit-issuing organizations also pass these losses on to their customers through higher interest rates and late charges, so any small losses they incur are fully paid for by the consumer.[165] CRAs seem to have only a negligible incentive to prevent identity theft, because they are not financially liable for fraudulent purchases and are also generally not liable for reporting inaccurate information. A final mark against the credit industry is the simple fact that the incidence of and costs associated with identity theft continue to increase almost exponentially year by year, despite the industry's purported efforts to prevent it. A law review article in 1985 noted that, around that time, credit card fraud was the "fastest growing crime against business,"[166] yet this is still the case more than twenty years later. Since these organizations admit they could prevent fraud, they are clearly not doing as much as they could.[167]

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161. Krebs, *Companies Forced to Fight Phishing*, *supra* note 31.

162. 15 U.S.C. § 1643(a)(1) (2000).

163. FTC SURVEY REPORT, *supra* note 7, at 7.

164. Stana, *Identity Theft: Prevalence and Cost*, *supra* note 5, at 22, 50. These losses are incurred by banks that issue credit under the MasterCard or Visa name. Visa and MasterCard do not offer credit themselves and therefore do not suffer these losses.

165. Sovern, *supra* note 16, at 368 nn.86-87.

166. *See* Caminer, *supra* note 10, at 746.

167. Victims of identity theft were also unimpressed with the consumer service they received when they contacted these organizations. One identity theft victim said, "My anger at my perpetrator quickly transferred to the credit-granting community itself... They don't care what this does to victims because they don't have to care." O'Brien, *supra* note 7. Thirty-one percent of identity theft victims who contacted multiple CRAs were "dissatisfied" with all of the CRAs they contacted. FTC SURVEY REPORT, *supra* note 7, at 55. Satisfaction was higher for those who contacted credit card companies: only 10% were dissatisfied when the consumer had one card misused, and 18% were dissatisfied when they had more than one card misused. *Id.*; *see also* Sovern, *supra*

Victims surveyed in the FTC study noted ways in which they thought the financial services industry could improve both its procedures for handling consumers' information and for dealing with consumers after their identity has been stolen. These suggestions included implementing improved authentication measures during transactions, making greater efforts to monitor consumers' account activity, and notifying consumers when unusual transactions occurred.[168] Victims also thought institutions could improve their follow-up and assistance by "listening to the victim and treating them with more understanding and less suspicion."[169]

Professor Jeff Sovern has argued that if the credit industry were held liable to consumers for identity theft-related damages when it could have prevented the theft, this would induce the industry to find the best ways to protect consumer information.[170] He argues this incentive would be better than changing or strengthening regulatory laws because instead of mandating procedures that may not be cost-effective and may be outdated quickly, it would allow the credit industry to be flexible in its responses to identity theft and to find its own best solutions.

The credit industry could make many changes that would benefit identity theft victims and that would in turn benefit potential phishing victims. However, without further financial incentives or stronger regulatory laws, it seems unlikely the industry will institute these changes on its own. Therefore, potential phishing victims cannot rely solely on the credit industry to protect them from identity theft.

D. Tertiary-Level Strategies—Public Law Enforcement

Law enforcement generally only plays a role in crime control when measures at the other two levels have failed. This is in large part because law enforcement does not have the resources to attend to all crimes. This is especially true when it comes to sophisticated and coordinated identity theft scams such as phishing, which are difficult and costly to investigate and prosecute.

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note 16, at 367 n.64, 368 n.66 (recounting stories and statistics on CRAs' poor customer service record).

168. FTC SURVEY REPORT, *supra* note 7, at 63.

169. *Id.*

170. *See generally* Sovern, *supra* note 16. Sovern argues that changing loss allocation rules so that the credit industry bears more of the costs of identity theft and the consumer bears less would spur the credit industry to make better changes than those the federal government has instituted. *Id.*

The main federal criminal laws used against identity thieves include the Credit Card (or "Access Device") Fraud Act[171] and the Identity Theft and Assumption Deterrence Act of 1998 (ID Theft Act).[172] The Credit Card Fraud Act makes it a felony to "knowingly and with intent to defraud," use, purchase goods aggregating $1,000 or more with, or possess fifteen or more unauthorized "access devices."[173] Access devices include account numbers and personal identifiers that can be used to "to obtain money, goods, services, or any other thing of value, or that can be used to initiate a transfer of funds."[174] The Credit Card Fraud Act includes penalties of up to 15 years and a fine.[175] It also allows for restitution to the "victim," although the Act considers the bank, credit issuer, or merchant to be the victim rather than the person whose identity was stolen, because the credit issuer is financially liable for the fraudulent purchases.[176]

The ID Theft Act includes similar penalties for the unauthorized transfer or use of "means of identification."[177] The ID Theft Act does not ex-

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171. 18 U.S.C. § 1029 (2000 & Supp. II 2002). This statute was called the "Credit Card Fraud Act" when it was first passed in 1984. Although it now covers fraud that extends beyond credit card misuse, I will continue to call it by its 1984 name as a shorthand.

172. Pub. L. No. 105-318, 112 Stat. 3007 (1998) (amending 18 U.S.C. § 1028). Almost all states have also enacted laws criminalizing identity theft. *See* Stana, *Identity Theft: Prevalence and Cost*, *supra* note 5, at 25 n.13.

173. 18 U.S.C. § 1029. Courts have also construed mere possession of counterfeit access devices to be a violation of the Act. *See, e.g.*, United States v. Scott, 250 F.3d 550 (7th Cir. 2001).

174. 18 U.S.C. § 1029(e)(1) (2000) states that:

> the term 'access device' means any card, plate, code, account number, electronic serial number, mobile identification number, personal identification number, or other telecommunications service, equipment, or instrument identifier, or other means of account access that can be used, alone or in conjunction with another access device, to obtain money, goods, services, or any other thing of value, or that can be used to initiate a transfer of funds (other than a transfer originated solely by paper instrument).

Courts have also held that a person can be charged with separate offenses for each unauthorized use of a credit card in excess of $1,000 (rather than aggregating the uses into one count). *See e.g.*, United States v. Iredia, 866 F.2d 114, 120 (5th Cir. 1989).

175. 18 U.S.C. § 1029(c)(1)(A)(ii) (Supp. II 2002).

176. *See supra* note 81; *see also Identity Theft: Hearing Before the Fin. Insts. and Consumer Credit Subcomm. of the House Financial Services Comm.*, 107th Cong. n.4 (2003) (statement of J. Howard Beales, III, Director, Bureau of Consumer Protection, FTC), *available at* http://www.ftc.gov/os/2003/06/030624idthefttestimony.htm.

177. 18 U.S.C. § 1028(a)(7) (2000). "Means of identification" include a person's name, date of birth, social security number, driver's license number, passport number, "electronic identification number, address or routing code," and "unique biometric data,

plicitly govern theft of credit card or bank numbers, which are considered "access devices" and protected under the Credit Card Fraud Act.[178] However, the United States Sentencing Commission has recognized that the unauthorized use of credit cards may be prosecuted under either or both of these statutes.[179] In fact, the Sentencing Commission has recognized that the ID Theft Act covers criminal activities that could also be independently prosecuted via about 180 other federal criminal statutes.[180]

The biggest difference between the Credit Card Fraud Act and the ID Theft Act is that the ID Theft Act considers the "victim" to be the person whose identity was stolen, and allows sentencing enhancements based on factors such as the number of victims and the harm done to their reputation.[181] It also enables law enforcement to initiate an investigation earlier because it criminalizes the act of stealing the information with intent to perpetrate a fraud rather than the use of that information for fraudulent purposes.[182] However, it too does not include a restitution provision for a person whose identity has been stolen, so the fact that it characterizes this person as the victim is not much of a benefit.[183]

Various problems with law enforcement specific to phishing and other sophisticated forms of identity theft make the use of federal and state laws difficult. For example, jurisdictional issues can prevent proper investigation at the state or local level.[184] Victims' first line of defense is their local police department, but while victims may be able to file a police report in their own state,[185] they may not be able to do so in the location where their

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such as fingerprint, voice print, retina or iris image." 18 U.S.C.S. § 1028(d)(7)(A)-(C) (LEXIS Supp. 2004).

178. 18 U.S.C. § 1029(e)(1) (2000).

179. *See* Stana, *Awareness and Use*, *supra* note 26, at 97.

180. *Id.* at 98.

181. Kristen S. Provenza, *Identity Theft: Prevention and Liability*, 3 N.C. BANKING INST. 319, 325 (1999).

182. *Id.* at 324.

183. *See* Saunders & Zucker, *supra* note 11, at 671. The Senate version of the bill included a restitution provision, but this version did not pass. Thus, "federal courts are precluded from awarding restitution to individuals who incur expenses associated with the theft of their identities." *Id.*

184. Katyal, *supra* note 62, at 1018–19 (noting that the patchwork of state laws addressing cybercrime are ineffective due to the difficulty in tracking cybercrime and enforcing laws across jurisdictions).

185. Victims may not be able to file a police report at all—the FTC Report and many other consumer organizations have noted that local police often do not fully understand the criminal nature of identity theft and recommend that victims talk with their credit card company rather than file a report. This can be problematic because many of the new information-blocking services are only available to consumers who can provide a police

information was actually used fraudulently.[186] Another problem is that local police may not want to spend limited resources investigating a crime that has occurred in another jurisdiction and can be passed off to that jurisdiction. Finally, phishing attacks and other online scams present a challenge to law enforcement because they are designed to appear to be disconnected and small-scale, when in fact they are coordinated and large-scale.[187] The FTC is trying to combat all of these problems through a program called the "Consumer Sentinel Network," which is accessible to law enforcement agencies across the country and links to an "Identity Theft Data Clearinghouse" containing over 666,000 consumer complaints.[188] However, out of an estimated 18,000 state and local law enforcement agencies in the United States, only about 1,040 agencies have signed up for access to the network so far.[189] Thus, both the FTC and local law enforcement have a long way to go to provide more of a benefit to the phishing victim.

Jurisdictional issues also affect federal law enforcement efforts because phishing scams are increasingly operating across national borders. The physical evidence and contraband may be located anywhere on the planet, and phishers may be operating out of countries that do not have laws criminalizing their conduct, thus preventing extradition due to the dual criminality doctrine.[190] In addition, United States evidence and crimi-

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report. *See supra* note 16; *see also* O'Brien, *supra* note 7 (discussing victims' problems with trying to file a police report).

186. Stana, *Identity Theft: Prevalence and Cost*, *supra* note 5, at 24.

187. Krebs, *Companies Forced to Fight Phishing*, *supra* note 31.

188. *FTC Statement 9/28/04*, *supra* note 9; *see also Consumer Sentinel*, *at* http://www.ftc.gov/sentinel (last visited Mar. 7, 2005).

189. *FTC Statement 9/28/04*, *supra* note 9 (noting that as of September 2004, "more than 1042 law enforcement agencies" had signed up for access to the database); Stana, *Awareness and Use*, *supra* note 26, at 119 (noting that there are approximately 18,000 state and local law enforcement agencies in the United States). For example, as of 2002, the Los Angeles Police Department, one of the largest investigators of identity theft in the country, did not subscribe to the Network. Over 8,000 cases of identity theft were reported to the LAPD during calendar year 2001, and relative to other states, California has a very high prevalence of identity theft cases. Stana, *Awareness and Use*, *supra* note 26, at 104, 120.

190. Katyal, *supra* note 62, at 1095 n.244. The dual criminality doctrine provides that if two countries have overlapping criminal laws, a criminal located in one country may be extradited to or prosecuted in the other country, even if the two countries' specific criminal laws are not included in the treaty between them. *See* Amalie Weber, Note, *The Council of Europe's Convention on Cybercrime*, 18 BERKELEY TECH. L.J. 425, 426–428 (2003) (discussing the doctrine and other jurisdictional issues facing international cybercrime investigations). *See generally* Marian Nash (Leich), *Contemporary Practice of the*

nal procedure laws may prevent some criminals arrested in foreign countries from going to trial in the United States—for example, if foreign search and seizure or taking-of-testimony practices are inconsistent with United States standards.[191]

Federal law enforcement and investigation agencies also may not help the individual victim because they operate at a higher level than individual crimes. The Secret Service has shifted its focus from investigating "'street crime' level offenders" to individuals and groups involved in systematic, high-dollar crimes with a broader community impact.[192] The FBI has also moved in this direction: it tries to bundle smaller cases into larger "high-profile, high-impact prosecutions" before it tries to get resources to prosecute them.[193] The FBI also does not get involved until victims' losses total more than $50,000,[194] a figure that is much higher than losses that most if not all individual phishing victims and other victims of identity theft will ever suffer.

Most victims of identity theft must have a sense of these problems with law enforcement because most never report their case to law enforcement.[195] Of those who report, almost a third were "very dissatisfied" with the response they received.[196] Victims felt law enforcement could improve the investigation of identity theft through a stronger commitment to catching the thief, better follow-up and communication, and increased assistance.[197] Many also thought penalties for thieves should be stiffer.

Unfortunately, recent developments in the law have not addressed many of these core concerns. Instead of increasing resources and training for law enforcement, legislators have chosen to focus on stiffer penalties and trying to pass more specialized laws.[198] During the summer of 2004, in response to the increasing frequency of identity theft scams such as

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United States Relating to International Law, 92 AM. J. INT'L. L. 44 (1998) (discussing the use of "dual criminality" clauses in treaties).

191. *See* GRABOSKY ET AL., *supra* note 13, at 10.

192. Stana, *Identity Theft: Prevalence and Cost*, *supra* note 5, at 43.

193. O'Brien, *supra* note 7; *see supra* Part II.B (discussing Operations Websnare and Firewall).

194. Krebs, *Companies Forced to Fight Phishing*, *supra* note 31.

195. FTC SURVEY REPORT, *supra* note 7, at 9.

196. *Id.* at 61.

197. *Id.* at 62.

198. Katyal notes that the standard solution to the problem of lack of cost deterrence in cybercrime is to increase the penalties. Katyal, *supra* note 62, at 1011. However, it is difficult to increase the penalties enough to compensate for the low probability of catching thieves without creating a completely disproportionate and cruel sentence. *See id.* at 1040.

phishing, the vast costs attributable to identity theft, and terrorist attacks, Congress passed a new law called the Identity Theft Penalty Enhancement Act (ITPEA).[199] This Act does not change the substantive identity theft laws but does increase penalties for identity theft-related crimes. It also creates a new crime of "aggravated identity theft," defined as using a stolen identity to commit other crimes.[200] The law adds a minimum sentence of two years to any felony punishment for crimes committed using the stolen personal information[201] and a five-year sentence enhancement if the stolen identity was used during a terrorism offense.[202]

This new change in the law would only affect phishing if the phisher were caught and prosecuted under the ID Theft Act. This raises two issues. First, since phishers are so hard to catch, adding on two to five years to a sentence probably will not act as a deterrent for a crime that already may have a 15 year sentence.[203] Moreover, like most criminals, phishers do not think they are going to get caught.[204] Thus, "tougher sentencing laws would only induce 'false guilty pleas' by innocent defendants who do not want to risk trial."[205] This likelihood is buttressed by the Justice Department's statements that sophisticated criminals are much better at covering their tracks (for example, through use of anonymizer software), while less-sophisticated criminals leave "fingerprints," making them easier to catch.[206] This suggests law enforcement will not be able to catch the worst criminals, and the longer sentences under the ITPEA may become disproportionate to the crime of those who are actually caught.

The second reason why this change will have little affect on phishing attacks is because other laws, such as the Credit Card Fraud Act may be more appropriately used against these criminals. In one recent case against a phisher, the Justice Department chose to prosecute him under the Credit Card Fraud Act rather than the ID Theft Act, despite the fact that his theft of social security numbers and other identifying information would subject

199. Pub. L. No. 108-275, 118 Stat. 831 (2004) (to be codified at 18 U.S.C. § 1028A); *see* Ramasastry, *supra* note 2.

200. Pub. L. No. 108-275, § 2, 118 Stat. 831; Ramasastry, *supra* note 2.

201. Pub. L. No. 108-275, § 2, 118 Stat. 831.

202. *Id.*

203. Declan McCullagh, *Season Over for 'Phishing'?*, CNET NEWS.COM, July 15, 2004, *at* http://zdnet.com.com/2100-1105_2-5270077.html.

204. Hansen, *supra* note 131, at 322.

205. *Id.*

206. *See* Katyal, *supra* note 62, at 1073 n.185 (citing James K. Robinson, Remarks at the International Computer Crime Conference: Internet as the Scene of Crime (May 29-31, 2000)), *at* http://www.usdoj.gov/criminal/cybercrime/roboslo.htm).

him to liability under that act as well.[207] As crimes covered by the ID Theft Act could also be prosecuted via 180 other federal criminal statutes,[208] it is unclear whether this law will ever be used.

Another problem in efforts to combat phishing scams and to prevent consumers from suffering loss stems from limitations within the laws. Most laws that could be used against phishers require proof that a victim suffered "measurable losses,"[209] so the laws cannot take effect until after a consumer has already been defrauded.[210] Since most phishing sites remain online for only a short amount of time,[211] by the time a consumer realizes she has suffered "measurable losses" and has filed a complaint with law enforcement (if one is ever filed) it may be too late to catch the thief.

In response to this problem, Senator Patrick Leahy introduced a bill in July 2004 that would have criminalized phishing before a person is defrauded.[212] While this bill did not pass out of committee, it is useful to discuss it as a possible solution against phishing because its purpose was more to protect consumer confidence in the Internet, rather than individual phishing victims. The proposed bill would have made it illegal to create a website that misrepresented itself as a legitimate online business in order to induce a person to transmit personal identification.[213] It would also have made it illegal to knowingly send out spoofed e-mails that linked to these websites with the intention of committing a crime of fraud or identity theft.[214] The penalty for each new crime would have been a fine and/or up to five years imprisonment.[215] Senator Leahy argued that it was important to target scams before they have defrauded anyone of any money to prevent "one of the greatest harms caused by phishing: a diminished trust in the Internet's system of addressing and linking" and to protect the "integrity" of the Internet itself.[216]

Professor Kaytal echoes the importance of such protections. He suggests that crimes that "undermine interconnectivity should be singled out for special disfavor,"[217] and compares these scams to offline crimes such

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207. *See* Hill Criminal Complaint, *supra* note 65; Hill Plea Agreement, *supra* note 65; Hill Press Release, *supra* note 25.

208. Stana, *Awareness and Use*, *supra* note 26, at 98.

209. McGuire, *supra* note 30.

210. Ramasastry, *supra* note 2.

211. *Id.*

212. Anti-Phishing Act of 2004, S. 2636, 108th Cong. § 1351 (2004).

213. *Id.* §1351(a).

214. *Id.* §1351(b).

215. *Id.* §1351.

216. Senator Leahy Statement, *supra* note 6.

217. Katyal, *supra* note 62, at 1088.

as bombing a major highway or a club where people go to interact. Kaytal argues that "[w]e punish not simply because of the harm to the individual victim, but because the crime fragments trust in the community, thereby reducing social cohesion and creating atomization."[218] While these are valid arguments, they may not demonstrate a true need for such a specific and limited law as Senator Leahy's proposed bill. Operations Websnare and Firewall demonstrate that law enforcement already has laws it can use against phishers. The real problem seems to be lack of resources and incentive rather than lack of laws. Considering the difficulties involved in tracking and catching phishers, a new, more specialized law probably would not make much of a difference.

Even if Senator Leahy's bill had passed, it would not have reached all phishers. As noted above, most victims of identity theft do not report the crime to law enforcement. In addition, many phishers operate overseas; even if United States jurisdiction under this proposed law could reach to foreign countries, the United States might not be able to extradite criminals due to dual criminality problems. There also may be some question about whether we want to criminalize an act before anyone is really harmed, and whether this new law adequately addresses parody and First Amendment concerns.[219] Senator Leahy's bill stated that it protected against criminalizing a legitimate parody website or e-mail by requiring that the actor have the *intent* of committing a crime of fraud or identity theft. However, this might place too much discretion in the hands of law enforcement. For all these reasons, Senator Leahy's anti-phishing bill might have been helpful, but would not have solved the phishing problem.

IV. CONCLUSION

Phishing differs from many other types of identity theft in that it relies on an active response from the victim. In most attacks, if the victim does not fall for the scam and does not enter her personal information, the thief cannot steal anything from her. As such, it is both simpler and more difficult to combat—simpler because an educated and aware recipient should not be fooled, but more difficult because an uneducated recipient may fall for the bait, enter her personal information, never realize that that was how her identity was stolen, and thus thwart any chance for law enforcement to track and catch the thief. This conundrum necessitates coordinated efforts between potential victims, law enforcement agencies, and other organiza-

218. *Id.* at 1089.

219. *See, e.g.*, IFCC Intelligence Note, *supra* note 4 (mentioning, as examples of "spoofed" sites, "whitehouse.com" and "whitehouse.org").

tions that have the means to control financial information and Internet security.

The foregoing discussion demonstrates that there is no one solution at any one level that will solve the phishing problem. Stakeholders at each level can and must make greater efforts and institute new practices to prevent identity theft. Stakeholders among the levels also must collaborate with each other to find cross-level solutions. The organizations discussed in this Note are already moving in the right direction. The Anti-Phishing Working Group and Digital Phishnet, both of which combine law enforcement at the tertiary level and businesses at the secondary level, are already finding solutions. Secondary level organizations such as banks and ISPs are also working with consumers at the primary level to further educate them about ways they can protect themselves from identity theft scams such as phishing. While the phishing problem may never be solved, with these efforts it could remain more of an annoyance than a true cybercrime threat.

THE CAN-SPAM ACT: AN INSUFFICIENT RESPONSE TO THE GROWING SPAM PROBLEM

By Lily Zhang

Although "Spam"[1] is tasty in a can, it is never tasty when it lands in our e-mail inboxes. Spam is an especially pernicious form of advertising because of its low cost, high-volume nature. Traditional advertisers, such as telemarketers and junk mailers, incur significant costs by employing workers, paying long-distance telephone bills, and buying envelopes and paper. In contrast, spammers expend significantly less and even shift costs to recipients, who must sort through the voluminous spam they receive. Thus, spam's attractive nature has led to many abusive uses, which all contribute to the growing spam problem.

As spam becomes a daily nuisance, various responses are being utilized to combat it. Earlier methods employed vigilantism in the forms of self-regulation and self-help, but more sophisticated methods quickly emerged. Those methods included suits against spammers under both common and state law doctrines and technological responses such as filtering. Then in December 2003, the federal government enacted the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (CAN-SPAM Act or "the Act") to provide a uniform federal body of law against spamming.[2]

While the Act attempts to curb the spam problem, it still has some shortcomings. Some of the criticism heaped upon the Act centers around its preemptive effects on stricter state spam laws, the severity of the penalties, and its alleged attempt to curb spammers' constitutional rights. Much of the criticism also accuses the Act of potentially increasing the amount of spam because the Act merely provides a set of guidelines for spammers on how to spam legally—in effect legitimizing spam. Many critics believe that the Act will lead more advertisers to rely on spam as their preferred method of advertising.

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1. See White Buffalo Ventures, LLC v. Univ. of Tex., No. A-03-CA-296-SS, 2004 U.S. Dist. LEXIS 19152, at *3 n.1 (W.D. Tex. Mar. 22, 2004) (noting that the term "spam" started in Internet chat rooms and interactive fantasy games "where someone repeating the same sentence or comment was said to be making a spam" and that "[t]he term referred to a Monty Python's Flying Circus scene in which actors keep saying 'Spam, Spam, Spam, and Spam' when reading options from a menu") (citation and internal quotation marks omitted).

2. 15 U.S.C.A. §§ 7701-7713 (Supp. 2004).

Although some of the prior and current methods of combating spam have been mildly successful, their success has been tempered by one factor: the Internet. As the medium used to propagate spam, the Internet allows spammers to disguise their e-mail addresses, utilize stolen e-mail accounts, and operate across borders. Consequently, the Internet complicates the ability to bring suit or apply legislation against spammers. Moreover, technological responses are costly and not always foolproof. As a result, an effective response to spam must include both technological and legislative components.

This Note provides a brief overview of spam, its characteristics, the problems associated with it, and responses to combat this problem. Part I discusses the fundamentals of spam: its economic structure; the profile of spammers and how they are funded; and spam's attractiveness compared to traditional methods of advertising. Part II focuses on the various techniques used to combat spam, ranging from vigilantism to state legislation to common law causes of action. Part III discusses the CAN-SPAM Act, its weaknesses, and its strengths. Part IV discusses the more progressive and technology-based solutions proposed by various sectors within society. Ultimately, the best response to combating the spam problem is not found in any one of these solutions alone. Rather, spam's unique nature mandates a combination of these solutions, both technological and legislative.

I. OVERVIEW OF SPAM

A. The Rise of Spam

Electronic mail, commonly known as e-mail, began in 1965 and quickly became a method of communication for users to pass messages between different computers.[3] As the Internet increased in popularity and usage in the mid-1990s, e-mail usage became widespread.[4] Concomitant with the rise in e-mail usage, "spam" messages increasingly appeared in e-mail inboxes, becoming a major nuisance.

Generally, e-mail recipients associate "spam" with e-mail that market various products. However, spam refers to other categories of messages as well. Spam is frequently defined as either unsolicited commercial e-mail

3. *See, e.g.*, *Email*, MICROSOFT® ENCARTA® ONLINE ENCYCLOPEDIA, *at* http://encarta.msn.com/encyclopedia_761566348/E-Mail.html (last visited Mar. 2, 2005).

4. *Id.*

(UCE) or unsolicited bulk e-mail (UBE).[5] UBEs encompass not only UCEs but also various forms of non-commercial spams, including opinion surveys, fundraising solicitations, religious and political messages, and chain letters.[6] Thus, spam can take various forms outside of mere commercial marketing.

However, the greatest quantity of spam is still commercial in nature.[7] Most state laws define "commercial e-mail" as e-mail that "advertises or promotes the sale or lease of goods, services, or real property."[8] Under the CAN-SPAM Act, commercial e-mail is similarly defined as "any electronic mail message the primary purpose of which is the commercial advertisement or promotion of a commercial product or service."[9] Furthermore, commercial e-mail does not include transactional or relationship messages, those which serve the primary purpose of facilitating, completing, or confirming a commercial transaction that the recipient has previously agreed to enter with the sender.[10] Essentially, the Act's definition of spam focuses on messages that are *unsolicited* commercial e-mail—the UCEs, which are the messages that clog our inboxes daily.

B. The Problems Associated With Spam

1. General Overview

Spam has established itself as a preferred method of advertising among some because of its quick, cheap, and efficient nature. Spam is quick because it is received within minutes and need not be manually processed and delivered. Because spam messages can be sent to millions of e-mail addresses very quickly, it is more effective in reaching large numbers of consumers than traditional junk mail or telemarketing.[11] Additionally, unlike traditional junk mail or telemarketing, the cost of sending spam

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5. Adam Zitter, Note, *Good Laws For Junk Fax? Government Regulation of Unsolicited Solicitations*, 72 FORDHAM L. REV. 2767, 2775 (2004).

6. *Id.*

7. *Id.*

8. Jordan M. Blanke, *Canned Spam: New State and Federal Legislation Attempts to Put a Lid On It*, 7 COMPUTER L. REV. & TECH. J. 305, 307-08 (2004).

9. 15 U.S.C.A. § 7702(2)(A) (Supp. 2004).

10. *Id.* § 7702(2)(B); *see also*, John E. Brockhoeft, *Evaluating the CAN-SPAM Act of 2003*, 4 LOY. L. & TECH. ANN. 1, 5 (2004) (discussing the various categories of spam e-mail).

11. *See, e.g.*, Jacquelyn Trussell, *Is the CAN-SPAM Act the Answer to the Growing Problem of Spam?*, 16 LOY. CONSUMER L. REV. 175, 176 (2004).

does not rise proportionally to the number of e-mails sent.[12] Such advantages help to explain the estimated 2 *trillion* spam messages sent in 2004, one hundred times the volume of "snail" mail advertisements delivered by the United States Postal Service last year.[13] Spam's inherent advantages undoubtedly make spam a desirable form of advertising.

Furthermore, spam advertising is cost effective because spammers need generate only a small percentage of sales in order to garner a profit.[14] A 2002 Wall Street Journal study noted a case in which, among 3.5 million spam messages sent, only eighty-one resulted in a purchase.[15] The success rate in this case was 0.0023% with each sale generating $19 in profit, netting a total profit of $1500 in the first week alone.[16] The cost of sending the 3.5 million spam messages was $350, a small price to pay for generating a profit that was more than four times as much.[17] Spammers are able to generate such a large amount of profit because there is no per-message charge for every piece of spam sent.[18] Instead, a spammer's overhead costs are negligible and confined to equipment, monthly rental fees for an e-mail account, if any, and sometimes the price of a mailing list.[19] Such costs are much less than those associated with telemarketing or paper mailers, activities which can cost hundreds of thousands of dollars because of the various costs imposed, such as telephone bills, postage, paper, staffing, and facilities.[20] One study estimates that the minimum cost for mailing ten thousand letters would be $3,925.[21] Thus, a spammer can potentially send millions of messages for a few hundred dollars, far less than what traditional advertisers have to pay.[22]

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12. *See, e.g.*, John Magee, *The Law Regulating Unsolicited Commercial E-Mail: An International Perspective*, 19 SANTA CLARA COMPUTER & HIGH TECH. L.J. 333, 338 (2003).

13. *See, e.g.*, Trussell, *supra* note 11, at 177.

14. *See* Sameh I. Mobarek, Note, *The CAN-SPAM Act of 2003: Was Congress Actually Trying to Solve the Problem or Add to it?*, 16 LOY. CONSUMER L. REV. 247, 248-49 (2004).

15. *Id.*

16. *Id.*

17. *Id.*

18. *See* Zitter, *supra* note 5, at 2776.

19. Scot M. Graydon, *Much Ado About Spam: Unsolicited Advertising, the Internet, and You*, 32 ST. MARY'S L.J. 77, 82-83 (2000).

20. Larry Riggs, *Special Report: Costs: Telemarketing*, DIRECT, Mar. 15, 2001, *at* http://www.directmag.com/mag/marketing_special_report_costs_3; Alex Stevenson, *The Dollars and Sense of Direct Mail Advertising for Publishers*, PMA, June 1999, *at* http://www.pma-online/org/scripts/shownews.cfm?id=180.

21. Riggs, *supra* note 20; Stevenson, *supra* note 20.

22. Riggs, *supra* note 20; Stevenson, *supra* note 20.

2. *Not Your Regular Old Advertising Scheme: Spam's Unique Cost-Shifting Structure*

Unlike traditional methods of advertising, spam imposes the bulk of advertising fees on recipients rather than spammers. Spam is junk mail that arrives "postage-due."[23] On a daily basis e-mail users' inboxes are clogged with spam, requiring the expenditure of considerable amounts of time separating spam e-mail from legitimate e-mail. The problem is significant because of the volume of spam sent, as well as the fact that much spam disguises its commercial nature until opened. Spam recipients may have to pay for additional disk space for their e-mail accounts in order to accommodate the influx of messages due to spamming.[24] Some remotely-located Internet users may even incur higher long-distance Internet connection fees as they spend time deleting spam.[25] Thus, individual recipients can potentially incur substantial monetary and non-monetary costs.

Spam also translates into real costs at the workplace. Productivity decreases as employees are forced during working hours to weed out spam e-mail in their inboxes.[26] Such decreases in productivity are reflected in a recent study estimating that spam costs U.S. companies around $9 billion annually.[27] The increased cost faced by companies in the fight against spam is ultimately passed on to consumers in the form of increased prices for the companies' goods and services.[28]

Much of the cost is also shifted to Internet Service Providers (ISPs). Many spammers engage in "Dictionary Attacks," where they send millions of spam messages to e-mail addresses generated by going through the entire alphabet in each letter placeholder of an e-mail address.[29] As a result of this and other spamming techniques, much of the e-mail sent gets bounced because many of the automatically generated addresses are non-functioning.[30] ISPs must then expand their networks and systems not only to accommodate the large quantity of spam but also to process bounced messages.[31] Additionally, ISPs must devote significant monetary resources

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23. *See, e.g.*, Frequently Asked Questions About Spam, http://spam-mirror.idefix.net/faq (last visited Mar. 2, 2005).
24. *Id.*
25. *Id.*
26. *Id.*
27. Mobarek, *supra* note 14, at 250-51.
28. *Id.*
29. *Id.*
30. *Id.* at 251.
31. *Id.*

to hire personnel to field subscribers' spam-related complaints.[32] One recent study found that spam costs both United States and European ISPs $500 million annually in the form of providing additional server and network capabilities.[33] Like costs imposed at the workplace, the costs incurred by ISPs are also passed onto consumers in the form of higher Internet usage fees.[34]

Spam also creates other secondary costs by forcing the private market to combat spam by using e-mail filters. ISPs spend significant resources implementing filtering mechanisms in their e-mail programs as a way to block spam and maintain customer satisfaction.[35] In addition, private companies offer filtering programs to combat spam. Recently, more sophisticated filters known as Bayesian filters are being used to block out spam in users' inboxes.[36] These filters search for patterns of words that are close to those patterns found in recognized spam messages.[37] Bayesian filters take filtering a step further in that they can "learn" to differentiate between certain terms and patterns that are characteristic of spam versus those that are characteristic of legitimate e-mail.[38] Although some filters are provided free as a part of Internet service, the more effective filters, as rated by Consumer Reports, cost around thirty to forty dollars, a cost that might be prohibitive for some e-mail users.[39] In addition, by the time filtering is being utilized, many of the costs associated with spam have already been incurred. Although the recipient may automatically remove filtered messages to their computer trash can, the spam at this point has already used ISPs' bandwidth, passed through ISPs' staff and filters, and used the recipients' connection time and computer space.[40] Consequently, filters will not alleviate many of the problems associated with spam be-

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32. Christopher D. Fasano, *Getting Rid of Spam: Addressing Spam in Courts and in Congress*, 2000 SYRACUSE L. & TECH. J. 1, 4.

33. *Id.*

34. *See* Magee, *supra* note 12, at 339.

35. Cindy M. Rice, Comment, *The TCPA: A Justification for the Prohibition of Spam in 2002? Unsolicited Commercial E-Mail: Why is it Such a Problem?*, 3 N.C. J.L. & TECH. 375, 382 (2002).

36. Jeffrey D. Sullivan & Michael B. de Leeuw, *Spam After CAN-Spam: How Inconsistent Thinking Has Made a Hash Out of Unsolicited Commercial E-Mail Policy*, 20 SANTA CLARA COMPUTER & HIGH TECH. L.J. 887, 920 (2004).

37. *Id.*

38. *Id.* at 920-21.

39. *See, e.g.*, *CR Investigates. Protect Yourself Online*, CONSUMER REPS., Sept. 2004, at 12 (2004) (discussing problems with the CAN-SPAM Act and suggesting anti-spam software to lessen the amount of spam received).

40. Gary Miller, *How to Can Spam: Legislating Unsolicited Commercial E-Mail*, 2 VAND. J. ENT. L. & PRAC. 127, 130 (2000).

cause filters perform their function after much of the damage has already been done.

Furthermore, filters could impose additional costs on consumers through over-protection. There is a risk that filters will incorrectly identify legitimate e-mail as spam messages, resulting in the rejection of legitimate messages from a user's e-mail inbox.[41] One report tested numerous filtering programs, all of which failed to filter out 100% of spam messages.[42] The study found that while the most effective program claimed to filter out 95% of spam, actual users reported a rate of only 70%.[43] Furthermore, there is a risk that spammers will eventually tailor their e-mail text to include words and phrases that are uncharacteristic of spam, and that such messages will bypass the filters.[44] These risks suggest that filters should not be overly relied upon as a technological response.

The problem with spam is further aggravated because, unlike traditional junk mail or telemarketing, recipients of spam incur costs regardless of whether the message is opened. With traditional advertising campaigns, recipients can simply discard the mailing if there is no interest by tossing it into the garbage or opting for removal from telemarketing lists by joining the Federal Trade Commission's (FTC) Do-Not-Call list. Although spam recipients can also discard the messages, the process of discarding spam imposes many more costs. Such costs include the usage of valuable disk space, decreased productivity as recipients sift through legitimate and spam e-mail, loss of customer satisfaction, and costs associated with filtering programs. Thus, even if recipients can eventually discard spam, the costs incurred prior to and during removal are generally much greater than those associated with traditional advertising.

3. *The Offensive and Deceptive Nature of SPAM Also Distinguishes It from Traditional Methods of Advertising*

Not only is spam a problem because it shifts the costs from senders to recipients, but spam messages are also often offensive and deceptive. An FTC study reported that 100% of e-mail addresses posted in chat rooms and 86% of addresses posted in newsgroups and webpages received spam

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41. *Id.*

42. *See* Sharon D. Nelson & John W. Simek, *Canning the Spam: Unclogging Law Firm Mailboxes*, 64 OR. ST. B. BULL. 9, 12-14 (2004) (discussing filter programs used to sift out spam and testing various filtering software, a combination of which failed to sort out 100% of spam messages received).

43. *Id.* at 12.

44. Sullivan & de Leeuw, *supra* note 36, at 920-21.

messages.[45] Among the most common types of spam are those that advertise "get-rich-quick" schemes,[46] pornographic websites, and pirated software.[47] Another FTC study revealed that among a random sampling of one thousand spam e-mails, 20% of the messages offered a variety of business investment opportunities, 18% offered adult-oriented products/services, and 17% involved financial products such as mortgages and credit cards.[48] In this same study, 40% of all the spam contained false information in the body of the message, 33% exhibited false information in the "from" line of the message, and 22% in the "subject" line of the message.[49] Among all the messages sampled, two-thirds contained some form of deception.[50] Furthermore, the study found that only 63% of the "remove me" or "unsubscribe" options in the messages actually worked.[51]

These statistics demonstrate the increased costs e-mail recipients must incur. False information in the body of the message, subject line, and sender line will inevitably lead some recipients to open the message, only to discover that the e-mail is of a completely unexpected and undesirable nature. As a result, recipients cannot rely on such signals to determine whether the e-mail is spam. Instead, they will have to expend time and energy to physically sort through the e-mail to determine which ones are truly spam.

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45. Blanke, *supra* note 8, at 305.

46. Recently, the Nigerian e-mail fraud has emerged as an example of a "get rich quick" scheme gone awry. This scheme occurs when a criminal sends out thousands of spam messages luring recipients to pay certain fees in exchange for helping the sender, disguised as a high ranking official, transfer millions of dollars to the spam recipient. According to the FBI, in 2001, about 2,600 people in the United States reported problems with the Nigerian e-mail fraud, and of that number, sixteen claimed financial losses totaling $345,000. Additionally, in some cases, recipients have been lured to Nigeria to pay for the fees. Upon their arrival, victims are held against their will, beaten, and blackmailed. The frequently offensive and even dangerous contents found in spam messages differentiate it from traditional modes of advertising that usually do not result in such deception and risk. *See, e.g.*, Michelle Delio, *Meet the Nigerian E-Mail Grifters*, WIRED-NEWS, July 17, 2002, *at* http://www.wired.com/news/culture/0,1284,53818,00.html; Aaron Larson, *Nigerian Email Fraud—419 Scams*, EXPERTLAW, June 2004, *at* http://www.expertlaw.com/library/pubarticles/Consumer_Protection/spam_email_fraud2.html.

47. Christopher Scott Maravilla, *The Feasibility of a Law to Regulate Pornographic, Unsolicited, Commercial E-Mail*, 4 TUL. J. TECH. & INTELL. PROP. 117, 118 (2002).

48. Blanke, *supra* note 8, at 305-06.

49. *Id.* at 306.

50. *Id.*

51. *Id.*

C. From Consumers to Advertisers—How Spammers Generate Profits

Despite the fact that some spammers send out millions of e-mails per day, not all of them generate profits in the same way. While some spammers—especially those whose messages are most familiar to consumers—generate profits through sales of products or services, others profit from paid advertisements. Still others may employ illegal means to obtain profit.

Although many spammers turn a quick profit by selling products and services directly,[52] some spammers generate profits by spamming on behalf of other businesses. One such company, BulkingPro.com, sends spam messages for other businesses.[53] It also provides clients with technical support and monthly improvements designed to "penetrate tough domain filters and spam blocking techniques."[54] One bundle offered by the company features spamming to 50 million e-mail addresses for a mere $299.[55] Such low costs undoubtedly appeal to businesses attempting to reach consumers quickly and cheaply.

Other spammers who rely on advertisers for funding engage in even more disruptive tactics. Some spam messages invite recipients to click on website links provided in the e-mail.[56] When a recipient clicks on the link, various browser windows pop up simultaneously.[57] The perpetrator's website then disables the victim's "back" and "window close" buttons while

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52. *See, e.g.*, AL COOLEY, ASTARO INTERNET SECURITY, THE COCKTAIL APPROACH TO SPAM PROTECTION 3 (2004) (citing that spammers on average yield only around 0.005% of purchases from spamming, meaning that out of 1 million messages sent, only about fifty will result in purchases; however, because the costs of emailing millions of recipients can be as low as $300, the potential for profits is high), *available at* http://www.astaro.com/content/download/164/747/file/The_Cocktail_Approach_To_Spam_Protection_en.pdf; Stephen Baker, *The Taming of the Internet*, BUS. WK., Dec. 15, 2003, at 78 (reporting that 7% of U.S. Web surfers have purchased a product or service from an unsolicited spam message).

53. *E-mail Spam: How to Stop It from Stalking You*, CONSUMER REPORTS.ORG, *at* http://www.consumerreports.org/main/detailv2.jsp?CONTENT%3C%3Ecnt_id=322715&FOLDER%3C%3Efolder_id=162693 (last visited Mar. 12, 2005); *see* Bob Sullivan, *Who Profits From Spam? Surprise*, MSNBC NEWS, Aug. 8, 2003, *at* http://msnbc.msn.com/id/3078642.

54. *Id.* (quoting BulkingPro.com sales pitch).

55. *Id.*

56. John Harms & Michael Howden, *The Internet's Dark Side*, *at* http://www.troblewith.com/stellent/groups/public/%5C@fotf_troubledwith/documents/articles/twi_013927.cfm?channel=Parenting%20Teens&topic=Internet%20Concerns&sssct=Background%20Info (last visited Mar. 2, 2005).

57. *Id.*

more windows advertising related goods or services appear on-screen.[58] This technique is known as "mousetrapping."[59] These spammers lure spam recipients to mousetrapping websites, and are funded by advertisers who display banners on those websites.[60] Typically, these advertisers employ contract spammers who are paid based on the number of victims who actually click on the advertisements.[61] Such disruptive spam messages can ultimately lead to consumer confusion as users expend time and energy in escaping the mousetrap.

While such methods of funding spammers perpetuate annoyances for many spam recipients, other spammers resort to illegal means to fund themselves, most notably through identity theft. Some spammers send messages disguising themselves as system administrators, requesting recipients to change their passwords to a specified one, and threatening suspension of the recipients' accounts for failure to do so.[62] Variations on this type of message also include spammers posing as a person in authority, requesting recipients to send copies of passwords or other sensitive personal or financial information.[63] Once spammers obtain this information, they can place charges on credit cards, ruin credit ratings, and cause other financial injuries to unsuspecting victims.[64] The losses incurred by victims go beyond just simple annoyance in receiving spam messages, and could include very damaging financial injuries.

Spammers employ a variety of techniques to generate profits ranging from those which are mere annoyances to those that are illegal. However, regardless of the funding method, all of these techniques result in the congestion of e-mail systems and inboxes.

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58. *Id.*; *see also*, Golden Gate Univ., *Spam and Scams*, *at* http://internet.ggu.edu/university_library/spam_scam.html#trap (last updated Nov. 3, 2003).

59. Golden Gate Univ., *supra* note 58.

60. *Id.*

61. Ed Falk, *Spam Glossary*, *at* http://www.rahul.net/falk/glossary.html#mousetrap (last visited Mar. 2, 2005).

62. Stephanie Austria, *Forgery in Cyberspace: The Spoof Could be on You!*, 5 PGH J. TECH. L. & POL'Y 2, para. 9 (2004).

63. *Id.*

64. *See generally*, Jennifer Lynch, Note, *Identity Theft in Cyberspace: Crime Control Methods and Their Effectiveness in Combating Phishing Attacks*, 20 BERKELEY TECH. L.J. 259 (2005) (providing an in-depth discussion of "phishing" and obtaining sensitive information); *Phishing: Identity-theft Spam*, CONSUMER REPORTS.ORG, Sept. 2004 (providing a general discussion of phishing and tips to combat it), *at* http://www.consumerreports.org/main/detailv4.jsp?CONTENT%3C%3Ecnt_id=464561&FOLDER%3C%3Efolder_id=162693&ASSORTMENT%3C%3East_id=333133.

D. Who Spams?

It is believed that most spam originate from a small group of hard-core spammers.[65] These hard-core spammers might number as few as two hundred.[66] Some of these spammers profit by sending out millions of messages per day.[67] One such spammer, Jeremy Jaynes, sent out at least 10 million e-mails per day through sixteen high-speed lines.[68] Although Jaynes averaged one sale out of every 30,000 e-mails he sent, he nevertheless made up to $750,000 per month with overhead expenses of only $50,000.[69] Not only are such spammers irritating because they send millions of messages per day, but they are also dangerous because much of their spam contains fraudulent information and pitches bogus goods and services.[70] One idea peddled by Jaynes was a scheme to earn $75 by working at home as a Federal Express refund processor, an idea that Jaynes charged spam recipients $39.95 to learn.[71] This fraudulent scheme resulted in over 10,000 credit card orders in one month alone.[72] Big time spammers like Jaynes are the pernicious spammers whom legislation and policing should focus on first because of the propensity of these spammers to rely on fraudulent schemes to make a profit.

Aside from individuals, some businesses are also pernicious spammers. As briefly noted above, BulkingPro.com sends millions of spam messages each day for other businesses.[73] Many of these companies claim that their e-mail lists are directed toward certain target demographic groups and are updated regularly to ensure that all e-mail addresses are functioning.[74] Although these claimed practices appeal to potential adver-

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65. Ron Wyden & Conrad Burns, *Why We've Finally Canned Spam*, CNET NEWS.COM, Dec. 16, 2003, *at* http://news.com.com/Why+we've+finally+canned+spam/2010-1028_3-5125699.html.

66. *Id.*

67. *Id.*

68. Associated Press, *Prolific Spammer's Strategies Come to Light in Trial*, TAIPEI TIMES, Nov. 17, 2004, at 12.

69. *Id.*

70. *See World's Top 10 Spammers*, MSNBC, *at* http://www.msnbc.com/news/wld/tech/brill/Top10Spammers_dw.htm (last visited Mar. 2, 2005); *supra* Part I.B.

71. *See* Charles Arthur, *E-mail Spammers Face Nine Years in Jail*, BELFAST TEL., Nov. 5, 2004 (discussing the punishment of Jeremy Jaynes and his sister Jessica DeGroot for their involvement in spamming fraudulent schemes to millions of e-mail recipients).

72. *Id.*

73. *E-mail Spam: How to Stop It from Stalking You*, *supra* note 53; *see* Sullivan, *supra* note 53.

74. *See, e.g.*, Ad-Site.com, *at* http://www.ad-site.com/eMailLists.php (last visited Mar. 2, 2005); InetGiant, *at* http://www.inetgiant.com/email_blaster.html?source=goog

tisers, companies such as BulkingPro.com also rely on deceptive practices. BulkingPro.com's website and literature offer updated lists of proxy servers,[75] information on inserting random characters into e-mail to pass spam filters, and "other new tricks to get past aggressive domain filters."[76] Not only are these businesses contributing to the mass volume of spam sent to consumers and other businesses, but they also are employing questionable tactics while doing so.

In addition to the hardcore spammers, there are small-time spammers, who range from teenagers in basements to legitimate businesses.[77] Some small-time spammers are legitimate businesses trying to develop their clientele through the use of e-mail as a form of marketing.[78] Most of these businesses are small businesses seeking cost-effective strategies to increase readership and familiarity with their products.[79] Even well-established businesses, such as MasterCard, send out bulk e-mail advertising their services.[80] Also on the rise is political spam sent for political purposes such as spreading a certain candidate's platform or soliciting votes.[81] For these entities, spamming is a cost-effective way to generate profits, increase the company's consumer base, and to acquaint potential voters with a certain political party or candidate.

II. EARLY SPAM REGULATION

In combating spam, recipients have utilized a variety of tools, some more effective than others. The simplest methods included self-regulation and self-help. Recipients also resorted to common law suits to regulate spammers. Because these methods were generally inadequate, the need for

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&keyword=email+list (last visited Mar. 2, 2005); MyOpt, *at* http://www.myopt.com/?source=google (last visited Mar. 2, 2005).

75. *See E-mail Spam: How to Stop It from Stalking You*, *supra* note 53 (describing proxy servers as computers that spammers can use to transmit e-mail anonymously).

76. *Id.*

77. Saul Hansell, *Finding Solution to Secret World of Spam*, N.Y. TIMES, May 5, 2003, at C8.

78. Rachel Henwood, *Spam—A Global Epidemic*, AD.WRIGHT!, Sept. 2, 2004, *at* http://www.adwright.com/portal/comm/control.cfm?ID=716.

79. Linda Formichelli, *When Spam Burns You: Why Unsolicited Bulk E-Mail Is Bad News*, *at* http://www.twowriters.net/spam.htm (last visited Mar. 2, 2005).

80. *Id.*

81. *See generally*, Seth Grossman, *Keeping Unwanted Donkeys and Elephants Out of Your Inboxes: The Case for Regulating Political Spam*, 19 BERKELEY TECH. L.J. 1533 (2004) (discussing the nature of political spam and its exemption from federal spam legislation, and suggesting model legislation to curb political spam).

more effective approaches spurred the growth of state legislation. This Part provides a brief account of these approaches to combating spam.

A. Self-Regulation and Self-Help: Vigilantism on the Internet

When spamming first began, recipients resorted to self-regulation and self-help to inhibit spammers from operating.[82] Recipients would "mail-bomb" the sender by sending a massive volume of e-mail to retaliate against the sender, resulting in a complete overload of the sender's mail-box.[83] This prevented any prospective client from contacting senders for their advertised products.[84] Others recipients issued direct complaints to ISPs while some created their own software to filter and automatically delete spam messages.[85] Still others established anti-spam groups with hopes of stigmatizing spammers into retirement.[86] Groups such as the Mail Abuse Prevention System provided both legal and technical advice on blocking spam.[87] These groups also established blacklists of servers that were friendly or indifferent to spam and provided these lists to ISPs so that they could block mail sent from those servers on the blacklist.[88]

The effectiveness of each of these methods, if any, was short-lived. Numerous problems with these methods quickly emerged, indicating the long-term ineffectiveness of such approaches. Mailbombing soon proved to be ineffective as spammers quickly learned to forge false return addresses in their e-mail headers.[89] As a result, mailbombs clogged the inboxes of innocent users and even collapsed smaller ISP servers.[90] The creation of blacklists also created problems. For example, a political rival or a commercial competitor could easily and anonymously place a particular individual or company on the list of spammers, thereby removing that person's ability to communicate via e-mail.[91] Thus, the ineffectiveness of self-regulation encouraged the development of various legal approaches to combating spam.

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82. *See* Magee, *supra* note 12, at 337.

83. *Id.* For definition of "mailbomb," see *MailBomb Definition*, MONSTER ISP, *at* http://www.monster-isp.com/glossary/mailbomb.html (last visited Mar. 2, 2005).

84. *See* Magee, *supra* note 12, at 337.

85. *Id.*

86. *Id.* at 342.

87. *Id.* at 337.

88. *Id.*

89. *Id.* at 341.

90. *Id.*

91. *Id.* at 342.

B. Common Law Theories

Spam recipients next turned to common law theories to bring spammers to justice. Breach of contract,[92] trademark dilution,[93] and false designation of origin[94] were some of the common law theories alleged against spammers. One of the more successful theories is the doctrine of trespass to chattels.[95] A plaintiff advancing this theory must have incurred "actual injury" as a result of the spammer's intermeddling in order for the claim to

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92. *See generally* Hotmail Corp. v. Van Money Pie Inc., No. C98-20064 JW, 1998 U.S. Dist. LEXIS 10729, at *1 (N.D. Cal. Apr. 16, 1998) (finding that defendants breached the Hotmail user agreement to refrain from spamming when they created a number of Hotmail accounts with the specific purpose of sending spam to thousands of Internet e-mail users advertising pornography, bulk e-mailing software, and get-rich-quick schemes).

93. *See* Am. Online, Inc. v. IMS, 24 F. Supp. 2d 548, 552 (E.D. Va. 1998). In *America Online, Inc. v. IMS*, the court found that plaintiffs successfully advanced a trademark dilution claim under 15 U.S.C. § 1125(c) of the Lanham Act when defendant spammers used the letters "aol.com" in their headers. Under this theory, an owner of a mark is entitled to relief against another person's commercial use of the mark "'if such use begins after the mark has become famous and causes dilution of the distinctive quality of the mark.'" *Id.* (quoting 15 U.S.C. § 1125(c)). To set forth a claim for dilution, plaintiff must show: (1) the ownership of a distinctive mark; and (2) a likelihood of dilution. *Id.*

94. *See id.* at 548-51 (finding that plaintiffs successfully advanced a false designation of origin claim under 15 U.S.C. § 1125(a)(1) of the Lanham Act because many of defendant spammer's e-mail contained the letters "aol.com" in their headers). The court in *IMS* stated that a false designation of origin contains three elements: "(1) the alleged violator must employ a false designation; (2) the false designation must deceive as to origin, ownership, or sponsorship; and (3) the plaintiff must believe that 'he or she is or is likely to be damaged by such [an] act.'" *Id.* at 551 (citing 15 U.S.C. § 1125(a)(1)). Not only does this claim provide protection of trademarks in order to secure to the owner of the mark the goodwill of his business, but it is also intended to protect consumers and their ability to differentiate among competing products. *Id.* In this case, the court held that any of plaintiff's subscribers could logically conclude that the message containing "aol.com" originated from plaintiff and cause subscribers to believe that plaintiff sponsored or approved of defendant's spam messages. *Id.* at 551-52.

95. *See, e.g.*, Compuserve, Inc. v. Cyber Promotions, Inc., 962 F. Supp. 1015 (S.D. Ohio 1997); Thrifty-Tel, Inc. v. Bezenek, 54 Cal. Rptr. 2d 468 (Ct. App. 1996); Ashley L. Rogers, *Internet & Technology: Is There Judicial Recourse to Attack Spammers?*, 6 VAND. J. ENT. L. & PRAC. 338, 340 (2003) (discussing that a trespass of chattels in the spam context occurs when spamming "intermeddles" or interferes with the possessory interest of another through unauthorized use of their computer network and that a plaintiff advancing this theory must also "demonstrate an object on which a person could trespass and a mechanism for that trespass to take place" and actual injury); Steven Kam, Note, Intel Corp. v. Hamidi: *Trespass to Chattels and a Doctrine of Cyber-Nuisance*, 19 BERKELEY TECH. L.J. 427 (2004) (analyzing the use of trespass to chattels when protecting e-mail systems).

be actionable.[96] This element has proved to be problematic as various courts have produced different standards as to what constitutes actual injury. While a California court held that a mere formula or a statistical average of the damages is insufficient,[97] an Ohio court held that the tremendous burden imposed upon plaintiffs was sufficient proof of actual injuries.[98] These inconsistent rulings are problematic because they impose starkly different burdens on plaintiffs who may have similar trespass to chattels actions against spammers.

Additionally, plaintiffs may run into other problems when filing common law actions. Spammers often operate outside the United States or disguise their identities, making it difficult to locate them or bring them into court.[99] Another difficulty in filing lawsuits is that only those with sufficient resources and incentives will be able to endure what may be a lengthy trial. As a result, many individual spam recipients will have neither the desire nor the ability to maintain lawsuits against spammers.

C. State Law Regulation

In 1997, Nevada was the first state to pass a statute regulating unsolicited commercial e-mail.[100] Other states such as California, Washington, and Virginia quickly followed.[101] These states became models for others, and there are currently thirty-six states that have a statute aimed at combating spam.[102]

Most of these statutes primarily target fraudulent or misleading spam.[103] These statutes prohibit falsifying the point of origin and transmis-

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96. Intel Corp. v. Hamidi, 71 P.3d 296, 302-04 (Cal. 2003).

97. *Thrifty-Tel*, 54 Cal. Rptr. 2d at 475.

98. *Compuserve*, 962 F. Supp. at 1023.

99. *See* Brian Morrisey, *AOL Files Spam Suits*, CLICKZ NEWS, Apr. 15, 2003 (indicating that America Online has filed various lawsuits against spammers with some cases referring to defendants as "John Does" or "unnamed" because of difficulties in ascertaining the spammers' identities), *at* http://www.clickz.com/news/article.php/2190881.

100. *See* NEV. REV. STAT. ANN. §§ 41.330, 41.705-41.735 (Michie 2002 & Supp. 2003); *see also* Magee, *supra* note 12, at 356.

101. *See* CAL. BUS. & PROF. CODE § 17529 (West Supp. 2005); WASH. REV. CODE ANN. §§ 19.190.10 to -.070 (West 1999 & Supp. 2005); VA. CODE ANN. § 18.2-152.3:1 (Michie 2004); *see also* Magee, *supra* note 12, at 356.

102. *See, e.g.*, COLO. REV. STAT. ANN. § 6-2.5-103 (West 2002); IOWA CODE ANN. § 714E.1 (West 2003); TENN. CODE ANN. § 47-18-2501 (2001 & Supp. 2004); Magee, *supra* note 12, at 356. *See generally* David E. Sorkin, *Spam Laws*, http://www.spamlaws.com (showing various state spam laws currently in place) (last revised Dec. 16, 2003).

103. Magee, *supra* note 12, at 356.

sion path of unsolicited commercial e-mail.[104] In addition, such legislation typically prohibits misleading information in the subject line of the message.[105] Most states also require subject lines to begin with "ADV:" for all commercial e-mail solicitations, and "ADV: ADLT" for adult-content e-mail.[106] These statutes focus on the regulation of spam content rather than reshifting spam's costs back onto the senders or decreasing the amount of spam sent.

These state statutes also provide for varying penalties and generally allow individuals to bring a private cause of action against spammers.[107] In some states, spammers who send fraudulent or misleading spam or utilize fraudulent methods in doing so face a combination of both civil and criminal penalties.[108] In other states, the degree of damage also determines the classification of the crime as either a misdemeanor or felony.[109]

Most states also rely on opt-out requirements to discourage spamming rather than an opt-in requirement. Under an opt-in system, spammers can only send e-mail to recipients who have explicitly consented to receiving the e-mail.[110] The opt-in requirement would place the burden on spammers to ask for consent prior to communications with the recipient; most state statutes do not prescribe an opt-in requirement.[111] Instead, most state statutes maintain a more business-friendly opt-out approach. Under this approach, spammers can contact recipients and need only maintain a valid link or e-mail address for recipients to unsubscribe themselves from the

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104. *Id.*

105. *Id.*

106. *Id.*

107. *See, e.g.*, CAL. PENAL CODE § 502(e)(1) (West 1999 & Supp. 2005); ME. REV. STAT. ANN. tit. 10, § 1497(7) (West Supp. 2004); N.C. GEN. STAT. § 14-458(c) (2003).

108. *See, e.g.*, CAL. PENAL CODE § 502(d)(1) (West 1999) (punishable by a fine not exceeding $10,000, or by imprisonment in state prison for 16 months, or two or three years, or by both that fine and imprisonment); MICH. COMP. LAWS. ANN. § 445.2507(7)(1) (West Supp. 2004) (punishable by imprisonment for not more than 1 year or a fine of not more than $10,000, or both).

109. *See, e.g.*, N.C. GEN. STAT. § 14-458(b) (2003). In North Carolina, any person falsely identifying with the intent to deceive or defraud recipient or forget commercial electronic mail transmission information or routing information in connection with transmission of unsolicited bulk commercial electronic mail is guilty of a Class 3 misdemeanor. *Id.* If there is damage to property of another valued at less than $2,500, offense will be classified as a Class 1 misdemeanor. If the damage is greater than $2,500, then offense punishable as a Class I felony. *Id.*

110. Blanke, *supra* note 8, at 308.

111. *See* CAL. BUS. & PROF. CODE §§ 17529 to .9, 17538.45 (West Supp. 2005); *see also* Blanke, *supra* note 8, at 308 (stating that California recently became the first state to approve an opt-in approach).

mailing list.[112] Although the volume of spam would be lessened significantly more through the use of an opt-in system, most states have chosen to rely on the less restrictive opt-out requirement.

While state statutes share a common goal of regulating spam, their differing approaches points to a key weakness in a state-centered approach to regulating spam.[113] Although some states like California require that spam messages contain a statement informing recipients of the spammer's contact information, other states like Iowa are much less strict and require only that messages provide an e-mail address that is "identifiable" which recipients can contact.[114] As a result, a spammer under Iowa law places a heavier burden on the recipient to read through the text to locate the contact information. In addition, although most states require the placement of "ADV" in the subject line of a commercial e-mail, some states require only that subject lines do not contain "false or misleading information."[115] The latter approach makes separating spam messages from legitimate ones more time consuming. Thus, the burdens imposed on both spammers and recipients vary considerably among state statutory schemes.

A more significant problem with state legislation is that the majority of spam is transmitted across state lines.[116] For example, in the majority of circumstances, even if both the sender and recipient are located within the same state, the spam will most likely be routed through a server located in another state.[117] This may result in confusion as to which state law should apply and how far each state's protection can and should extend.[118] Such weaknesses signaled the need for a more cohesive, federal approach.

III. FEDERAL LEGISLATION: CAN-SPAM ACT AS THE MOST PROMISING ANSWER?

A. Overview of the CAN-SPAM Act

The ineffectiveness of vigilantism and common law theories and a lack of uniformity among state spam legislation gave rise to a more centralized,

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112. *See, e.g.*, N.D. CENT. CODE §§ 51-27-01 to -09 (2003); 73 PA. CONS. STAT. ANN. §§ 2250.1 to .8 (West Supp. 2004); Blanke, *supra* note 8, at 308 (noting that twenty-four states have an opt-out requirement).

113. *See* Graydon, *supra* note 19, at 98.

114. *Id.* at 99.

115. *Id.* at 100-01.

116. *See* David E. Sorkin, *Spam Legislation in the United States*, 22 J. MARSHALL J. COMPUTER & INFO. L. 3, 7 (2003).

117. *Id.*

118. *Id.*

focused, federal approach: the CAN-SPAM Act. The Senate passed the first version of the Act on October 23, 2003. Following two modifications to the bill by the Senate and the House, President George W. Bush signed the Act into law on December 16, 2003.[119]

Although the Act targets spam, it is solely applicable to spam messages which are commercial in nature.[120] "Commercial electronic mail message" under the Act includes "any electronic mail message the primary purpose of which is commercial advertising or promotion of a commercial product or service"[121] and excludes "transactional or relationship message[s]."[122] Thus, the Act is not applicable to messages associated with an ongoing, existing business relationship or to those messages that the recipient has specifically requested from the spammer.[123]

The provisions of the Act parallel many of those found in state statutes aimed at reducing spam, especially fraudulent spam. However, the Act does not provide for a private right of action.[124] Rather, only the U.S. Department of Justice, the FTC, state attorneys general, and ISPs have the ability to institute actions.[125] Violators of the Act face potential fines up to $2 million and possibly treble damages if the spammer "committed the violation willfully and knowingly."[126] Some provisions in the statute include:

- The prohibition of misleading or false information and subject headings in e-mail messages. It is unlawful for any person to initiate the transmission, to a protected computer, of a commercial e-mail message that is materially false or materially misleading.[127]
- Unsolicited commercial e-mail must be clearly identified as advertisements for products or services. Furthermore, sexually oriented messages require warning labels.[128]
- The senders' e-mail must contain a functioning return e-mail address or other Internet-based mechanism, clearly and conspicuously displayed so that recipients may reply to the e-mail and re-

119. Trussell, *supra* note 11, at 181.
120. Sorkin, *supra* note 116, at 10.
121. 15 U.S.C.A. § 7702 (Supp. 2004).
122. *Id.*; *see* Sorkin, *supra* note 116, at 110.
123. Blanke, *supra* note 8, at 307.
124. Trussell, *supra* note 11, at 183.
125. *Id.*
126. 15 U.S.C.A. § 7706(f)(3)(B)-(C).
127. *Id.* § 7704(a)(1)-(2).
128. *Id.* § 7704(d).

quest not to receive future commercial e-mail messages from that sender at the e-mail address where the message was received.[129]

- Spammers are prohibited from utilizing automated means to establish multiple e-mail accounts solely to send out spam and from engaging in automated means that generate e-mail addresses (bulk solicitation).[130] Examples of such techniques include address harvesting[131] and dictionary attacks.[132]

- The creation of a plan and a timetable by the FTC for a Do-Not-E-mail list, similar in scope to the Do-Not-Call list within six months of the Act's enactment. The FTC is required to establish and implement the plan within nine months after the passage of the Act. If the FTC is unable to establish and implement the plan, then it must explain to Congress why it cannot do so.[133]

- Criminal penalties against spammers who send predatory and abusive commercial e-mail, including those who send obscene messages, child pornography, or messages used to perpetrate identity theft, if such offenses involve the sending of large quantities of e-mail.[134]

B. Criticism of CAN-SPAM

Soon after the passage of the Act, criticism erupted over what had appeared to be a promising federal effort to combat the ever-increasing problems associated with spam. Some opponents see the Act as merely symbolic—an Act with no teeth because it merely provides a set of guidelines on how to spam legally rather than addressing the disruptive, cost-shifting

129. *Id.* § 7704(a)(3).

130. *Id.* § 7704(b).

131. *Id.* § 7704(b)(1)(A)(i) (defining "address harvesting" as usage of e-mail addresses obtained via an automated means from an Internet website or proprietary online service operated by another person, and such website or online service included, at the time the address was obtained, a notice stating that the operator of such website or online service will not give, sell, or otherwise transfer addresses maintained by it to another party for purposes of initiating, or enabling others to initiate e-mail messages).

132. *Id.* § 7704(b)(1)(A)(ii) (defining "dictionary attacks" as the usage of e-mail addresses of recipients obtained using an automated means that generates possible e-mail addresses by combining names, letters, or numbers into numerous permutations).

133. *See id.* § 7708; *see also* Trusell, *supra* note 11, at 181-83.

134. 15 U.S.C.A. § 7703.

structure of spam.[135] These critics raise myriad concerns, emphasizing that the Act neutralizes stricter state statutes because of its preemptive effect and the impossibility of creating a sustainable Do-Not-E-Mail list. Other critics believe that the harsh penalties imposed by the Act are disproportionate to the crime. Still others are concerned with the Act's impact on the First Amendment right of spammers to engage in commercial speech and question the constitutional validity of the Act. Nevertheless, the Act is not without its proponents, who believe that some of the criticized aspects of the Act only contribute to its efficiency and potential for success in combating spam.

1. *Preemption of State Statutes That May Provide More Protection*

One of the primary criticisms against the Act is that it preempts stricter state laws.[136] For example, California's law contained an opt-in provision, a stricter standard than the Act's opt-out standard.[137] As previously described, spammers under the opt-in approach would be prohibited from sending e-mail to recipients who do not have a preexisting business relationship with the sender or to people who have not provided their express consent to receive their messages.[138] This approach is more beneficial to recipients since an opt-out system is triggered only after the message has been sent and after the damage has been done. In addition, critics are wary of opt-out links in e-mail because recipients, by clicking on the link, are validating their e-mail addresses.[139] Consequently, spammers become aware of valid e-mail addresses, which may result in an even greater flood of spam for those e-mail accounts.[140] In addition, California's law would have provided recipients with the right to file private, individual lawsuits, a right absent from the federal Act.[141] Such criticism casts doubt on whether the federal law actually affords better protection than existing state laws.

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135. *See, e.g.*, Thomas K. Ledbetter, Comment, *Stopping Unsolicited Commercial E-Mail: Why the CAN-SPAM Act Is Not the Solution to Stop Spam*, 34 SW. U. L. REV. 107, 112-14 (2004).

136. *See* 15 U.S.C.A. § 7707(b); *see, e.g.*, Elizabeth A. Alongi, Comment, *Has the U.S. Canned Spam?*, 46 ARIZ. L. REV. 263, 287 (2004).

137. Alongi, *supra* note 136, at 287-88.

138. *Id.*; *supra* Part II.C.

139. Alongi, *supra* note 136, at 288.

140. *Id.*

141. *See* CAL. PENAL CODE § 502(e)(1) (West 1999 & Supp. 2005); *see also* Sharon D. Nelson & John W. Simke, *Hi-Tech in the Law Office: The Basics of Spam & Strategies for Defense*, ALASKA B. RAG, Winter 2004, at 26.

Many proponents of the Act believe that the adoption of a uniform federal law is more favorable than having a wide variety of state spam laws.[142] Undoubtedly many of these proponents are businesses who find it difficult to comply with disparate state laws.[143] For marketers, having a uniform federal law might make their operations more cost efficient as they would only have to comply with one set of standards and requirements when distributing e-mail messages.[144] In assessing the advantages of the Act, it is important to recognize that some of its most vocal supporters are those spammers who will directly benefit from the legislation.

2. *Criminal Penalties*

Criticism has also been directed towards the possible penalties imposed under the Act. Under the Act, excessive spamming is punishable as a felony, thereby making it a criminal act.[145] Some criminal defense lawyers and civil libertarians believe that the penalty is too harsh and does not fit the crime.[146] They believe that spamming does not constitute misconduct that harms people—conduct that is ordinarily criminal.[147] These critics point out that spam does not even harm trees.[148]

Proponents of the Act believe the severe penalties will deter excessive spamming.[149] They emphasize that there exists only a relatively small number of hard-core spammers who are sending out millions of e-mails daily.[150] They believe that these spammers will discontinue or at least decrease the amount of e-mails they send because they are reluctant to risk criminal prosecution under the Act.[151] In addition, proponents of the Act assert that the severity of punishment under the Act is similar to those penalties already imposed under existing state statutes that provide for felony classifications of fraudulent or misleading spam.[152] Although the penalties incurred under the Act may be harsh, perhaps they are necessary as spam becomes an increasingly unwelcome part of our daily lives.

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142. Trussell, *supra* note 11, at 184.

143. *Id.*

144. *Id.*

145. Paul Festa, *Stiff Spam Penalties Urged*, CNET NEWS.COM, Apr. 14, 2004, *at* http://news.com.com/2100-1028-5191651.html.

146. *Id.*

147. *Id.*

148. *Id.*

149. Wyden & Burns, *supra* note 65.

150. *Id.*

151. *Id.*

152. *See, e.g.*, N.C. GEN. STAT. § 14-458(b) (2003) (criminalizing spammers who engage in deceitful practices with misdemeanor or felony classifications).

3. *Constitutional Concerns*

A major concern raised by critics is that the Act may challenge fundamental free speech rights under the First Amendment.[153] The Act allows the government to regulate commercial speech since enforcement resides with the government.[154] Accordingly, the government must: 1) show a substantial interest in the regulation, 2) prove that the imposed restrictions will advance its interests, and 3) prove that the regulation is narrowly tailored so that it does not regulate more speech than necessary.[155] These are valid concerns, going to the heart of the debate between allowing the free dissemination of information and speech versus the elimination of spam.

Advocates of the CAN-SPAM Act insist that it will pass judicial scrutiny on the First Amendment issue. Ultimately, the government has a valid and strong interest in preventing consumer fraud, invasion of consumer privacy, and realigning costs to the sender—concerns that the Act attempts to address.[156] Requiring spammers to provide and honor opt-out links is an approach to preventing the invasion of consumer privacy and shifting costs back onto the sender.[157] Furthermore, since some studies indicate that two-thirds of spam contains some type of fraud, the Act's requirement of truthful information in subject lines and return addresses will advance the government's interest in fraud prevention.[158] Although the Act will probably be challenged on First Amendment issues, it seems likely that it will be upheld as the government has a substantial interest in spam regulation. Additionally, the Supreme Court has held that the Constitution provides less protection for commercial speech than for other forms of communication.[159] As such, the Act is likely to pass judicial scrutiny under the First Amendment.

4. *Do-Not-E-mail List*

Although the Act proposes a Do-Not-E-mail list, similar to the Do-Not-Call list for telemarketers, the fact that spam is transmitted through the Internet renders this enforcement mechanism less effective. The FTC implemented the Do-Not-Call list as a response to the growing problems

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153. Mainstream Mktg. Servs. v. FTC, 358 F.3d 1228, 1236-37 (10th Cir. 2003) (citing Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 564 (1980)).

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. Alongi, *supra* note 136, at 287.

159. Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 562-63 (1980).

associated with telemarketers. Although the list has been challenged by telemarketers as a violation of their First Amendment rights, the Tenth Circuit upheld the constitutionality of the list, a decision that the Supreme Court refused to reconsider.[160] The CAN-SPAM Act proposes a similar scheme, a scheme struck down by the FTC as ineffective.[161]

Since Internet identities are difficult to track, a Do-Not-E-mail list would likely be of little practical value. In the telemarketing world, the list is more effective since centralized telephone lines allow authorities to trace phone calls to the violating telemarketer.[162] In contrast, e-mail systems run across borders and are far more decentralized, making spam more difficult to trace.[163] In addition, spammers regularly use stolen computers and e-mail accounts to spam, making enforcement of such a list difficult.[164] Not only is enforcement of such a list extremely difficult in the context of spam, but it also could lead to even more pernicious spamming. The list could fall into the wrong hands—a spammer's hands—thereby enabling the wrongdoer with a very powerful list of *valid* e-mail addresses to spam.[165] Although the Act sets out to protect consumers through the creation of a Do-Not-E-mail list, the medium in which spam operates limits the potential utility of such a list.

5. *Insufficiency of Litigation Under the CAN-SPAM Act*

Although many cases brought under the Act are still pending, it appears that at least in the early stages of prosecution, courts are reluctant to dismiss charges against spammers. The FTC has hauled spammers into court alleging that their e-mail contained false and misleading information.[166] While these cases are being litigated, courts have enjoined these spammers from sending further e-mail until a verdict is reached.[167] The courts imposed these injunctions reasoning that there was good cause to

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160. Mainstream Mktg. Servs. v. FTC, 358 F.3d 1228, 1232-33 (10th Cir. 2003), *cert. denied*, 125 S. Ct. 47 (2004).

161. *See* 15 U.S.C.A. § 7708 (Supp. 2004); Bob Sullivan, *Do-Not-Spam List Won't Work, FTC Says*, MSNBC NEWS, June 15, 2004, *at* www.msnbc.com/id/5216554.

162. Sullivan, *supra* note 161.

163. Marc Simon, *The CAN-SPAM Act of 2003: Is Congressional Regulation of Unsolicited Commercial E-Mail Constitutional?*, 4 J. HIGH TECH. L. 85, 106 (2004).

164. Sullivan, *supra* note 161.

165. *Id.*

166. *See, e.g.*, FTC v. Bryant, No. 3:04-cv-897-J-32MMH, 2004 U.S. Dist. LEXIS 23315 (M.D. Fla. Oct. 4, 2004); FTC v. Harry, No. 04C 4790, 2004 U.S. Dist. LEXIS 15588 (N.D. Ill. July 27, 2004).

167. *Bryant*, 2004 U.S. Dist. LEXIS 23315, at *10-*11; *Harry*, 2004 U.S. Dist. LEXIS 15588, at *8-*9.

believe that the spammers had violated the Act.[168] These decisions are promising and may lead to a decreased volume of false and misleading e-mail. However, they do very little to address the central complaint of spam recipients: receiving any quantity of spam at all, regardless of whether they were false or misleading.

Other suits brought against spammers have settled out of court, leading to the question of whether such settlements will sufficiently deter spammers. In the first suit filed by any state under the Act, a Florida spammer paid $25,000 to settle a lawsuit alleging violations of the Act.[169] State officials alleged that the spammer violated the Act by using fake return addresses to conceal the e-mails' origin, that the messages failed to provide recipients an easy way to opt-out of the mailings, and did not clearly identify itself as an advertisement.[170] Upon a cursory review, it may seem that the Act is performing its function of ensuring that only legitimate spam is sent. However, some spammers will probably continue to send misleading or false messages and risk being caught if they can generate significant profits. Additionally, even if spammers are caught, they might be able to settle out of court for what they may consider to be an insignificant penalty, and risk further criminal prosecution under the Act. These possibilities point to further shortcomings of the Act.

The Act has also been used offensively by spammers. In *White Buffalo Ventures, LLC v. University of Texas*, the defendant spammer unsuccessfully argued that the Act preempted private mechanisms of enforcement.[171] In that case, a spammer sent approximately 55,000 spam messages promoting LonghornSingles.com to members of the University of Texas with e-mail addresses ending in "utexas.edu."[172] Messages ending in utexas.edu are accumulated on computer servers owned and operated by the plaintiff University.[173] When the University received notice of the spam, it asked the defendant to discontinue sending spam pursuant to the University's general anti-solicitation policy.[174] The spammer did not com-

168. *Bryant*, 2004 U.S. Dist. LEXIS 23315, at *10-*11; *Harry*, 2004 U.S. Dist. LEXIS 15588, at *8-*9.

169. Hiawatha Bray, *Spammer to Pay $25,000 Settlement*, BOSTON GLOBE, Oct. 8, 2004, at D3.

170. *Id.*

171. White Buffalo Ventures, LLC v. Univ. of Texas, No. A-03-CA-296-SS, 2004 U.S. Dist. LEXIS 19152, at *5-*15 (W.D. Tex. Mar. 22, 2004).

172. *Id.* at *2.

173. *Id.*

174. *Id.* at *3-*4.

ply and brought suit claiming, in part, that the Act preempts any private regulation of spam.[175]

The court decided in the University's favor, holding that while the Act has preemptive effects, such preemption does not extend to private mechanisms of enforcement.[176] The court noted that although the Act preempts any state spam law, the Act also provides that it

> should not be "construed to have any effect on the lawfulness or unlawfulness, under any other provision of law, of the adoption, implementation, or enforcement by a provider of Internet access service of a policy of declining to transmit, route, relay, handle, or store certain types of electronic mail messages."[177]

The court stated that it was unclear whether the University's anti-solicitation policy is a state regulation and so should not be preempted by the Act.[178] It further held that the University's role as an Internet access provider to campus members enabled it to implement private spam policies as authorized under the Act.[179] As suggested by this case, private mechanisms of spam regulation may survive in a court of law, and Internet access providers may be able to continue implementing their own spam regulations.

Although most of these cases focus on the transmission of false and misleading messages under the Act, e-mail users are also concerned with decreasing the amount of spam. Various surveys suggest that the problems associated with spam have not been curbed since the Act's passage. One survey indicates that after the implementation of the Act, 53% of respondents noticed no changes in the amount of spam received, 24% received even more, and only 20% received less spam.[180] Other studies demonstrate that less than 10% of all spam sent comply with the Act.[181] Even ISPs such as MSN reported no decrease in spam after the passage of the Act.[182] These statistics suggest that the Act alone will be insufficient to address the problems associated with spam.

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175. *Id.* at *5-*6.

176. *Id.* at *8-*14.

177. *Id.* at *12.

178. *Id.* at *12-*13.

179. *Id.* at *13.

180. *See* Dave Gussow, *Users Say Law's No Help As They Drown in Spam Flood*, ST. PETERSBURG TIMES (Fla.), Mar. 18, 2004, at 1D (margin of error on this study is plus or minus 3%).

181. *Id.*

182. Jonathan Sidener, *Spam Still Exploding from Can Despite Law to Ban Junk E-Mail*, SAN DIEGO UNION-TRIBUNE, Mar. 17, 2004, at A1.

6. *Additional Concerns*

One great fear among critics is that the CAN-SPAM Act simply legitimizes, and thus, will increase the amount of spam sent, because the Act provides guidance on how to spam legally.[183] The legitimization of spam could increase the costs associated with it as recipients expend even more time and energy in sorting and deleting an ever increasing volume of unsolicited commercial e-mail.[184] Some believe that the implementation of the Act is a direct result of lobbying efforts by legitimate businesses who urged Congress to "redefine the spam problem as being about dishonesty rather than the negative effects of massive volumes of unwanted e-mail."[185] As such, the Act may provide more businesses with the right to send more e-mail so long as they conform to the Act.

Furthermore, the cloak of anonymity offered to spammers through the Internet might lessen the force of the Act. Unlike other forms of advertising such as telemarketing, spammers are difficult to track.[186] In *Federal Trade Commission v. Phoenix Avatar*, expert testimony indicated that e-mails contain an "electronic postmark" that allows it to be traced back to the computer of origin.[187] Once the originating computer has been identified, then other means can be employed to identify the actual sender.[188] However, spammers often utilize "an open proxy," a computer that, with or often without the owner's knowledge, accepts connections from anyone and forwards those e-mails as if the messages had originated from the open proxy.[189] Consequently, spam messages are difficult to track. Such devices employed by spammers make enforcement of the Act difficult. The fines imposed under the Act may never be realized if authorities are unable to locate and hold spammers responsible. Thus, the Act may not deter spammers, especially the most pernicious ones because they can easily escape capture.

Although the Act contains numerous provisions aimed at prohibiting misleading subject lines and false return e-mail addresses, it does not reshift spam's costs back onto senders. At best, the Act will simply replace misleading or fraudulent spam messages in our inboxes with more legiti-

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183. *See* Trussell, *supra* note 11, at 187.

184. *See id.*

185. Ray Everett-Church, *It's Not Called 'Can' Spam for Nothing*, CNET NEWS.COM, Dec. 16, 2003, *at* http://news.com.com/It's+not+called+'Can'+Spam+for+nothing/2010-1028_3-5125192.html.

186. Sullivan, *supra* note 161.

187. No. 04 C 2897, 2004 U.S. Dist. LEXIS 14717, at *22 (N.D. Ill. July 29, 2004).

188. *Id.*

189. *Id.* at *23.

mate e-mail messages from perhaps more legitimate advertisers. However, this will still result in increased disk usage on recipients' systems, loss of productivity as recipients will still have to sift through their e-mail and delete those that are spam messages, and the purchase of e-mail filters which consumers will still need. The cases pending against spammers under the Act address fraudulent or misleading spam rather than the sheer quantity of spam received. Although one of the problems with spam is that it is often fraudulent or misleading, spam also poses an annoyance to a large extent because of its high-volume nature and cost-shifting structure. Considering the limitations of the various legislative solutions implemented to date, the most effective response to the spam problem might be a combination of legislative and non-legislative solutions that will address all the concerns e-mail users and ISPs have about spam.

IV. THE NEED FOR MORE PROGRESSIVE SOLUTIONS BEYOND THE CAN-SPAM ACT

Although the CAN-SPAM Act has been somewhat successful in bringing spammers to justice, it is obviously not without its shortcomings. Perhaps the court in *White Buffalo Ventures* most accurately summarized the situation by acknowledging that in implementing the Act, Congress also "recognized [its] limitations" and that spam cannot be solved through "'Federal legislation alone.'"[190] In combating the problems associated with spam, it is imperative that more progressive solutions, especially technology-based ones also be employed.

In addition to the use of filters to weed out spam, more innovative technological solutions are on the rise. Some of the most prominent proposals are those advanced by Bill Gates and Microsoft. One proposal would force e-mail senders to pay for each piece of e-mail sent.[191] Every time a piece of e-mail is sent, a small amount, such as twenty cents, is indicated in the subject line of the e-mail.[192] This amount represents the amount of money a sender is willing to pay the recipient to open and view

190. White Buffalo Ventures, LLC v. Univ. of Tex., No. A-03-CA-296-SS, 2004 U.S. Dist. LEXIS 19152, at *11 (W.D. Tex. Mar. 22, 2004) (quoting 15 U.S.C. § 7701(a)(2)).

191. Kevin Maney, *Gates, Microsoft Look For Ways to Zap Spam*, USA TODAY, June 25, 2003, at 1B, *available at* http://www.usatoday.com/money/industries/technology/2003-06-25-gates_x.htm.

192. *Id.*

the e-mail.[193] It is then up to the recipient to determine whether that amount is sufficient inducement to open the e-mail.[194]

This proposal is like traditional junk mail because it shifts costs back onto advertisers by forcing them to pay postage. Although spammers might still spam, the amount of spam they send might decrease. Additionally, it might result in more efficient business relationships because recipients can open e-mail that are of genuine interest for products that they might indeed purchase. On the other hand, this proposal might not deter spam because undoubtedly the costs imposed would still be less than those associated with traditional junk mail or telemarketing. Unlike telemarketers and junk mail advertisers who incur tremendous costs by hiring employees, operating out of various locations, buying envelopes, and paying for long-distance telephone costs, spammers will still incur much lower overhead costs even if they have to pay a small fee to transmit e-mail.[195]

Unsurprisingly, this proposal has its critics. Some state that it "detracts from [the] ability to speak and to state . . . opinions to large groups of people."[196] Today, there are more and more groups that use e-mail as their primary form of communication.[197] This proposal might unnecessarily burden, for example, dozens of parents coordinating school events or hundreds of cancer survivors sharing tips on coping with the illness.[198] However, Gates's proposal is mindful of this. Under his proposal, recipients can also choose to open e-mail without being paid.[199] This option would then allow recipients to receive e-mail as they do now from familiar senders, such as their family, friends, other parents, and support groups without incurring any charges for the sender.

However, problems might arise with respect to the administration of the proposal, including how recipients will be paid. It is unclear whether senders will issue checks (which could bounce) or whether ISPs will track monetary credits and distribute them when the credits reach a certain amount. In addition, some critics charge that this proposal is highly U.S.-centric because senders in other countries, especially developing countries,

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193. *Id.*

194. *Id.*

195. Riggs, *supra* note 20; Stevenson, *supra* note 20.

196. Associated Press, *Gates: Buy Stamps to Send E-Mail*, CNN.COM, Mar. 5, 2004, *available at* http://www.cnn.com/2004/TECH/internet/03/05/spam.charge.ap.

197. *Id.*

198. *Id.*

199. Maney, *supra* note 191.

will probably be unable to afford such payments.[200] As a result, the proposal may need to issue varying monetary amounts depending from which country the e-mail originates. This lack of uniformity will inevitably cause administrative problems. In addition, advertisers could simply relocate their operations to countries that place a lower premium on sending messages. Such administrative problems suggest the need for further development of this proposal.

A similar Microsoft proposal known as the Penny Black project aims to place a non-monetary premium on every piece of unsolicited e-mail.[201] Microsoft summarizes the program as: "If I don't know you, and you want to send me mail, then you must prove to me that you have expended a certain amount of effort, just for me and just for this message."[202] Under this proposal, for every e-mail sent, the sending computer, not the spammers, will have to solve a computational algorithm.[203] This is designed to decrease the amount of spam since it will take a few seconds for the computer to solve each problem.[204] For example, a "price" of ten seconds per e-mail would limit a spamming computer to a maximum of eight thousand messages per day, a significantly smaller amount than the millions of messages sent by spamming computers currently.[205] This would not noticeably burden non-spammers since it takes a large amount of e-mail to actually cause a noticeable time delay.[206] In addition, users can maintain a "safe list," and messages from those on the list will be considered to be solicited and not subject to solving the algorithm.[207] However, it is likely that such a proposal will not hamper spammers who generally use more than just one computer to send messages. As a result, time delay in reality might not lead to a significant decrease in the number of spam sent.

One type of computational algorithm is based on a concept known as Human Interactive Proofs ("HIP"), a program designed to distinguish automated programs from actual human senders.[208] The HIP is an image

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200. Associated Press, *supra* note 196.

201. Microsoft Research, *The Penny Black Project*, *at* http://research.microsoft.com/research/sv/PennyBlack (last visited Mar. 2, 2005).

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.*

206. Maney, *supra* note 191.

207. Cynthia Dwork & Andrew V. Goldberg, *Common Misconceptions About Computational Spam-Fighting*, Microsoft Research, *at* http://research.microsoft.com/research/sv/PennyBlack/spam-com.html (last visited Mar. 2, 2005).

208. Suzanne Ross, *To Err is Not Always Human*, Microsoft Research, *at* http://research.microsoft.com/displayArticle.aspx?id=413 (last visited Mar. 2, 2005).

that contains both numbers and letters,[209] and it might look like the following:

[210]

As evidenced by the figure, the numbers and letters are distorted, and some of the characters are connected by arcs ("segmentation"). While some computers can learn to engage in character recognition regardless of distortion, computers have a more difficult time recognizing segmentation.[211] This proposal would decrease the amount of spam because automated computers and programs that generate spam messages would be unable to solve, or will have to expend considerable time in solving, the algorithm.[212] This program is currently in place at Microsoft's Hotmail, an e-mail service.[213] HIPs on Hotmail are utilized in the sign-up process to ensure that those who sign up are humans, not automated programs used by spammers to obtain numerous e-mail accounts to send their e-mail.[214] Immediately after the implementation of HIP at Hotmail, sign-ups decreased by 20%, a number that could translate into a significant decrease in spam as well.[215]

Another less technological proposal aims to eliminate spam by offering cash bounties to those who locate spammers, a proposal which has received limited support.[216] This program would provide monetary rewards of $100,000 to $250,000 to savvy technology sleuths who report spammers.[217] If this program is implemented, it would mainly focus on rewarding whistle-blowers who are either inside or close to spamming operations.[218] The large monetary rewards are designed to lure whistle-blowers to risk the consequences of coming forward.[219] Critics of the proposal cite that there are already established groups who spend their time finding

209. *Id.*
210. *Id.*
211. *See id.* (explaining that "segmentation" means that the letters and numbers are not clearly separated because of the use of arcs).
212. *See id.*
213. *Id.*
214. *Id.*
215. *Id.*
216. Jonathan Krim, *Cash Bounties For Spammers Win Limited FTC Backing*, WASH. POST, Sept. 17, 2004, at E01, *available at* http://www.washingtonpost.com/ac2/wp-dyn/A27220-2004Sep16.html.
217. *Id.*
218. *Id.*
219. *Id.*

spammers and so there is less incentive to offer cash rewards.[220] Furthermore, critics believe that such a program is inherently flawed because it burdens the FTC and transfers resources away from agency enforcement to private individuals.[221]

While it may take years to implement these more progressive solutions, they at least attempt to shift the costs of spam back onto senders and address the problems associated with its high-volume nature. Proposals such as the Penny Black project and e-mail postage would impose costs on senders much like the costs imposed on advertisers who use traditional methods of advertising. Although some spammers might be willing to incur these costs, it at least may deter some from sending as many spam e-mail. These solutions pick up where self-help and self-regulation methods and the CAN-SPAM Act leave off by addressing the high-volume nature of spam even if the messages are legitimate advertisements from legitimate businesses and attempt to re-shift the costs back onto senders.

V. CONCLUSION

Unlike traditional methods of advertising, the unique characteristics of spam make the problem highly difficult to combat. Spam's low-cost, high-volume nature make it a highly lucrative business since spammers need only generate one positive response out of thousands in order to make a quick profit. Part of what makes spam low cost is its inherent cost-shifting structure. Rather than spammers paying for their advertisements, it is spam recipients—individuals, ISPs, and businesses—who are harboring many of the monetary and non-monetary costs associated with spam, making spam distinct from traditional advertising campaigns that rely on advertisers themselves to incur the costs.

As spam worsens, responses to it have become more sophisticated, ranging from vigilantism to legislation to private-market technological solutions. When spam first became problematic, individual recipients engaged in mailbombing and creating blacklists. In addition, complaints were filed with ISPs. As the problem worsened, state regulation of spam emerged. However, state legislative solutions lacked uniformity and failed to address jurisdictional problems. Passed in 2003, the federal CAN-SPAM Act attempted to address some of the problems associated with earlier efforts at combating spam. The advantages of the Act are that it provides more uniformity than state laws and aims to combat fraudulent or misleading spam. However, critics are quick to point out that the CAN-

220. *Id.*
221. *Id.*

SPAM Act might actually increase spam because it provides a set of guidelines on how to send spam legally. As promising as these approaches appeared at their inception, each of them has significant shortcomings.

Perhaps the solution to spam will lie with more innovative, non-legislative solutions. In this way, progressive solutions such as the Penny Black project, e-postage, and bounty payments might render legislative solutions less of a necessity. While legislation may help in lessening the volume of fraudulent or misleading e-mail, other progressive, non-legislative solutions may help address more directly the mass volume of all spam messages. By reshifting the costs back onto spam senders, progressive solutions may better address spam's unique high-volume, cost-shifting structure.

Ultimately, the most effective method to combating spam is a multi-prong approach, incorporating many of these various solutions. State and federal legislation can be effective in regulating spam sent from legitimate, identifiable businesses. Additionally, technological and other progressive solutions can help to counteract fraudulent spam and the most pernicious, anonymous spammers. A combination of these approaches will ensure not only the legitimacy of spam as a quick and efficient form of communications but also decrease the quantity of spam by re-shifting costs back onto those who should have been paying for it all along—the senders.

ADDITIONAL DEVELOPMENTS—CYBERLAW

BARRETT V. ROSENTHAL

9 Cal. Rptr. 3d 142 (Ct. App.), cert. granted,
12 Cal. Rptr. 3d 48 (2004)

A California court of appeals ruled that an individual may not claim immunity from civil liability for reposting a third party's defamatory message on a newsgroup under the Communications Decency Act's service provider exception, found at 47 U.S.C. § 230.

Plaintiffs Barrett and Polevoy are physicians primarily engaged in combating the promotion and use of "alternative" healthcare practices. In their writings, they attack products, services, and theories that are marketed with claims that are false, unsubstantiated, and/or illegal. Defendant Rosenthal directs the Humantics Foundation for Women and participates in two alternative medicine newsgroups. During a two-year period, the defendant allegedly posted 10,900 messages to newsgroups, among which one or both of the plaintiffs allegedly were mentioned in more than two hundred. The plaintiffs claim these messages were intended to injure their reputations. Among the messages at issue was a reposting of a statement made by a third party, Bolen, alleging that Polevoy had engaged in criminal activity—specifically, stalking women.

Appellants commenced civil action for damages against Rosenthal and others, claiming libel, liber per se, and conspiracy. The trial court found Rosenthal immune from liability for the reposting of Bolen's message under the Communications Decency Act (CDA) §230, interpreting the statute as protecting her from liability even if the republished charge that the doctor had engaged in criminal conduct was false and defamatory.

The court of appeals reversed. The appellate court ruled that the CDA was not intended to abrogate common law liability for knowingly redistributing false statements on the Internet. Therefore, the CDA safe harbor provision does not confer immunity upon a distributor who both (1) publishes on the Internet alleged defamatory content that originates from a third party; and (2) has knowledge of the alleged defamatory nature of the content. The court remanded the issue of the defendants' liability for the posting about Polevoy under California's anti-SLAPP statute (CAL. CIV. PROC. CODE § 425.16) absent the immunity shield.

The California Supreme Court has granted certiorari, requesting special briefing on two questions: (1) the meaning of the term "user" under 47 U.S.C. § 230; and (2) whether it matters, for purposes of the issue presented in the case, whether a user engaged in passive or active conduct.

(This case may not be cited.)

DOE V. GTE CORP.

347 F.3d 655 (7th Cir. 2003)

The Court of Appeals for the Seventh Circuit held that a web service provider through which a third party sold illegally obtained videotapes was not liable for aiding and abetting the third party's illegal interception and disclosure of oral communications under the Electronic Communications Privacy Act (ECPA).

An unknown party secretly videotaped football players undressing in a locker room at the University of Illinois. The videotapes were then sold on a website hosted by defendants. The defendants did not create or distribute the tapes; the only sales occurred directly between the person who created the videos and visitors to the website. Furthermore, defendants did not receive any direct monetary gain from the sale of the videotapes. Plaintiffs claimed, under §§ 2511 and 2520 of ECPA, that defendants were liable for aiding and abetting an entity that intercepted and disclosed oral communications that violated plaintiffs' privacy. The district court dismissed the complaint under 47 U.S.C. § 230(c), the Communications and Decency Act of 1996 (CDA), which states that a provider of Internet services shall not be held liable for information provided by another information content provider.

The Seventh Circuit examined the claims under the ECPA and affirmed the district court's dismissal of the case. The appellate court held that defendants did not intercept or disclose information as required for liability under the ECPA. Section 2511(1)(c) of the ECPA imposes liability on those who willfully disseminate the contents of unlawfully intercepted communications. The court held that a statute that specifically defines those other than the primary interceptor who can be liable should not be read to create a penumbra of additional but unspecified liability. Furthermore, defendant did not have a desire to promote the success of the sale of videotapes, but, instead, like a phone company or delivery service, was indifferent to the content being transmitted through its service and therefore did not satisfy the ordinary understanding of culpable assistance to a wrongdoer.

Plaintiffs also contended that defendants were liable for "negligent entrustment of a chattel" under the *Restatement (Second) of Torts* § 308 by neglecting to control the conduct of a third person to prevent him from intentionally causing harm to others. Again comparing defendants to a phone company or delivery service, the court held that defendants provided only a communications service and were not required to learn what its customers were doing with the provided service, nor were defendants required to act as "Good Samaritans" if they did learn of harmful actions. Defendants were also not liable for contributory infringement, as the services provided were capable of substantial noninfringing uses and were protected by the safe harbor provisions of the Digital Millennium Communications Act.

GRACE V. EBAY, INC.

16 Cal. Rptr. 3d 192 (Ct. App.), cert. granted, 19 Cal. Rptr. 3d 824, and dismissing review, 21 Cal. Rptr. 3d 611 (2004)

A California court of appeal held that the Communications Decency Act (CDA), 47 U.S.C. § 230, does not provide immunity against liability for a distributor of information who knew or had reason to know that the information was defamatory. In this case, however, a written release in the user agreement between the defendant and plaintiff relieved the defendant of liability.

Roger Grace purchased several items from another individual through eBay's online auction service. A dispute arose between Grace and the seller, which resulted in the seller posting negative feedback about Grace on eBay's site. Other users of the site could view the posted comments. Grace notified eBay that the comments were defamatory, but eBay did not remove them. Grace brought suit for libel and unfair competition, contending that eBay was not immunized against liability for libel under § 230 of the CDA because eBay was not a "provider or user of an interactive computer service" within the meaning of that section.

Section 230 states that no provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider. The court found that eBay was not an interactive computer service provider for the purpose of the statute but was, as a website operator, a user. Nonetheless, this definition did not itself relieve eBay of liability. The court turned to the common law distinction between a primary publisher and a distributor, and found eBay to be the latter. Under common law, a distributor is liable where he knows or has reason to know that the content he distributes is defamatory—and, the court concluded, Congress did not intend to preclude traditional distributor's liability in the CDA's safe harbor. In its reasoning, the court rejected a line of cases in the Fourth Circuit, including *Zeran v. America Online, Inc.*, 129 F.3d 327 (4th Cir. 1997).

Despite the above findings, the court did not hold eBay liable for defamation because the written release in the user agreement between eBay and Grace relieved eBay of liability for claims arising from disputes with other users.

(This case may not be cited.)

RAMEY V. DARKSIDE PRODUCTIONS, INC.

No. 02-730 (GK), 2004 U.S. Dist. LEXIS 10107 (D.D.C. May 17, 2004)

The district court for the District of Columbia held that an online publisher of an advertising guide was protected by immunity under the Communications Decency Act (CDA) for the content of its advertisements.

Defendant Darkside Productions ("Darkside") is a publisher of an online advertising guide for legal adult entertainment services. The plaintiff has performed and promoted herself as a nude dancer in the Washington, D.C. metropolitan area since 1996. The defendant displayed unauthorized photos of the plaintiff in an advertisement on its website. Plaintiff alleged intentional infliction of emotional distress, unjust enrichment, negligence, and fraud as a result of the unauthorized use. Defendant moved for summary judgment under § 230 of the CDA.

The district court held that defendant Darkside had full immunity under § 230(c)(1). The court held that defendant was an interactive computer service under the Act and not an information content provider because it did nothing more with the advertisements than: (1) print its website address on every advertisement that it published on its website; (2) place a watermark on the photos used; and (3) categorize the advertisements by subject matter. The court further held that although the publisher did not engage in "Good Samaritan activities" by blocking or screening offensive material from its website, it was still entitled to immunity under the CDA.

REGISTER.COM, INC. V. VERIO, INC.

356 F.3d 393 (2d Cir. 2004)

The Second Circuit affirmed a preliminary injunction prohibiting Verio from using Register.com's trademarks and from using automated software robots to perform multiple, successive WHOIS queries in order to identify and contact recent domain name registrants for marketing purposes.

Plaintiff Register.com is authorized through contractual agreement with the Internet Corporation for Assigned Names and Numbers (ICANN) to act as a registrar for issuing Internet domain names. The agreement requires Register.com to make its registrants' WHOIS information (including name, postal address, email address and telephone number) publicly available. The original agreement forbade Register.com from imposing any restrictions on the public's lawful use of WHOIS data other than for emailing spam. Defendant Verio provides web services such as website operation and design. Verio built its sales contact list by programming an automatic software robot ("bot") to perform multiple WHOIS queries each day on Register.com's servers and thus identify recent domain name registrants. Verio used the WHOIS data to contact Register.com's customers and solicit their business. Verio's sales pitches either made explicit reference to Register.com and its trademarks or implied that it was acting as Register.com's affiliate. Register.com responded by demanding that Verio stop these marketing practices and by modifying the disclaimer accompanying WHOIS query results. Whereas the old notice forbade use of the data only for sending spam, the new one also prohibited using WHOIS data for mass solicitation "via direct mail, electronic mail, or by telephone."

The court upheld the preliminary injunction against using bots to perform successive WHOIS queries on Register.com's computers, finding both a likelihood that Register.com would succeed on the merits, and the threat of irreparable harm. The court rejected Verio's attempt to claim that Register.com's new disclaimer violated Register.com's contract with ICANN, holding that Verio could not intervene to enforce the obligations placed on Register.com by its contract with ICANN unless the contract was made expressly for a third party's benefit. On the contrary, the ICANN agreement includes a "No Third-Party Beneficiaries" provision, and ICANN submitted an amicus brief arguing that enforcement of the agreement's terms should be made through its own procedures rather than in the courts.

The court further held that Register.com's disclaimer bound Verio even though the disclaimer was not displayed before a WHOIS query had been made. The court distinguished *Specht v. Netscape Communications Corp.*, 306 F.3d 17 (2d. Cir. 2002), noting that Verio could perhaps have pled ignorance as to Register.com's terms if its queries had been sporadic and infrequent. However, regular and repeated queries rendered Verio fully informed of Register.com's terms, with Verio admitting actual knowledge of the terms, and they were thus binding. The court also distinguished *Ticketmaster Corp. v. Tickets.com, Inc.*, CV99-7654-HLH (BQRx), 2000 U.S. Dist. LEXIS 12987 (C.D. Cal. Aug. 11, 2000), holding that clicking an "I Agree" button is not always prerequisite to forming a contract on the Internet. Instead, the court referred to the traditional tenet of contract doctrine providing that when an offeree takes a benefit with knowledge of stated conditions, the taking constitutes an acceptance of the terms, which then become binding.

On the issue of irreparable harm, the Second Circuit held that the possibility of other entities following Verio's example and ultimately causing Register.com's servers to crash posed sufficient impairment to satisfy a claim of trespass to chattel.

UNITED STATES V. COUNCILMAN

373 F.3d 197, reh'g en banc granted and opinion withdrawn by 385 F.3d 793 (1st. Cir. Oct. 5, 2004)

The First Circuit held that an Internet service provider's real-time surveillance of its customers' e-mail during the course of transmission did not violate the Wiretap Act because the communication was obtained from temporary storage rather than a non-storage component of the Internet's infrastructure.

Defendant Councilman was Vice President of Interloc, Inc. ("Interloc") and Alibris, the company that acquired Interloc in 1998. Interloc was an online literary clearinghouse that paired its customers, rare and used book dealers, with book buyers. As part of its service, Interloc provided its customers with e-mail service. According to the indictment, Councilman directed Interloc employees to write computer code to intercept and copy all incoming communications to Interloc's customers from Amazon.com. The e-mail messages were copied in real time as they entered the Interloc mail server, before being made available to subscribers. Councilman and other Interloc employees routinely read these e-mails.

The government charged Councilman with conspiring to engage in conduct prohibited by Title I of the Electronic Communications Privacy Act (ECPA), the Wiretap Act, 18 U.S.C. §§ 2510-2522. However, the First Circuit found that the plain language of ECPA showed that Congress did not intend that the Wiretap Act apply to electronic communications if they were in "electronic storage." The court focused on the fact that Interloc obtained the customer e-mail messages while they were in "temporary storage" in a computer system. According to the court's analysis, Title II of ECPA, the Stored Communications Act (SCA), 18 U.S.C. §§ 2701-2711, includes the phrase "temporary storage," while the Wiretap Act's definition of "electronic communications" does not. Consequently, the court believed that Congress did not intend that the interception provisions of the Wiretap Act apply to electronic communications in storage, whether temporary or not. The court noted that the stipulation signed by the parties stated that the e-mails were not affected while they were transmitted through wires or cables between computer systems. In light of these findings, the court determined that the e-mails were not "in transit" and subject to the Wiretap Act protections against "interception," but were instead stored communications.

In a dissenting opinion, Judge Lipez reasoned that the Wiretap Act and not the SCA should control. Citing legislative history and judicial precedent, he explained that the term "temporary storage" in the SCA referred to a message that sits in an e-mail user's mailbox after transmission is completed and prior to the user retrieving the message from the mail server. Judge Lipez concluded that the Wiretap Act, not the SCA, covered messages still in transmission, regardless of where they resided on the Internet's physical infrastructure.

The First Circuit reheard this case en banc on December 8, 2004, and at the time of this publication, it had not yet issued an opinion.

UTAH SPYWARE LEGISLATION

Spyware Control Act, Utah Code Ann. § 13-40-101 to -401 (2004)

WHENU.COM, INC. V. UTAH

No. 040907578 (D. Utah June 22, 2004)

In 2004, the state of Utah enacted H.B. 323, the Spyware Control Act ("SCA"), codified at UCA § 13-40-101 to -401 (2004). The Act makes installing spyware or causing spyware to be installed on another person's computer illegal. In June 2004, a federal district court in Utah granted a preliminary injunction ceasing enforcement of the statute on constitutional grounds.

The SCA defines spyware as any software that monitors computer usage; reports information about usage; or displays ads in response to usage and (1) does not identify the entity responsible for an ad, and/or (2) uses certain triggering mechanisms. Software that generates ads can be exempt if it meets rigorous consent standards including: plain language license agreements; notice of all information collected; examples of the ads that will be displayed; notice of the frequency of ads; an ability to tell these ads from other ads; and the ability to uninstall the software. The statute provides a private right of action allowing for recovery of the greater of actual damages or $10,000 for each violation, with treble damages available for willful violators. The statute also includes a safe harbor provision for Internet service providers that merely transmit information which may include spyware, and prohibits class actions.

WhenU.com, an Internet advertising company that engages in the use of spyware, filed suit in a Utah district court alleging that the SCA is unconstitutional. The court granted a preliminary injunction against enforcement of the statute, holding that WhenU.com was likely to prevail on a claim that the pop-up ad ban portion of the statute violated the United States Constitution, that irreparable harm would result if an injunction was not granted, and that potential injury to WhenU outweighed injury to the defendants and the public.

The plaintiff demonstrated irreparable harm by showing that compliance with the SCA was either technologically impossible, or possible but prohibitively expensive. The court also noted that vagueness in the statute made compliance difficult, raised the specter of widespread litigation, and may deter the plaintiff's business partners. These economic losses would not be recoverable because the defendant is the state of Utah.

On the balancing question, the court held that the threatened injury to the plaintiff outweighed damage to the government and was not counter to the public interest. Even taking into account how consumers could be harmed by delaying the enforcement of this statute and the public interest in giving full effect to legislation, the court also noted the public interest in guaranteeing that laws are constitutional in finding that the balance weighed toward granting the injunction.

Finally, the court held that WhenU was substantially likely to succeed on the merits of its constitutional claim against some provisions of the SCA. Specifically, the court found that the prohibition on pop-up advertising could violate the Commerce Clause of the United States Constitution.

BERKELEY TECHNOLOGY LAW JOURNAL
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CONSTITUTIONAL LAW

POLITICS, TECHNOLOGY, & INDECENCY: RETHINKING BROADCAST REGULATION IN THE 21ST CENTURY

By Matthew C. Holohan

The Federal Communications Commission (FCC or "Commission") has been extremely active in the field of indecency regulation since early 2004. The Commission has driven popular radio hosts off the air, issued several record-breaking fines, and reached highly structured settlements with a number of large media conglomerates. While there have been a handful of significant controversial broadcasts over the past two years, a closer inspection of the circumstances surrounding the FCC's "crackdown" suggests that the Commission has been motivated by politics and unduly influenced by private media watchdog groups, rather than responding to a significant social problem with neutrally-applied legal principles. The visibility of the FCC's activities during 2004 has raised serious questions as to whether the Commission is effectively working in the public interest, and whether indecency on the air should be regulated at all. This Note will discuss recent significant events and FCC rulings in the indecency area, address the motivations behind the FCC's flurry of activity, and critique the current state of indecency law.

Part I provides a brief overview of indecency law, including First Amendment issues and FCC procedures, before moving on to a survey of the year's significant events in Part II. Part III analyzes several key decisions from 2004 and demonstrates that the FCC has been uneven in its application of indecency standards. Part IV questions the true impetus behind the current "crackdown," concluding that politics are perhaps playing an inflated role in broadcast regulation. Finally, Part V critiques the current indecency regime, finding fault in particular with the influence and activities of the Parents Television Council, and concludes that technological advances have rendered existing indecency law obsolete and unjustifiable. Because these problems with indecency law are partially rooted in the flawed doctrine of reduced First Amendment protection for broadcasters, the ultimate conclusion is that indecent broadcasting should be fully protected by the First Amendment.

I. INDECENCY LAW

A. Broadcast Media and the First Amendment

Given the central role of broadcast media in disseminating information and viewpoints, one might expect the First Amendment's protection of free speech to apply with special force to regulations implicating broadcasters. However, the opposite is true. In fact, "[o]f all forms of communication, it is broadcasting that has received the most limited First Amendment protection."[1] This reduced protection enables the government to exercise certain forms of editorial control over broadcasters, as well as to regulate protected speech in ways that would be forbidden in other media.

Reduced First Amendment protection for the broadcast media dates back to the United States Supreme Court's 1969 decision in *Red Lion Broadcasting Co. v. FCC*.[2] In *Red Lion*, the Court held that, because broadcast frequencies are a scarce resource, the government may impose certain restrictions on license holders as required by the public interest.[3] Thus, while free expression is generally considered to be a fundamental right of the speaker, in the case of broadcasters, "[i]t is the right of the viewers and listeners, not the right of the broadcasters, which is paramount."[4]

Building on its decision in *Red Lion*, the Court later held that "special treatment of indecent broadcasting" was justified given the unique qualities of the broadcast media.[5] In *FCC v. Pacifica Foundation*, the Court held that the FCC had the power to regulate broadcast material that was indecent but not obscene, despite the fact that non-obscene speech is protected by the First Amendment.[6] Specifically, the Court upheld FCC action against a radio station that had broadcast a monologue by comedian George Carlin entitled "Filthy Words" which, while indecent and profane, was not obscene.[7]

The Court justified its holding in *Pacifica* on two principal grounds. First, the broadcast media are "uniquely pervasive" in the lives of all Americans, present not only in public but in the privacy of the home.[8]

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1. FCC v. Pacifica Found., 438 U.S. 726, 748 (1978).
2. 395 U.S. 367 (1969).
3. *Id.* at 389.
4. *Id.* at 390.
5. *Pacifica*, 438 U.S. at 750.
6. *Id.*
7. *Id.* at 729.
8. *Id.* at 748.

Second, "broadcasting is uniquely accessible to children."[9] Because certain forms of protected speech may nonetheless be withheld from children, special restrictions on indecent broadcasting were justified in light of this unique accessibility.[10] The *Pacifica* decision thus enabled the FCC to regulate indecent and profane broadcasts despite Supreme Court precedent holding these forms of speech to be constitutionally protected.

B. The FCC Indecency Standard

Congress created the FCC via the Communications Act of 1934, empowering the agency to regulate interstate and international communications by various electronic means.[11] The FCC's statutory authority to regulate indecent speech, upheld in *Pacifica*, is found at 18 U.S.C. § 1464, which provides that "[w]hoever utters any obscene, indecent, or profane language by means of radio communication shall be fined under this title or imprisoned not more than two years, or both."[12] Consistent with this statutory authority, the FCC has adopted a rule prohibiting the broadcast of indecent material on radio and television between 6:00 a.m. and 10:00 p.m.[13]

Notably absent from § 1464 is a definition of indecency, a matter largely left to the FCC. For several years after *Pacifica*, the FCC limited its definition to the specific list of objectionable words in George Carlin's monologue.[14] However, in 1988 the FCC's definition of indecency changed abruptly from this clearly defined list of banned words to the more obtuse definition currently in effect.[15] The FCC currently defines indecency as "language or material that, in context, depicts or describes, in terms patently offensive as measured by contemporary community stan-

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9. *Id.* at 749.

10. *Id.*

11. *About the FCC*, Fed. Communications Comm'n, *at* http://www.fcc.gov/aboutus.html (last visited Feb. 22, 2005).

12. 18 U.S.C. § 1464 (2000).

13. 47 C.F.R. § 73.3999 (2004).

14. John Crigler & William J. Byrnes, *Decency Redux: The Curious History of the New FCC Broadcast Indecency Policy*, 38 CATH. U. L. REV. 329, 336 (1989).

15. *Id.* According to Crigler and Byrnes, "the Commission announced that it would no longer limit the definition of indecency to Carlin's 'seven dirty words,' but would thereafter apply the 'generic' definition of indecency set forth in *Pacifica*." *Id.* (quoting New Indecency Enforcement Standards to be Applied to All Broadcast and Amateur Radio Licenses, 2 F.C.C.R. 2726 (1987)).

dards for the broadcast medium, sexual or excretory activities or organs."[16]

For the purposes of indecency analysis, the FCC breaks the rule into a two-step process.[17] First the Commission determines whether the material falls within the "subject matter scope" of the indecency definition, that is, whether the material is "language or material" that "depicts or describes . . . sexual or excretory activities or organs."[18] Once the FCC determines that the material falls within this scope, it then determines whether the broadcast was "*patently offensive* as measured by contemporary community standards for the broadcast medium."[19]

The Commission maintains that the full context in which the material appears is "critically important" to the latter determination and has established three factors to be used in the analysis:

> (1) the *explicitness or graphic nature* of the description or depiction of sexual or excretory organs or activities; (2) whether the material *dwells on or repeats at length* descriptions of sexual or excretory organs or activities; (3) *whether the material appears to pander or is used to titillate,* or *whether the material appears to have been presented for its shock value.*[20]

While no single factor is meant to be more significant than any other, the FCC has emphasized the "graphic nature" factor at the expense of other factors.[21]

C. FCC Procedures

Although the FCC is empowered by Congress to regulate indecency, the FCC does not actively monitor broadcasts. Rather, "[e]nforcement actions in this area are based on documented complaints received from the public about indecent, profane, or obscene broadcasting."[22] While the FCC

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16. *In re* Industry Guidance on the Commission's Case Law Interpreting 18 U.S.C. § 1464 and Enforcement Policies Regarding Broadcast Indecency, 16 F.C.C.R. 7999, 8000 (2001) [hereinafter Industry Guidance].

17. *Id.* at 8002.

18. *Id.* at 8000, 8002.

19. *Id.* at 8002 (emphasis in original).

20. *Id.* at 8002-03 (emphasis in original).

21. *See infra* Part III.

22. *Obscene, Profane & Indecent Broadcasts: FCC Consumer Facts*, Fed. Communications Comm'n, *at* http://www.fcc.gov/cgb/consumerfacts/obscene.html (last visited Mar. 14, 2005). Complaints may be submitted via U.S. mail, e-mail, phone, and fax. *Filing a Complaint*, Fed. Communications Comm'n, *at* http://www.fcc.gov/cgb/complaints.html (last visited Feb. 22, 2005).

itself investigates viewer complaints to make indecency determinations, the detection function has been delegated entirely to the public. As discussed in Section V.B, *infra*, this delegation has created the opportunity for special interest groups to manipulate FCC indecency enforcement.

When the FCC receives a viewer complaint, the FCC Enforcement Bureau conducts an investigation to determine whether a violation occurred.[23] The Enforcement Bureau recommends appropriate action depending on whether a violation appears to have occurred.[24] If the FCC determines that no violation has occurred, the complaint is dismissed.[25] If the FCC determines that a violation has occurred, the Commission issues a "Notice of Apparent Liability" ("NAL").[26] The NAL includes a description of the alleged violation, an explanation of the Commission's indecency analysis, and (often) a proposed fine.[27] Upon receipt of an NAL, the accused broadcaster may either pay the fine, contest liability, or negotiate a settlement with the Commission.[28]

II. THE YEAR IN REVIEW: A CRACKDOWN ON INDECENCY

Indecency was essentially a nonissue for the first three years of former FCC Chairman Michael Powell's tenure, as the Commission worked to relax ownership restrictions in the broadcast industry.[29] Until 2004, the

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23. *See The FCC Enforcement Bureau: A Broadcaster's Guide*, Fed. Communications Comm'n, *at* http://www.fcc.gov/eb/broadcast/bcenf.html (last visited Feb. 22, 2005).

24. *Id.* The Bureau makes recommendations to the Commission as a whole, which has ultimate authority as to whether actionable violations have occurred and whether to impose fines. *See The FCC Enforcement Bureau: A Broadcaser's Guide*, Fed. Communications Comm'n, *at* http://www.fcc.gov/eb/broadcast/bcenf.html (last visited Feb. 22, 2005).

25. *Obscene, Profane, & Indecent Broadcasts: FCC Consumer Facts*, *supra* note 22.

26. *See* Action for Childrens Television v. FCC, 827 F. Supp. 4, 6-7 (D.D.C. 1993).

27. See *infra* Part III for an analysis of several recent NALs.

28. See *infra* Part II for examples of consent decrees and legal challenges arising from NALs.

29. The new ownership rules that the Commission ultimately released were highly controversial. Passed by a 3-2 Commission vote along party lines, the rules were immediately challenged in federal court by numerous small media companies and consumer groups. The Third Circuit ultimately ordered the FCC to reconsider the rules in June of 2004, two days after the U.S. Senate had voted to restore the pre-existing media limits. Prometheus Radio Project v. FCC, 373 F.3d 372 (3d Cir. 2004); Stephen Labaton, *Court Orders F.C.C. to Rethink New Rules on Growth of Media*, N.Y. TIMES, June 25,

FCC's agenda under Powell focused on deregulating the communications industry. The Commission's controversial revisions to media ownership restrictions were ultimately reversed by the U.S. Senate.[30]

The FCC's inattention to indecency during its deregulation campaign was not for lack of controversial programming. According to data collected by the FCC, the Commission received complaints regarding 389 programs in 2002, and 375 programs in 2003.[31] The Commission issued no NALs regarding television broadcasts during either of these years, fining only a total of ten radio broadcasts (seven in 2002 and three in 2003).[32] The FCC refrained from acting against television broadcasters despite controversial programming such as the Victoria's Secret Fashion Show, which aired on CBS in 2002 and which drew criticism from women's organizations and media watchdog groups alike.[33] In addition, the airing of the Golden Globe Awards on NBC in January of 2003 contained an uncensored use of the word "fucking" by singer Bono.[34] While this offense would later jump-start the 2004 indecency crackdown, the Commission said nothing about the incident for nearly a year.[35] CBS aired a second Victoria's Secret Fashion Show in November 2003, and again the FCC took no action.

Even after the FCC Enforcement Bureau issued a decision in October 2003, in which it declined to fine NBC for the Golden Globes incident,[36] then-Chairman Powell had nothing to say on the subject until three months later. In January of 2004, Powell gave a speech at the National Press Club at which he publicly criticized on-air indecency, apparently for the first

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2004, at A1; Stephen Labaton, *Senate Votes to Restore Media Limits*, N.Y. TIMES, June 23, 2004, at C5 [hereinafter Labaton, *Senate Votes to Restore Media Limits*].

30. Labaton, *Senate Votes to Restore Media Limits*, *supra* note 29.

31. *Indecency Complaints and NALs: 1993 – 2004*, *available at* http://www.fcc.gov/eb/broadcast/ichart.pdf (last visited Feb. 22, 2005).

32. *Id.*

33. *See* Parents Television Council, *Dereliction of Duty: How the Federal Communications Commission Has Failed the Public* [hereinafter PTC, *Dereliction of Duty*], *at* http://www.parentstv.org/PTC/publications/reports/fccwhitepaper/main.asp (last visited Mar. 14, 2005) (reporting that members of the Parents Television Council filed more than 4,000 complaints against the broadcast of the fashion show); *see also* Lisa Bennett, *NOW Foundation Criticizes TV's Distorted Image of Women*, *at* http://www.now.org/nnt/fall 2002/wolu.html (last visited Feb. 22, 2005).

34. *In re* Complaints Against Various Broadcast Licensees Regarding Their Airing of the "Golden Globe Awards" Program, 19 F.C.C.R. 4975, 4976 n.4 (2004) [hereinafter Complaints Against Golden Globe Awards].

35. By comparison, then FCC Chairman Powell released a public statement within hours of the broadcast of Super Bowl incident, described *infra*.

36. Complaints Against Golden Globe Awards, *supra* note 34, at 4975.

time.[37] Specifically, he called upon Congress to increase maximum indecency fines by a factor of ten to augment their deterrent effects and allow the FCC to pursue tougher enforcement actions against offenders.[38] Thus, as the election year began, Powell's focus shifted abruptly from controversial and divisive media deregulation to combating indecency on the airwaves.

Although Powell announced his anti-indecency stance in January, the FCC's "crackdown" did not begin in earnest until the following month. On February 1, during the Super Bowl halftime show on CBS, performer Janet Jackson's breast was exposed briefly on the air.[39] As viewer complaints poured in, Powell sprang into action almost immediately, condemning the incident as a "classless, crass, and deplorable stunt" and personally calling for an FCC investigation into the program.[40] Thus, while it took Powell a year to comment on the Golden Globes, he commented on Jackson's breast exposure within hours of the incident.

Even as the Super Bowl controversy was unfolding, the Parents Television Council (PTC), a powerful media watchdog group with over 800,000 members, released a scathing report taking the FCC to task for ignoring indecency rules in pursuit of its ownership deregulation agenda.[41] The report was released two days after the Super Bowl incident, though it did not mention the Super Bowl itself. Rather, it focused on a handful of specific broadcasts (including the Victoria's Secret Fashion Show) which the PTC considered particularly offensive and which the FCC had ignored.

The Super Bowl was truly a turning point for federal indecency regulation, both at the FCC and congressional levels. On February 11, the Senate held hearings on broadcast indecency. Notably, the hearings did not address the *effects* of indecency, but rather the state of affairs with respect to enforcement. Shortly after the Senate hearings, Powell gave a speech at the Dole Institute on Politics at which he discussed the growing problem

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37. *FCC Chief Wants Crackdown on Obscenity over the Airwaves*, CNN.COM, Jan. 14, 2004, *at* http://www.cnn.com/2004/LAW/01/14/fcc.obscenity/index.html.

38. *Id.*

39. Bill Carter & Richard Sandomir, *Halftime-Show Fallout Includes F.C.C. Inquiry*, N.Y. TIMES, Feb. 3, 2004, at D1. It is unclear whether the exposure was planned or accidental.

40. *Id.*

41. *See* PTC, *Dereliction of Duty*, *supra* note 33.

of indecent material on the air and called for a study into the effects of indecent programming on children.[42]

As the Super Bowl fallout continued and the federal government began to actively address indecency, the focus shifted quickly from television to radio as media companies began to self-regulate for fear of FCC attention. Two weeks after the Senate hearings, Clear Channel Communications announced its "Responsible Broadcasting Initiative," intended "to make sure the material aired by its radio stations conforms to the standards and sensibilities of the local communities they serve."[43] In a separate release issued the same day, Clear Channel announced what appeared to be the first step in its new initiative: the company suspended controversial radio personality Howard Stern from all of its stations, removing Stern from six major markets.[44] Clear Channel claimed that the Stern suspension was prompted by unspecified material aired on Stern's show the day before, attacking the broadcast as "vulgar, offensive, and insulting" to women, African Americans, and "anyone with a sense of common decency."[45]

As Stern left the air, the following months saw a flurry of activity from Congress, the FCC, and the broadcasting industry. On March 11, the House passed a sweeping increase in the FCC's power, enabling the Commission to fine offenders up to $500,000 per offense (up from the previous maximum of $27,500) and authorizing license revocation for serious or repeated offenses.[46] The bill passed overwhelmingly, by a vote of 391-22.[47] A similar bill began moving through the Senate, though the Senate bill was stalled by disagreement over certain provisions relating to media ownership rules.[48]

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42. Chad Lawhorn, *FCC Leader Wants Study of Effects of Indecent TV*, LAWRENCE JOURNAL-WORLD, Feb. 21, 2004, *at* http://www.ljworld.com/section/kudole/story/161965.

43. Press Release, Clear Channel, Clear Channel Imposes Strict New Standards For Broadcast Decency (Feb. 25, 2004), *available at* http://www.clearchannel.com/Radio/PressReleases/2004/2004_02_25_CC_RBI.pdf.

44. Press Release, Clear Channel, Howard Stern Taken Off Clear Channel Stations (Feb. 25, 2004), *available at* http://www.clearchannel.com/Radio/PressReleases/2004/20040226_Rad_Stern.pdf; *see also* Preston Turegano, *S.D. Clear Channel Station Suspends Stern Show*, SAN DIEGO UNION-TRIB., Feb. 27, 2004, at E2.

45. Press Release, Clear Channel, Howard Stern Taken Off Clear Channel Stations, *supra* note 44.

46. Frank James, *House Bill Increases Fine for Indecent Broadcasts*, CHI. TRIB., Mar. 12, 2004, at C1.

47. *Id.*

48. Bill McConnel, *Indecency Battle Rocks The House and Senate*, BROAD. & CABLE, Mar. 15, 2004, at 12.

A week after the House bill passed, the FCC issued its first significant post-Super Bowl decision, reversing the Enforcement Bureau's Golden Globes decision and altering a long-standing indecency rule. Prior to the Commission's Golden Globes ruling, a single or fleeting use of a profane word was not grounds for enforcement.[49] The FCC overturned this precedent and held that Bono's use of the word "fucking" was indecent.[50] However, since the Commission acknowledged that it was altering its rule, it declined to impose a fine for the violation.[51] The new standard would be applied prospectively only.

The following month, the FCC issued an NAL to Clear Channel threatening a fine of $495,000.[52] The fine was directed at material that had aired on the Howard Stern Show in April of 2003, including dialogue regarding sexual practices of cast members and a sexual personal hygiene product.[53] Significantly, the fine marked the first time that separate utterances within a single program were treated as separate violations (and thus separately fined).[54] Clear Channel responded to the NAL immediately. The day after the FCC threatened its fine, the media giant permanently pulled the Howard Stern Show from all of its affiliates.[55] The power and ambition of the FCC was now clear. One day after the Commission threatened a huge media conglomerate with a nearly half-million dollar fine, the most popular radio host in America was silenced in six major markets.

The Stern cancellation had a significant impact on the entertainment industry. Broadcasters across the country began to self-regulate to avoid being targeted by the FCC. Notably, CBS and Limited Brands, Inc., announced in mid-April that the Victoria's Secret fashion show would not return to CBS that year.[56] Other media outlets began to consider toning down popular yet racy programming in order to avoid the attention of the FCC.[57]

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49. Complaints Against Golden Globe Awards, *supra* note 34, at 4980.

50. *Id.* at 4979.

51. *Id.* at 4981-82.

52. *In re* Clear Channel Broadcasting Licenses, 19 F.C.C.R. 6773, 2004 FCC LEXIS 1795, at *1 (2004).

53. *Id.* at *2-*3.

54. *Id.* at *30.

55. Jube Shiver, Jr., *Radio Chain Boots Stern Off Stations*, L.A. TIMES, Apr. 9, 2004, at C1.

56. Shelly Branch, *Limited Brands Decides to Cancel Lingerie TV Show*, WALL ST. J., Apr. 12, 2004, at B2.

57. *See Broom Sweeps Clean at U.S. Networks*, EDMONTON SUN, Apr. 13, 2004, at 45.

As the broadcast media struggled to avoid fines, the FCC was busy working toward a settlement with Clear Channel arising out of the $495,000 NAL issued in April. In early June, the Commission announced that Clear Channel had settled all pending FCC actions for a fine of $1.75 million, the largest such settlement in FCC history.[58] In addition to the fine, Clear Channel agreed to implement a comprehensive compliance plan, which included training for employees as well as possible disciplinary actions against them for violations, including termination if necessary.[59] In exchange, the FCC granted Clear Channel a clean slate. Not only did it drop the NAL issued in April, but it agreed to terminate all pending indecency investigations involving Clear Channel and dismiss all pending complaints against the media company, including those not involving Howard Stern.[60]

As the summer progressed, the entertainment industry finally showed signs of resistance against the FCC's anti-indecency crusade. At the end of June, *The Howard Stern Show* reappeared in several Clear Channel markets, having been picked up in those areas by Infinity Broadcasting.[61] In July, Les Moonves, a top executive at Viacom (the owner of CBS), announced that he would fight against any FCC fines arising from the Super Bowl incident.[62] In addition, as the broadcast networks announced their Fall schedules, it became clear that television programmers were still willing to push the limits.[63]

The entertainment industry's resistance did not deter the FCC, however. In October, the Commission finally released an NAL regarding the Super Bowl incident, threatening Viacom with a $550,000 fine.[64] This fine represented the statutory maximum fine of $27,500 for each of the twenty Viacom stations that aired the incident.[65] The following month Viacom made good on Les Moonves' promise by filing a 78-page challenge to the

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58. *In re* Clear Channel Communications, Inc., 19 F.C.C.R. 10880, 10887 (2004) [hereinafter Clear Channel Settlement].

59. *Id.* at 10883, 10890.

60. *Id.*

61. David Carr, *Howard Stern, Silenced in Some Cities, Gains Some Others*, N.Y. TIMES, July 1, 2004, at E1.

62. Jay Woodruff, *See No Evil?*, ENT. WKLY., Aug. 6, 2004, at 40.

63. *Id.*

64. *In re* Complaints Against Various Television Licensees Concerning Their February 1, 2004, Broadcast of the Super Bowl XXXVIII, 19 F.C.C.R. 19230, 2004 FCC LEXIS 5444, at *1 (2004) [hereinafter Complaints Against Super Bowl].

65. *Id.* at *1-*2.

fine, attacking not only the FCC's ruling but the constitutionality of the entire broadcast regulatory regime.[66]

As the FCC continued to push for strong indecency fines, support from Congress collapsed at the end of the congressional session. Failing to reach an agreement on competing provisions, the House and Senate dropped legislation that would have enabled the FCC to levy increased indecency fines.[67] Still undaunted, however, the FCC issued a record-breaking NAL just as the legislation failed, assessing a $1,183,000 fine against Fox Television for material included in an April 2003 episode of *Married by America*.[68] Like Viacom, Fox has filed a challenge to this fine.[69]

The force of the FCC continued to affect broadcasters as well. For example, in November, several ABC affiliates announced that they would not air the award-winning film *Saving Private Ryan* on Veteran's Day because of indecency concerns.[70] In a more significant development, the FCC announced in late November that it had a reached a clean slate settlement with Viacom similar to the controversial Clear Channel settlement

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66. *CBS Challenges Fine Over Jackson Incident*, CHI. TRIB., Nov. 9, 2004, at C5; *see* Opposition to Notice of Apparent Liability for Forfeiture, *In re* Complaints Against Various Television Licensees Concerning Their February 1, 2004, Broadcast of the Super Bowl XXXVIII Halftime Show, File No. EB-04-IH-0011 (Fed. Communications Comm'n Nov. 4, 2004) [hereinafter Viacom Opposition], *available at* http://www.fcc.gov/eb/broadcast/Pleadings/Viacom.pdf.

67. Broadcast Decency Enforcement Act of 2005, H.R. 310, 109th Cong. (2005); Frank Ahrens, *Legislation Increasing Indecency Fines Dropped*, WASH. POST, Oct. 8, 2004, at E01. Although indecency legislation failed to pass in 2004, the House revisited the issue in February 2005. Once again, the House voted to increase maximum indecency fines. Under the new bill, broadcasters and individual performers can be fined up to $500,000 for each violation. *House Votes to Raise Fines for Indecency*, N.Y. TIMES, Feb. 17, 2005, at C5.

68. *In re* Complaints Against Various Licensees Regarding Their Broadcast of The Fox Television Network Program "Married By America" on April 7, 2003, 19 F.C.C.R. 20191, 2004 FCC LEXIS 5791, at *1 (2004) [hereinafter Married by America].

69. Opposition to Notice of Apparent Liability for Forfeiture, *In re* Complaints Against Various Licensees Regarding Their Broadcast of the Fox Television Network Program "Married By America" on April 7, 2003, File No. EB-03-IH-0162 (Fed. Communications Comm'n Dec. 3, 2004) [hereinafter Fox Opposition], *available at* http://www.fcc.gov/eb/broadcast/Pleadings/Fox_Broadcasting_Company.pdf.

70. *Some Stations Won't Show "Private Ryan"*, N.Y. TIMES, Nov. 11, 2004, at C6. The FCC later found that the broadcast of *Saving Private Ryan* did not violate any applicable indecency rules. *In re* Complaints Against Various Television Licensees Regarding Their Broadcast on November 11, 2004, of the ABC Television Network's Presentation of the Film "Saving Private Ryan", No. EB-04-IH-0589, 2005 FCC LEXIS 1268, at *1 (Fed. Communications Comm'n Feb. 28, 2005)

earlier in the year.[71] Like Clear Channel, Viacom agreed to implement an indecency compliance plan, including training, suspension, and termination of offending employees.[72] Under the terms of the agreement Viacom agreed to pay $3.5 million, doubling Clear Channel's record-breaking settlement in June.[73] Significantly, the settlement does *not* cover the Super Bowl fine, which Viacom is still challenging.

As of November 23, the FCC had received complaints regarding 279 programs in 2004, and issued eleven NALs totaling over $7.7 million. Over half of this amount consists of the two large settlements reached with Viacom and Clear Channel, and another $550,000 is the Super Bowl fine. Thus, the FCC indecency crackdown was not simply a matter of tougher case-by-case enforcement (indeed, the overwhelming majority of broadcasts were found not indecent), but rather targeted efforts to censure high-profile infractions (such as the Golden Globes and the Super Bowl) and to regulate large, powerful media conglomerates (such as Viacom and Clear Channel).

III. IN SEARCH OF A STANDARD: ANALYZING RECENT FCC DECISIONS

As described in Part I.B, *supra*, the FCC uses a three-factor test in determining whether a given piece of material is offensive enough to be indecent. The three factors are: explicitness or graphic nature; dwelling on or repeating; and titillation or shock value.[74] Despite the Commission's claim that "[n]o single factor generally provides the basis for an indecency finding," numerous FCC decisions issued during the crackdown indicate that the current Commission is placing excessive emphasis on the first, "explicitness or graphic nature" factor. The resulting doctrine is one in which arguably minor violations are deemed indecent while more developed sexual and excretory themes are given a pass.

An example of this doctrinal development is the Golden Globe Awards case, in which the Commission held that any use of the word "fuck" falls within the FCC definition of indecency.[75] The Commission reached this determination based on "the core meaning" of the word, identifying "fuck" as "one of the most vulgar, graphic and explicit descriptions of

71. *Viacom Fined $3.5 Million for Indecency*, N.Y. TIMES, Nov. 24, 2004, at C5.

72. *In re* Viacom Inc., 19 F.C.C.R. 23100, 2004 FCC LEXIS 6631 (2004) [hereinafter Viacom Settlement].

73. *Id.*

74. Industry Guidance, *supra* note 16, at 8003.

75. Complaints Against Golden Globe Awards, *supra* note 34, at 4978-79.

sexual activity in the English language."[76] The assignment of an inherently sexual meaning to Bono's statement runs contrary to the FCC's purported emphasis on context. There is nothing remotely sexual about the phrase, "This is really, really fucking brilliant," and yet the FCC deemed this statement indecent by isolating a single word and attaching an inflammatory meaning to it. A more contextual analysis reveals that the word "fucking" in this context was, as NBC claimed, a modifier, and had nothing to do with explicit or graphic sex.

The FCC engaged in similarly simplistic analysis in the *Super Bowl* case, in which the FCC found indecent the exposure of Janet Jackson's breast for 19/32 of a second.[77] The Commission concluded that, although the exposure was brief, there was "no doubt that the Jackson/Timberlake segment is both explicit and graphic."[78] In addition, because the exposure came at the end of a performance involving sexual song lyrics and choreography, the Commission concluded that the exposure "was designed to pander to, titillate and shock the viewing audience."[79] This conclusion is difficult to justify in light of the fact that (1) there was substantial evidence that the exposure was accidental and (2) the station cut away almost immediately once the breast was exposed. Given these two considerations, it is unlikely that the exposure was *designed* to do anything at all, let alone to "pander to, titillate and shock the viewing audience."[80] Nonetheless, the explicitness and graphicness of an exposed breast seems to have swayed the Commission's view so strongly that they failed to engage in a thorough analysis of all relevant circumstances.

The paramount significance of the "explicit and graphic nature" factor was also apparent in a number of FCC declining to impose indecency fines against material that was arguably more sexual or excretory than the Golden Globe Awards or Super Bowl incidents. In cases involving episodes of the television programs *Off Centre* and *Coupling*, the Commission found "sustained and repeated references to [sexual or excretory] activities," the cumulative effect of which was to "render the material shocking, titillating, or pandering," but held that the material was not indecent because these considerations were "outweighed" by the "lack of explicit or

76. *Id.*

77. Complaints Against Super Bowl, *supra* note 64, at *17.

78. *Id.* Viacom denies that the exposure was explicit or graphic based on the fact that "the unscripted moment . . . involved a long shot of the stage that lasted just over half a second." Viacom Opposition, *supra* note 66, at 21.

79. Complaints Against Super Bowl, *supra* note 64, at *18.

80. Viacom raised a similar argument in its Opposition Brief, claiming that "[o]ne cannot pander by accident." Viacom Opposition, *supra* note 66, at 30.

graphic depiction or description."[81] In one of these cases Commissioner Michael Copps dissented on the grounds that, had the dialogue been broadcast on a radio station, the Commission would have found it indecent.[82]

In addition to denying enforcement against these verbal discussions of sexual acts and excretory functions, the FCC in at least two decisions has declined enforcement against programming depicting sexual *acts* based on lack of explicitness or graphic nature. In August, the Commission issued an opinion dismissing complaints against the airing of an episode of the NBC sitcom *Will & Grace* which "included a scene in which '[a] woman photographer passionately kissed [a] woman author and then humped her (what she called a 'dry hump.')'"[83] The Commission (somewhat conclusorily) determined that the material was "not sufficiently explicit or graphic to be indecent."[84] The same day, the Commission dismissed complaints involving the airing of an episode of *Buffy the Vampire Slayer* which depicted two characters "fighting one another before engaging in what is alleged in the complaint to be sexual intercourse."[85] In an even more conclusory opinion, the Commission stated that "[b]ased upon our review of the scene, we did not find that it is sufficiently graphic or explicit to be deemed indecent. Given the non-explicit nature of the scene, we cannot conclude that it was calculated to pander to, titillate or shock the audience."[86]

An analysis of these decisions reveals that the FCC appears to be ignoring the words "explicitness" and "activities" in its indecency analysis.

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81. *In re* WBDC Broadcasting, Inc., 19 F.C.C.R. 23014, 2004 FCC LEXIS 6626, at *8 (2004) [hereinafter Off Centre]; *In re* NBC Telemundo License Co., 19 F.C.C.R. 23025, 2004 FCC LEXIS 6627, at *8 (2004) [hereinafter Coupling]. The *Off Centre* episodes in question included "sustained and repeated references to excretory activities, with bowel movements the constant theme of the program" and "sustained and repeated references to [a] young man's sexual organ." Off Centre, 2004 FCC LEXIS 6626, at *8-*9. The Coupling episodes at issue included "sustained and repeated use of sexual innuendo and double entendre, with sex the constant theme of the program episodes." Coupling, 2004 FCC LEXIS 6627, at *8.

82. Off Centre, *supra* note 81, at *12.

83. *In re* KSAZ License, Inc., 19 F.C.C.R. 15999, 2004 FCC LEXIS 4508, at *1 (2004).

84. *Id.* at *8.

85. *In re* Complaint Against Various Broadcast Licensees Regarding Their Airing of the UPN Network Program "Buffy the Vampire Slayer" on November 20, 2001, 19 F.C.C.R. 15995, 2004 FCC LEXIS 4507, at *1-*2 (2004).

86. *Id.* at *7. Viacom has argued that the Super Bowl incident "cannot be reasonably distinguished from the sexual situations described in *Will and Grace* and *Buffy the Vampire Slayer*." Viacom Opposition, *supra* note 66, at 25.

Discussions about excretory activities, and depictions of sexual acts, were found not to be indecent because they did not involve nudity or specific references to organs. Clearly, a discussion about excretory activities can be explicit (and therefore legally indecent) without being graphic, and sexual intercourse can be explicitly conveyed without depicting organs. If such depictions in fact "pander to, titillate, or shock" viewers they are at least as harmful, if not more harmful, than fleeting expletives or briefly exposed breasts.[87] The FCC has essentially rewritten the rule so that a sufficiently graphic depiction or description is *per se* indecent, while an explicit, titillating description or depiction cannot be indecent without graphic content.[88] This approach removes the much-touted contextual analysis from the process. It is not a surprise, then, that numerous television stations refused to air *Saving Private Ryan* on Veteran's Day fearing that the film's use of profane words would lead to indecency fines.

Although the FCC's manipulation of the indecency standard is problematic, the issue goes beyond FCC enforcement actions. As noted above, the FCC produced only eleven NALs in 2004, despite receiving complaints about 279 programs. Given that two large settlements accounted for over half of the 2004 indecency fines, a complete analysis of the indecency crackdown must account for this nondoctrinal development as well.

The large FCC settlements add a number of new dimensions to the indecency crackdown. To begin with, numerous indecency complaints were summarily dismissed without full adjudication, raising concerns as to whether the settlement amounts accurately reflected the extent to which the broadcasters violated regulations. In addition, the fact that revised corporate policies were built into the settlements suggests that private media companies are surrendering a certain degree of editorial control to the government in exchange for dismissals. But perhaps most problematically, the fact that indecency standards are subject to manipulation by the FCC enables the Commission to obtain these large cash settlements and policy

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87. This is not to say that any of these depictions are in fact harmful enough to warrant legal action. As discussed in Part V.B, *infra*, there is substantial support for the proposition that indecent broadcasting should not be legally regulated at all. The comparison is drawn here to illustrate the FCC's unprincipled application of existing indecency standards.

88. This standard is illustrated by the FCC's decision to levy a $1,183,000 fine against Fox for airing an episode of *Married by America*. The episode depicted numerous sexual acts, including men licking whipped cream from strippers' bodies and being spanked. The Commission emphasized the significance of the nudity in the program, stating that "[a]lthough the nudity was pixilated, even a child would have known that the strippers were topless and that sexual activity was being shown." Married by America, *supra* note 68, at *11.

capitulations without a sense that legal standards are being meaningfully applied.

IV. EXPLAINING THE INDECENCY CRACKDOWN

While the airing of the Super Bowl halftime show on February 1 is a tidy starting point for analyzing the FCC's increased indecency activity, such an approach cannot fully account for the Commission's motivation in targeting indecency. As noted above, then-FCC Chairman Michael Powell began calling for increased indecency fines over two weeks *before* the Super Bowl. Given that the FCC was likely organizing an anti-indecency crusade before the nation's attention turned to Janet Jackson's breast, something else must account for the Commission's timing. The question, then, is why did the FCC decide to make 2004 into the Year of Decency. The answer, as will be shown, appears to be a combination of increased pressure from media watchdog groups to rein in risqué broadcasters, and increased social conservatism among the American public.

A. The Last Straw?

The Bureau's Golden Globe Awards decision regarding Bono's unbleeped "F-word" came at a time when controversial programming was increasingly popular and, for the most part, ignored by the FCC. As cable programs such as *The Sopranos* and *Sex and the City* enjoyed great success, broadcasters attempted to capitalize on the nation's renewed interest in sex and violence by pushing the limits of propriety further and further.[89] Because the FCC was chiefly concerned with restructuring media ownership rules during the first three years of Michael Powell's chairmanship, this trend toward the racy was largely disregarded by the FCC.

The Bureau's Golden Globe Awards decision brought the FCC's apparent inaction into the public eye. Although the decision was limited to the incident at hand, the reasoning (as quoted throughout the media) appeared to suggest that profanity was *always* permissible on the air as long as it was used as "an adjective or expletive to emphasize an exclamation."[90] The decision was seen by one lawmaker as the latest in a string of FCC decisions establishing a permissive standard for vulgarity on the air.[91] In addition, pressure was mounting from media decency groups such as the Parents Television Council, who objected not only to the FCC's lax stance on indecency but also to the erosion of localism and community

89. *Broom Sweeps Clean at U.S. Networks*, *supra* note 57.
90. *FCC Chief Wants Crackdown on Obscenity over the Airwaves*, *supra* note 37.
91. *Id.*

programming embodied in the Commission's relaxation of media ownership restrictions.[92]

While this explanation accounts for the inception of the indecency crackdown, it leaves a few key questions unanswered. It does not explain why the focus of the FCC abruptly shifted from television to radio as the Super Bowl fallout led the FCC to target Clear Channel and Howard Stern. In addition, it fails to explain why the Commission passed over programming that was arguably more explicit than many of the FCC's other high-profile targets.[93] This focus on high-profile and publicly recognizable cases suggests that the FCC's crackdown is partially political in nature.

B. The Politics of Decency

The sudden backlash against indecency may have been a lagging by-product of the nation's recent rise in conservatism. As demonstrated by the 2004 election, conservative politics have become increasingly dominant in the United States.[94] There is a long-standing link between decency campaigns and conservatism. According to Margaret Blanchard, movements to "clean up" artwork, literature, film, and music have traditionally coincided with broader campaigns to squelch radical political and economic movements.[95] For example, the "social, political, and economic unrest" of the late nineteenth century gave rise to a movement to clean up literature and artwork.[96] A similar movement arose amid the highly conservative atmosphere during the early stages of the Cold War.[97] President Nixon also targeted controversial entertainment in response to the countercultural movements of the 1960s.[98]

A final example, and one which closely mirrors the current indecency crackdown, is the campaign against offensive music lyrics in the 1980s,

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92. *See* PTC, *Dereliction of Duty*, *supra* note 33; *see infra* Part V.A for a detailed account of the actions and influence of the PTC.

93. *See supra* Part III.

94. In addition to President Bush's reelection, the 2004 election saw eleven states overwhelmingly pass constitutional amendments outlawing gay marriage. This has led many to assume that social conservatism is currently a dominant force in American politics. *See* James Dao, *Same-Sex Marriage Issue Key to Some G.O.P. Races*, N.Y. TIMES, Nov. 4, 2004, at P5.

95. *See generally* Margaret A. Blanchard, *The American Urge to Censor: Freedom of Expression Versus the Desire to Sanitize Society—From Anthony Comstock to 2 Live Crew*, 33 WM. & MARY L. REV. 741 (1992).

96. *Id.* at 744-46.

97. *Id.* at 788.

98. *Id.* at 801-02. The anti-indecency activity under President Nixon ultimately gave rise to the U.S. Supreme Court's seminal *Pacifica* decision. *See id.* at 810-13.

headed by Tipper Gore and Susan Baker.[99] The campaign ultimately resulted in the "voluntary" placement by the RIAA of parental advisory labels on music merchandise containing explicit lyrics.[100] In a parallel to the direction the current indecency crackdown is taking, the music campaign of the 1980s focused (at least in theory) on self-regulation.[101] As noted above, the FCC's relatively small number of NALs are arguably not the most significant aspect of the current crackdown. Rather, negotiated settlements and self-regulation by the entertainment industry (such as the decision not to air *Saving Private Ryan*) comprise the core of today's anti-indecency campaign. As in the 1980s, the threat of severe government enforcement is enough to exact content regulation in the media, creating a sense that the government is not directly restricting speech.

Another key aspect of the indecency crackdown of the 1980s also present today is the bi-partisan nature of the movement. A generally conservative atmosphere can drive anti-indecency sentiments across party lines, and participating in campaigns to "clean up" the airwaves allows Democratic politicians to gain political capital in conservative climates. The principal leaders of the advisory label campaign in the 1980s were a prominent Democrat and a prominent Republican. Similarly, the current indecency crackdown has enjoyed broad bi-partisan support both in Congress and the FCC. The House indecency bill initially passed by a very large margin, and the two Democrats sitting on the FCC are even more enthusiastic about indecency regulation than the three Republicans.[102]

While none of the factors described above singularly accounts for the indecency crackdown during 2004, the fact remains that the attack against controversial entertainment programming appears to be at least partially, if

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99. *Id.* at 822. Tipper Gore is the wife of then-prominent Democratic Senator and future Vice President Al Gore, and Susan Baker is the wife of then-Treasury Secretary James Baker III. *Id.*

100. *Id.* at 822-27.

101. *Id.* at 827. Discussing the advisory label solution, Tipper Gore insisted that the campaign had "never been for anything but the voluntary system allowing people to make their own decisions. . . . We do not support any restrictions on sales or performances or anything." *Id.*

102. For example, Democratic Commissioner Michael J. Copps agreed with the more strict profanity rule announced in the Commission's Golden Globe Awards decision, but dissented in part on the grounds that the broadcasters should have been fined. Complaints Against Golden Globe Awards, *supra* note 34, at 4983. Commissioner Copps also dissented to the Commission's determination that the material in the Off Centre case was not indecent. Off Centre, *supra* note 81, at *12. In addition, Democratic Commissioner Jonathan S. Adelstein dissented in part to the Commission's settlement with Clear Channel, objecting to the dismissal of "pending but uninvestigated complaints." Clear Channel Settlement, *supra* note 58, at 10,890.

not significantly, motivated by political considerations. This explains both the FCC's bright-line rule and its decision to focus on large media conglomerates and high-profile cases. By reacting strongly to clearly objectionable content (like the word "fucking" or an exposed breast), the FCC projects the image of being tough on indecency even as a large amount of sexual broadcasting goes unpunished. In addition, the enormous settlements with highly visible media giants such as Viacom and Clear Channel suggest to the public that the Commission is actively working with the entertainment industry to address the problem of indecency on the air. Politics also explain the sudden shift in focus to Howard Stern after the Super Bowl broadcast. A popular radio personality known for his crude humor, Stern was an easy target for a Commission wishing to establish itself as an enemy of indecency.

Given that indecency regulation involves the restriction of protected speech, it is problematic to leave enforcement subject to the political whims of the electorate and special interest groups. Indeed, the purpose of the First Amendment is to protect politically unpopular speech. Notably absent from the power structure controlling the indecency crackdown, however, is any sincere interest in fully promoting free expression. The Commission is not split between punishing indecency and permitting free expression; it is split between punishing indecency and *severely* punishing indecency. Accordingly, it once again falls to the courts to defend politically unpopular (though socially popular) speech from government regulation.

V. A CRITIQUE OF INDECENCY REGULATION

Given the political nature of indecency crackdowns like the one currently ongoing, indecency regulation is not simply a matter of balancing "the interests of the First Amendment with the need to protect our children," as former Chairman Powell claims.[103] Rather, it is a complex political process subject to interests of FCC Commissioners and pressure from outside interest groups. Given the fundamental expressive rights affected by this political posturing, the system must be closely scrutinized to ensure that legitimate public interests are being served by the government's heightened regulation of the broadcast media.

103. Clear Channel Settlement, *supra* note 58, at 10,887.

A. Parents Television Council: Overstating the Problem

By far the most significant defect in the regulation of indecency is the disproportionate influence of media watchdog groups such as the PTC[104] and Morality in Media ("MIM")[105] over broadcast regulators. As noted above, the FCC relies entirely on viewer complaints to detect violations. Accordingly, groups such as the PTC can exercise substantial control over FCC enforcement by organizing large-scale complaint campaigns among their members. A recent estimate by the FCC shows that the PTC was responsible for 99.8% of indecency complaints in 2003, and 99.9% of indecency complaints unrelated to the Super Bowl through October of 2004.[106] This ability leads both to an overstatement of the problem of indecency and selective enforcement of indecency standards.

The PTC has capitalized on the ease of Internet communication to generate hundreds of thousands of FCC complaints. The front page of the PTC website features a prominent "File an FCC Complaint" link, leading to an online form which can be filled out on the website and transmitted directly to the FCC by clicking on a second link at the bottom of the page.[107] Thus, what once required paper, ink, and postage can now be accomplished with two clicks and less than a minute of typing.

In many cases, PTC members do not even have to visit the website to file a complaint. The PTC issues "e-alerts" to its 860,000 members via e-mail advising them of material which the PTC deems objectionable.[108] The alerts contain a description of the material (written by the PTC) along with a link to the online FCC complaint form described above.[109] Significantly, this creates an opportunity for hundreds of thousands of individuals to file detailed complaints with the FCC regarding programming they may not have seen or heard. In addition, because the members proceed based

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104. *See* Parents Television Council, *at* http://www.parentstv.org (last visited Mar. 14, 2005).

105. *See* Morality In Media, *at* http://www.moralityinmedia.org (last visited Mar. 14, 2005).

106. Todd Shields, *Activists Dominate Content Complaints*, MEDIAWEEK, Dec. 6, 2004, *at* http://www.mediaweek.com/mediaweek/headlines/article_display.jsp?vnu_content_id=1000731656.

107. *File an FCC Broadcast Indecency Complaint*, Parents Television Council, *at* https://www.parentstv.org/ptc/fcc/fcccomplaint2.asp (last visited Feb. 22, 2005).

108. Chris Baker, *TV Complaints to FCC Soar as Parents Lead the Way*, WASH. TIMES, May 24, 2004, at A01.

109. *Id.* Examples of e-alert headlines include "Graphic Depiction of Male Rape on The Shield. Take Action Now!", "File a Complaint with the FCC about Sex-filled episode of 'That '70s Show'", and "CBS's 'Without a Trace' features scenes of teen group sex during prime time—FILE YOUR COMPLAINT NOW." *Id.*

on descriptions provided by the PTC, they may file complaints based on distorted or exaggerated characterizations of the actual broadcasts at issue. Accordingly, while a substantial portion of the U.S. population may feel strongly about regulating broadcast indecency, the PTC is able to convince these people that the problem is worse than it is.

Recent statistics indicate that the PTC is responsible for the overwhelming majority of FCC complaints, and that the complaints are rising dramatically. The FCC received 111 complaints in 2000.[110] In 2002, the Commission received approximately 14,000 complaints.[111] The number continued to climb in 2003, with the FCC receiving more than 240,000 complaints that year.[112] Significantly, in both 2002 and 2003 only a few hundred complaints pertained to shows that the PTC was not actively targeting through its e-alerts.[113] The success of the PTC's Internet campaign has led its founder and president, L. Brent Bozell III, to claim that "[PTC] members pay Mr. Powell's paycheck."[114]

The problem with the PTC's influence is not just that it overstates the indecency problem. The PTC's influence, coupled with the FCC's reactive approach to detecting violations, allows the PTC to channel the FCC's immense enforcement power toward programming that the PTC itself finds objectionable. This creates a strong possibility of selective prosecution, exacerbated by the PTC's political ties.[115]

The Howard Stern cancellation illustrates the problem of selective prosecution. A long-time adversary of Howard Stern, the PTC has consistently fought against the radio host and recently identified Howard Stern's upcoming move to satellite radio as "a serious victory for the defenders of decency on the public airwaves."[116] Meanwhile, Stern has identified an episode of *The Oprah Winfrey Show* that contained material comparable to

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110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.* Although indecency determinations are theoretically governed solely by the FCC's implementation of the *Pacifica* standard, in certain cases the number of complaints appears to have factored into the analysis. For example, the Super Bowl decision explicitly states that the Commission received over 542,000 complaints regarding Janet Jackson's performance. Complaints Against Super Bowl, *supra* note 64, at *3 n.6.

114. Baker, *supra* note 108.

115. *See* Woodruff, *supra* note 62. Bozell is closely tied to the Republican party, having served as Pat Buchanan's national finance chairman during his 1992 Presidential campaign. *Id.*

116. L. Brent Bozell III, *Stern Sleaze in Space*, Parents Television Council, Oct. 7, 2004, *at* http://www.parentstv.org/PTC/publications/lbbcolumns/2004/1007.asp.

the Stern broadcast that produced the $495,000 NAL against Clear Channel.[117] The PTC apparently filed no complaints regarding the frank discussion of "oral anal sex" on *Oprah*. Whether the differential treatment was politically motivated is unclear, but the fact remains that the PTC's selectivity translates directly into uneven enforcement by the FCC.

Influence over the FCC by family-oriented media groups is not a new phenomenon. The indecency crackdown in the 1980s was largely the result of concerted efforts by MIM, the National Federation of Decency, and the National Decency Forum.[118] In addition, the *Pacifica* decision establishing the FCC's authority to regulate indecency and profanity arose from an FCC complaint by a high-ranking member of MIM.[119] However, while the participants in early movements engaged in complex negotiations with FCC commissioners and other political leaders, the PTC's approach is to use the Internet to bombard the FCC with complaints every time its leaders find something objectionable on the air. This less measured approach increases the problem of allowing a politically unaccountable special interest group to have such control over a government enforcement agency.

Requiring the FCC to actively police the airwaves rather than relying on viewer complaints is not a practical solution to this problem. In addition, the PTC cannot (and should not) be prevented from making its voice heard. Nonetheless, the broadcast regulatory structure is clearly problematic, and therefore it becomes necessary to rethink the doctrinal underpinnings of indecency regulation.

B. Children and Indecency: The Role of Actual Harm

Government regulation of the broadcast media is most often justified by the need to protect children from indecent material. The broadcast media's unique accessibility to children was one of the two factors that led the Court to uphold indecency restrictions in *Pacifica*.[120] Former FCC Chairman Michael Powell characterized the role of the FCC as balancing the First Amendment against the need to protect children.[121] PTC presi-

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117. *Oprah & Howard Transcripts: Oral, Anal & Balloon Knots*, HOWARDSTERN.COM, *at* http://www.howardstern.com/oprah.php (last visited Mar. 4, 2005).

118. Crigler & Byrnes, *supra* note 14, at 344-45. The role of these groups included "outlin[ing] the steps the FCC should take to crack down on 'indecent' programming and provid[ing] a legal analysis of the basis for proceeding." *Id.* at 345.

119. Blanchard, *supra* note 95, at 809-10. The complaint was filed six weeks after the broadcast of the Carlin monologue, raising questions as to whether the complainant actually heard the monologue. *Id.* at 810.

120. FCC v. Pacifica Found., 438 U.S. 726, 749 (1978).

121. Clear Channel Settlement, *supra* note 58, at 10887.

dent L. Brent Bozell III identifies the need to preserve childhood innocence as a key motivator behind his organization's activities.[122]

This line of reasoning is supported by a line of Supreme Court cases allowing the government to prohibit the sale of certain materials to minors, even where the sale of such materials to adults is protected by the First Amendment.[123] In *Ginsberg v. New York*, the Court upheld a statute prohibiting the sale of pornography to minors, despite the fact that pornography is protected speech. Acknowledging that "the supervision of children's reading may best be left to their parents," the Court nonetheless determined that "the knowledge that parental control or guidance cannot always be provided and society's transcendent interest in protecting the welfare of children justify reasonable regulation of the sale of material to them."[124] Significantly, the Court couched its approval of the state's regulation of protected speech in terms of "society's transcendent interest in protecting the welfare of children."[125] Accordingly, elsewhere in the opinion the Court explicitly conditioned the validity of such regulations on the conclusion that "it was rational for the legislature to find that the minors' exposure to such material might be harmful."[126] The Court in *Ginsberg* did not reach the issue of whether the material at issue was in fact harmful to minors since the defendant did not claim that it was not.[127] Given the arguably incomplete analysis of the harm issue in *Ginsberg*, a showing that there is no rational link between access to indecent material and harm to children would undermine the rule in *Ginsberg*.

The holding in *Ginsberg* that protected speech may be restricted to make it inaccessible to children was the principal support for the "unique accessibility" justification in *Pacifica*.[128] In explaining this justification, the *Pacifica* Court characterized *Ginsberg* as holding that "the government's interest in the 'well-being of its youth' and in supporting 'parents' claim to authority in their own household' justified the regulation of otherwise protected expression."[129] The Court said nothing about the additional language in *Ginsberg* suggesting that these justifications are prem-

122. Woodruff, *supra* note 62.
123. Ginsberg v. New York, 390 U.S. 629, 640 (1968).
124. *Id.*
125. *Id.*
126. *Id.* at 639.
127. *Id.* at 635.
128. FCC v. Pacifica Found., 438 U.S. 726, 749-50 (1978)
129. *Id.* (quoting *Ginsberg*, 390 U.S. at 639-40).

ised on the legislature rationally determining that the restricted speech is actually harmful to children.[130]

Since *Pacifica*, content regulation of broadcast media has proceeded on the assumption that indecent material is harmful to children without requiring factual support. Recent decisions, however, have emphasized the significance of showing actual harm to children in justifying restrictions on expression.

A dramatic example of this is *Ashcroft v. Free Speech Coalition*, in which the Supreme Court held that a statute prohibiting "virtual child pornography" was an unconstitutional infringement on free speech.[131] Finding the causal link between virtual child pornography and actual child abuse to be "contingent and indirect," the Court struck down the statute for lack of a compelling interest justifying the speech restriction.[132] While the *Free Speech Coalition* case did not address the sale or accessibility of virtual child pornography to minors, it is notable that the Court resisted the presumption that thematic depictions of child abuse were necessarily harmful.[133]

Similarly, in *Denver Area Educational Telecommunications Consortium Inc. v. FCC*, the Court struck down an FCC provision imposing special regulations on indecent programming on public access stations.[134] Finding the factual findings in the legislative history inadequate to justify added restrictions aimed at protecting children from offensive programming, the Court held that "[i]n the absence of a factual basis substantiating the harm and the efficacy of its proposed cure, we cannot assume that the harm exists or that the regulation redresses it."[135]

The Court struck down another indecency-based FCC regulation in *Sable Communications of California, Inc., v. FCC*, which involved a

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130. Ironically, the stated purpose of the controversial monologue in *Pacifica* was precisely to show that the objectionable words in question were "harmless," and that society's attitudes toward them were "essentially silly." *Id.* at 730. The Court addressed this argument in a cryptic footnote without identifying any harm beyond offensiveness. *Id.* at 746 n.22.

131. 535 U.S. 234 (2002).

132. *Id.* at 250.

133. For Fox's analysis of this case with regard to the harm requirement for speech restrictions, see Fox Opposition, *supra* note 69, at 21.

134. 518 U.S. 727, 766 (1996).

135. *Id.* Although the "harm" that the Court envisioned was the accessibility of indecent programming to children rather than any substantive harm arising out of that exposure, the Court's requirement of a factual record suggests a move toward requiring a more concrete basis for indecency regulation.

criminal ban on pornographic telephone services.[136] The Court found that Congress's "conclusory" consideration of the failures of less restrictive regulations to protect minors from pornographic phone messages was insufficient to justify an outright criminal ban.[137] Joining that part of the judgment but dissenting on other grounds, Justice Brennan stated that while "the Government has a strong interest in protecting children against exposure to pornographic material *that might be harmful to them* . . . a complete criminal ban on obscene telephonic messages for profit is 'unconstitutionally overbroad, and therefore invalid on its face, as a means for achieving this end.'"[138]

A final example is *Interactive Digital Software Ass'n v. St. Louis County*.[139] There, the Eighth Circuit struck down a county ordinance prohibiting the sale of violent video games to minors. The court held that for such a restriction to be upheld based on psychological harm to children, the county "must demonstrate that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way."[140] The court held that the violent video game law was an unconstitutional restriction on free speech, finding that the asserted harms to minors were "unsupported in the record."[141] Thus, courts have grown suspicious of content-based regulations that are premised on factually unsupported claims of harm to minors.

While FCC regulations are premised in large part on harm to children, none of the institutions leading the anti-indecency crusade have identified any actual harm caused by objectionable programming. Although numerous studies have addressed the effects of violent programming on children, the effects of indecency have not been seriously assessed.[142] The need to make such an assessment was recognized by former Chairman Powell himself in his remarks to the Dole Institute in early 2004.[143] The fact that Powell called for such a study *after* announcing his strong anti-indecency stance highlights his somewhat backwards approach to policymaking.

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136. 492 U.S. 115, 131 (1989).

137. *Id.* at 130-31.

138. *Id.* at 134-35 (Brennan, J., dissenting) (emphasis added).

139. 329 F.3d 954 (8th Cir. 2003).

140. *Id.* at 958.

141. *Id.* at 958-59.

142. A search of the Morality in Media website revealed numerous studies about violence and children, but none about indecency. A similar search of the Parents Television Council website returned a single news article describing a possible link between sexual television programming and increased sexual activity among minors. *See* Marilyn Elias, *TV Might Rush Teens into Sex*, USA TODAY, Sep. 7, 2004, at 9D.

143. *See* Lawhorn, *supra* note 42.

Rather than studying the facts and adjusting his course accordingly, Powell announced an agenda of protecting children from indecency before determining whether such a course was factually justified. Although Powell was able to launch the crackdown with popular support even without a factual basis, the FCC may have difficulty defending its activities against constitutional attacks going forward.

C. Reconsidering *Pacifica* in Light of Technological and Market Shifts

The FCC's authority over indecent broadcasting has come under fire by judges, commentators, and even the FCC itself. Critics have recognized that a significant defect in the Supreme Court's treatment of indecency regulation is the fact that much of the FCC's authority in this area traces back to decades-old technological evaluations that do not apply today.[144] Because technological developments have blurred the distinction between broadcast and non-broadcast electronic media, differing treatment of these forms of communication is no longer legally defensible.

The *Pacifica* rationale was called into question by Chief Judge Edwards of the D.C. Circuit in the 1995 case of *Action for Children's Television v. FCC*.[145] In that case, an *en banc* panel of the D.C. Circuit upheld the FCC's daytime ban on indecent material. In a scathing dissent, Chief Judge Edwards questioned both the legitimacy of restricting indecency without a finding of actual harm to children and the reduced First Amendment protection of broadcasters. Chief Judge Edwards noted that "[f]or years, scholars have argued that the scarcity of the broadcast spectrum is neither an accurate technological description of the spectrum, nor a 'unique characteristic' that should make any difference in terms of First Amendment protection."[146] Chief Judge Edwards also noted that broadcast is no more pervasive than cable, especially considering the fact that an increasing majority of American homes subscribe to cable television.[147] Finding no legally defensible distinction between broadcast and cable, Chief Judge Edwards concluded that *Pacifica* is a "flawed decision" and

144. Viacom argues this point as well in their general constitutional challenge to the FCC's indecency regulations. Viacom Opposition, *supra* note 66, at 58-61.

145. 58 F.3d 654 (D.C. Cir. 1995) (en banc).

146. *Id.* at 675 (Edwards, C.J., dissenting).

147. *Id.* at 676 (Edwards, C.J., dissenting).

that broadcasters should be entitled to the full First Amendment protection enjoyed by cable.[148]

The technological underpinnings of the *Pacifica* decision have also been questioned by the FCC itself. As early as 1987 the FCC determined that "the standard [of reduced First Amendment protection for broadcasters] applied in *Red Lion* should be reconsidered and that the constitutional principles applicable to the printed press should be equally applicable to the electronic press."[149] In particular, the FCC found that the "constitutional principles" promulgated in *Red Lion* and *Pacifica* "were developed for a telecommunications market that is markedly different from today's [1987] market."[150] While the Supreme Court has yet to accept the prior FCC invitation to change the law, the technological developments that rendered the *Pacifica* standard obsolete in 1987 are certainly more compelling today.

This sentiment persisted within the FCC through its 2001 release of *Industry Guidance*, when then-Commissioner Harold Furchtgott-Roth filed a concurrence in which he too questioned the validity of the FCC's indecency authority.[151] While acknowledging that the Commission's policy statement "establishes necessary boundaries for this elusive and highly subjective area of law," Furchtgott-Roth suggested that "Commission action to enforce the indecency guidelines would set the stage for a new constitutional challenge regarding [the FCC's] authority to regulate content."[152] Like Chief Judge Edwards in *Action for Children's Television*, Furchtgott-Roth claimed that technological developments have rendered the current broadcast restrictions archaic and obsolete. In particular, Furchtgott-Roth cited the decreasing dominance of broadcast media in light of the video marketplace's "abundance of programming, distributed by several types of content providers," along with the evolution of a "competitive radio marketplace."[153] In light of these "market transformations," Furchtgott-Roth concluded that "broadcast content restrictions must be eliminated."[154]

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148. *Id.* at 676-77 (Edwards, C.J., dissenting). The Supreme Court has held that cable television, unlike broadcast television, is entitled to full First Amendment protection. Turner Broad. Sys. v. FCC, 512 U.S. 622, 639 (1994).

149. *In re* Complaint of Syracuse Peace Council against Television Station WTVH Syracuse, New York, 2 F.C.C.R. 5043, 5053 (1987).

150. *Id.*

151. Industry Guidance, *supra* note 16, at 8017.

152. *Id.*

153. *Id.*

154. *Id.*

As recognized by Chief Judge Edwards and past FCC Commissioners, the rise of cable and satellite television has rendered greater restrictions for television broadcasters obsolete. A similar market shift appears imminent in radio. Embattled radio host Howard Stern has announced that he is leaving broadcast and joining Sirius satellite radio in 2006, a move that many believe will transform the fledgling satellite radio industry into an equal (if not dominant) competitor with broadcasters.[155] Thus, the "competitive radio marketplace" that Furchgott-Roth identified in 2001 continues to evolve today.

As non-broadcast stations increase in number and popularity, the *Pacifica* rules give broadcasters a severe competitive disadvantage. Indeed, cable and satellite stations appear to be making the most of the broadcast crackdown. For example, the highly sexual HBO series *Sex and the City* can now be seen weekday evenings on TBS, a basic cable network. While much of the original graphic sexuality is edited out of the TBS version, the sexual themes remain largely intact, as does some of the profane language. In addition, XM Radio (a Sirius competitor) has signed controversial radio duo Opie and Anthony, who were driven from their New York broadcast station after allegedly broadcasting the sounds of two people having sex in St. Patrick's Cathedral.[156] The satellite radio industry is already benefiting from these recent developments. Sirius announced in late November that it had topped 800,000 subscribers, and its stock has nearly doubled since the announcement that Howard Stern will be joining Sirius in 2006.[157] Given the likely future success of these programs, tying the hands of broadcasters as cable programmers enjoy comparable freedom is hardly justifiable.

VI. CONCLUSION

The technological underpinnings of the *Pacifica* decision have been rendered more or less obsolete by advances in communication technology and other changes in the way media programming is transmitted. These technological shifts, coupled with the dearth of evidence that indecent programming is actually harmful to children, calls into question the viability of decreased protection for broadcasters in the indecency realm. The FCC's enforcement procedures are incompatible with current communica-

155. Scott Collins, *Stern Vows He'll Rise Above FCC*, L.A. TIMES, Oct. 7, 2004, at A1.

156. Sabrina Tavernise, *The Broad Reach of Satellite Radio*, N.Y. TIMES, Oct. 4, 2004, at C8.

157. *Sirius Says Its Subscribers Top 800,000*, N.Y. TIMES, Nov. 24, 2004, at C7.

tions technology and have been severely manipulated by the Parents Television Council, a situation which has produced unprincipled enforcement of indecency laws and an atmosphere of chilled expression in the broadcast industry. Vesting so much power in an agency which has little accountability and is easily manipulated by political pressure cannot be justified in the context of expressive rights. This abuse, along with the waning justification for decreased First Amendment protection on the air, calls into question the validity of the entire broadcast regulatory regime as applied to constitutionally protected speech. Because cable television and satellite radio enjoy comparable freedom with respect to indecent content, and because these forms of media have become increasingly competitive in the entertainment industry, the time has come to revisit the *Pacifica* rationale and restore full First Amendment protection to radio and television broadcasters.

ASHCROFT V. ACLU: IN SEARCH OF PLAUSIBLE, LESS RESTRICTIVE ALTERNATIVES

By Tara Wheatland

Legislators have long sought to protect children from exposure to sexually explicit materials. With the proliferation of such materials on the Internet, Congress has perceived a growing threat in the ease with which minors can access these materials. However, the Internet has altered the landscape in more ways than just by making sexually explicit materials more prevalent and more easily accessible to children. Internet technologies also constrain and shape the approaches Congress is able to take in addressing the problem. Even as the legislature enacts laws and courts interpret them, the landscape continues to change—consumers of web services become more sophisticated, software providers become more aware of and responsive to consumer needs, and through it all, the technological features of the Internet are constantly evolving.

Congress, the courts, and commentators have contemplated various ways to address the problem of children's access to sexually explicit materials on the Internet, spanning the spectrum from pure technological solutions to pure legislative regulatory regimes. In *Ashcroft v. ACLU*,[1] the Supreme Court assessed Congress's most recent legislation in this arena, the Child Online Protection Act (COPA).[2] The Court upheld a preliminary injunction against COPA's enforcement, finding the ACLU likely to prevail on its claims of unconstitutionality.[3] In doing so, the Court indicated the legal boundaries within which Congress must work. Taking into account the changing landscape, a landscape defined by both technology and law, Congress might be able to devise a new form of legislation to curtail children's access to sexually explicit materials online that would be validated by the courts. But given the constraints imposed by the Constitution,

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1. Ashcroft v. ACLU, 124 S. Ct. 2783 (2004) [hereinafter *Ashcroft*].
2. Pub. L. No. 105-277, 112 Stat. 2681-736 (1998) (codified at 47 U.S.C. § 231 (2000)).
3. *Ashcroft*, 124 S. Ct. at 2788.

the practical limits of various institutional bodies, and the dynamic state of the technology surrounding the Internet, Congress would be well advised to explore the full range of options, some of which involve little or no congressional action. A desirable scheme is detailed in the Final Report of the Commission on Child Online Protection ("COPA Commission" or "the Commission"), a congressionally appointed panel whose mission was to "identify technological or other methods that will help reduce access by minors to material that is harmful to minors on the Internet."[4] The Commission's recommendations advocate an appropriately hands-off approach that takes advantage of myriad possible technological solutions in addressing Congress's concerns.[5]

Part I of this Note describes background principles of First Amendment law which illuminate the discussion at hand. It also details the passage and subsequent invalidation of COPA's predecessor, the Communications Decency Act (CDA). Part II discusses *Ashcroft v. ACLU* in the framework of First Amendment law and the Internet. Part III analyzes the reasons for COPA's unconstitutionality and explores what options remain for action by Congress. The part concludes that the best balance is achieved in the COPA Commission's recommendations for a technologically based solution blending voluntary and encouraged activities with options for affirmative acts on the part of governmental bodies.

I. BACKGROUND

A. First Amendment Law: Obscenity, Pornography, and Media

Sexually explicit speech has long been a desired target of government regulation. The First Amendment, however, places limits on such regulations.[6] Courts generally apply strict scrutiny to content-based restrictions on the freedom of expression, and such restrictions are permissible only if: (1) the government demonstrates that the regulation is in furtherance of a compelling state interest, and (2) the government demonstrates that the chosen method is the least restrictive means of achieving its stated goal.[7] However, there are some categories of speech, such as obscenity, that receive no protection whatsoever under the First Amendment. Particularly salient here are three issues: the Supreme Court's definition of unprotected

4. Pub. L. No. 105-277, § 1405(a), 112 Stat. 2681 (1998).

5. COMMISSION ON CHILD ONLINE PROTECTION (COPA), REPORT TO CONGRESS (2000) [hereinafter COPA REPORT], *available at* http://www.copacommission.org/report.

6. U.S. CONST. amend. I ("Congress shall make no law . . . abridging the freedom of speech . . . .").

7. *See, e.g.*, Sable Communications of Cal., Inc. v. FCC, 492 U.S. 115, 126 (1989).

obscene speech; cases in which the court has permitted the regulation of sexually explicit, but non-obscene, speech; and the medium-specific approach sometimes used by the Court in addressing First Amendment challenges.

In *Miller v. California*, the Supreme Court articulated the current operating definition of obscenity.[8] Under the *Miller* standard, the following three factors determine whether speech is obscene:

> (a) whether the average person, applying contemporary community standards, would find that the work, taken as a whole, appeals to the prurient interest;
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> (b) whether the work depicts or describes, in a patently offensive way, sexual conduct specifically defined by the applicable state law; and
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> (c) whether the work, taken as a whole, lacks serious literary, artistic, political, or scientific value.[9]

Obscene speech, so defined, is categorically outside the protection of the First Amendment.[10] However, the government may not use its authority to regulate obscenity in a way that overly burdens speech that is not obscene.[11]

The Court has also addressed the regulation of sexually explicit material that does not satisfy the *Miller* obscenity standard. Such regulations have traditionally been upheld where they are aimed at protecting minors from exposure to pornography and other sexually explicit speech. For example, *Ginsberg v. New York* presented a challenge to a state statute prohibiting selling to a minor (under the age of 17) materials that were obscene as to *minors* (not to *adults*, as in the *Miller* standard).[12] The Court held that minors' constitutional right to see or read material is narrower than that of adults and thus the government may proscribe the distribution to children of that which it may not withhold from adults.[13] This solution was justified, the Court reasoned, by the parents' interest in directing the rearing of their children and by the State's independent interest in the

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8. 413 U.S. 15, 24 (1973).

9. *Id.* (internal quotation marks and citations omitted).

10. *See, e.g.*, *id.* at 23.

11. *See, e.g.*, Smith v. California, 361 U.S. 147, 152 (stating that Supreme Court precedent "does not recognize any state power to restrict the dissemination of books which are not obscene"); *see also* Nitke v. Ashcroft, 253 F. Supp. 2d 587, 599 (S.D.N.Y. 2003) (holding that government may not restrict obscenity by methods that "chill[] an excessive amount of explicit but non-obscene speech").

12. 390 U.S. 629, 631 (1968).

13. *Id.* at 636.

well-being of its youth.[14] Similarly, in *FCC v. Pacifica Foundation*, the Court permitted regulation of sexually explicit but non-obscene broadcast material, in large part because the broadcast media are "uniquely accessible to children, even those too young to read."[15]

In several First Amendment cases, the Supreme Court has used a medium-specific approach to the analysis of the rights and interests at stake. This approach recognizes that "[e]ach method [of expression] tends to present its own peculiar problems."[16] In *Pacifica*, the Court noted that broadcasting, as a medium, has traditionally received the most limited First Amendment protection, for three primary reasons, related to the technological characteristics of the medium itself.[17] First, the scarcity of the broadcast spectrum requires that those allowed to make use of this resource do so in a way that serves the public interest.[18] Second, the practicalities of a continuous broadcast make prior warnings about forthcoming content ineffective, thus increasing the invasive nature of a potentially offensive broadcast.[19] Third, broadcasting is uniquely accessible to children.[20] Thus, sanctions against a radio broadcaster for a broadcast that was not obscene did not violate the First Amendment.

Similarly, in *United States v. Playboy Entertainment Group*, the Court took special notice of the characteristics of the medium of cable television in order to "inform [the] assessment of the interests at stake."[21] Interestingly, the Court pointed out that the nature of a particular medium can justify restrictions that might be unacceptable when applied to other media, but in this case, the medium-specific approach led it to strike down restrictions similar to those approved in other contexts.[22] The Court distinguished *Pacifica*, and found dispositive a crucial technological difference between cable television and broadcasting—the ability to block specific

14. *Id.* at 639-40.

15. 438 U.S. 726, 749 (1978). The broadcast at issue was a twelve-minute monologue entitled "Filthy Words," performed by comedian George Carlin, which listed and repeated "the words you couldn't say on the public . . . airwaves . . . ." *Id.* at 729.

16. Joseph Burstyn, Inc. v. Wilson, 343 U.S. 495, 503 (1952); *see also Pacifica*, 438 U.S. at 748.

17. *Pacifica*, 438 U.S. at 748-50.

18. *Id.* at 748.

19. *Id.* at 748-49.

20. *Id.* at 749-50.

21. 529 U.S. 803, 813 (2000).

22. *Id.* at 815 (finding that the "capacity of cable televisions to block unwanted channels on a household-by-household basis" was a key distinction between the cable and broadcast media, making restrictions imposed on broadcast media inappropriate for cable).

programs at the request of the user.[23] More specifically, this feature of cable television made possible a plausible, less restrictive alternative to the regulation at issue, which required cable operators to fully scramble channels displaying adult content or limit the display of such content to certain hours.[24]

Finally, in *Reno v. ACLU*, the Supreme Court applied this medium-specific approach to the Internet, in the course of its analysis of the Communications Decency Act of 1996.[25]

B. The Communications Decency Act and *Reno v. ACLU*

COPA was Congress's second attempt to limit children's access to harmful materials on the Internet. The first was the Communications Decency Act of 1996 (CDA),[26] which resembled COPA in many respects and which was invalidated by the Supreme Court on First Amendment grounds. The Court's decision invalidating the CDA both served as a model for COPA and foreshadowed its eventual demise.

In February 1996, President Bill Clinton signed into law the Telecommunications Act of 1996, which included Title V, the CDA.[27] All provisions of the CDA were added in committee or offered as amendments during floor debate—no hearings were held.[28] Immediately after the President signed the bill, plaintiffs challenged the constitutionality of two provisions of the CDA.[29] The first challenged provision prohibited the "knowing transmission of obscene or indecent messages to any recipient under 18 years of age."[30] The second provision prohibited the "knowing sending or displaying of patently offensive messages in a manner that is available to a person that is under 18 years of age."[31]

A three-judge panel of the district court entered a preliminary injunction against both challenged provisions.[32] One judge even went so far as to state that "the First Amendment denies Congress the power to regulate protected speech on the Internet," reasoning that the Court's prior cases required a medium-specific approach to regulation of mass communica-

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23. *Id.*
24. *Id.* at 806, 815.
25. *See infra* Part I.B.
26. Pub. L. No. 104-404, § 5202, 110 Stat. 133, 133-36 (1996) (codified as amended at 47 U.S.C. § 223 (2000)).
27. Reno v. ACLU, 521 U.S. 844, 858 (1997) [hereinafter *Reno*].
28. *Id.* at 858, n.24.
29. *Id.* at 861-62.
30. *Id.* at 859 (quoting 47 U.S.C. § 223(a)(1)(B)(ii)).
31. *Id.* (quoting 47 U.S.C. § 223(d)).
32. *Id.* at 862.

tion, and the Internet as a medium is entitled to "the highest possible protection from government intrusion."[33]

On appeal, the Supreme Court analyzed the particular qualities of the Internet as a medium, and held that applying a high level of scrutiny was appropriate.[34] Unlike broadcasting, the Court reasoned, the Internet was not a "'scarce' expressive commodity," and thus there was no reason, as there was in *Pacifica*, for qualifying the level of scrutiny applied.[35] Additionally, the Court noted the absence of a tradition of government supervision over the Internet, and the fact that the medium was not as invasive or subject to accidental exposure to unwanted material as is broadcast.[36]

The Court then determined that the "ambiguities concerning the scope of [the CDA's] coverage render it problematic for purposes of the First Amendment."[37] The ambiguities in the statute's language, which went beyond the inherent "vagueness" of the *Miller* obscenity standard, would provoke uncertainty among speakers and a chilling effect would be exacerbated by the criminal penalties imposed.[38] These ambiguities undermined the claim that the statute was narrowly drawn to further the government interest in protecting children from harm.[39]

The potential burdens on adult speech were not justified because "less restrictive alternatives would be at least as effective in achieving the legitimate purposes the statute was enacted to serve."[40] The Court first rejected the proposition that it must accept and defer to Congress's judgment that nothing less than a total ban would be effective in achieving the government's objectives.[41] The Court then held that the CDA placed too heavy a burden on lawful adult speech,[42] and that its provisions were overbroad.[43] The Court found that "[g]iven the size of the potential audience for most messages, in the absence of a viable age verification process, the sender must be charged with knowing that one or more minors will likely view it."[44] Thus, the burden on adult speech was great, espe-

33. ACLU v. Reno, 929 F. Supp. 824, 850 (E.D. Pa. 1996), *aff'd*, Reno v. ACLU, 521 U.S. 844 (1997).

34. *Reno*, 521 U.S. at 872-73.

35. *Id.* at 870.

36. *Id.* at 868-69.

37. *Id.* at 870.

38. *Id.* at 871-73.

39. *Id.*

40. *Id.* at 874.

41. *Id.* at 875.

42. *Id.* at 876.

43. *Id.* at 879.

44. *Id.* at 876.

cially in light of the district court's finding that at the time of trial, existing technology did not allow for the effective screening of minors without denying access to many adults as well.[45]

The Court also listed several overbroad aspects of the CDA. First, the scope of the CDA was not limited to commercial speech or commercial entities.[46] Second, the terms "indecent" and "patently offensive" would cover "large amounts of nonpornographic material with serious educational or other value."[47] Third, the "community standards" criterion in the context of communications over the Internet would mean that any communication would be judged by the "standards of the community most likely to be offended by the message."[48] The incredible breadth of the statute imposed an especially heavy burden on the government to explain why a less restrictive "provision" would not be as effective as the CDA.[49]

The Court then cited several possible alternatives to the CDA, and found that the government had failed to show (in hearings, findings, etc.) why these alternatives would be unacceptable.[50] These alternatives were as follows: (1) "requiring that indecent material be 'tagged' in a way that facilitates parental control of material coming into their homes"; (2) "making exceptions for messages with artistic or educational value"; (3) "providing some tolerance for parental choice"; and (4) "regulating some portions of the Internet—such as commercial Web sites—differently from others, such as chat rooms."[51] The Court also found that "currently available *user-based* software suggests that a reasonably effective method by which *parents* can prevent their children from accessing . . . material which *parents* may believe is inappropriate for their children will soon be widely available."[52]

C. The Child Online Protection Act

After failing in its first attempt at protecting children from sexually explicit materials online, Congress passed the Child Online Protection Act (COPA), which was intended to go into effect on November 29, 1998.[53] COPA imposes criminal liability, up to a $50,000 fine and six months in

45. *Id.*
46. *Id.* at 877.
47. *Id.*
48. *Id.* at 877-78.
49. *Id.* at 879.
50. *Id.*
51. *Id.*
52. *Id.* at 877.
53. Pub. L. No. 105-277, 112 Stat. 2681-736 (1998) (codified at 47 U.S.C. § 231 (2000)).

prison, and civil liability, up to $50,000 in damages, for the knowing or intentional posting online of content that is "harmful to minors" for "commercial purposes."[54] Content that is "harmful to minors" is defined as:

> [A]ny . . . matter of any kind that is obscene or that—
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> (A) the average person, applying contemporary community standards, would find, taking the material as a whole and with respect to minors, is designed to appeal to, or is designed to pander to, the prurient interest;
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> (B) depicts, describes, or represents, in a manner patently offensive with respect to minors, an actual or simulated sexual act or sexual contact, an actual or simulated normal or perverted sexual act, or a lewd exhibition of the genitals or post-pubescent female breast; and
>
> (C) taken as a whole, lacks serious literary, artistic, political, or scientific value for minors.[55]

The statute also defines "minors," "commercial purposes," and other key terms.[56] Furthermore, the statute criminalizes all transmissions within these definitions, but provides an affirmative defense for a provider that "in good faith, has restricted access by minors to material that is harmful to minors" through age verification or "any other reasonable measures that are feasible under available technology."[57]

Congress crafted COPA significantly more carefully than the CDA, but devoted only marginally more congressional time to its consideration. Responding to the Court's comments in *Reno* about the lack of thorough consideration of the CDA, Congress held two hearings on the harmful nature of exposing children to indecent, sexually explicit materials.[58]

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54. 47 U.S.C. § 231(a)(1) (2000).

55. *Id.* § 231(e)(6).

56. *Id.* § 231(e). Minors are defined as persons under the age of 17. *Id.* § 231(e)(7). "A person shall be considered to make a communication for commercial purposes only if such person is engaged in the business of making such communications." *Id.* § 231(e)(2)(A). One is engaged in the business of making such communications if they are "a regular course of such person's trade or business, with the objective of earning a profit as a result of such activities." *Id.* § 231(e)(2)(B).

57. *Id.* § 231(c)(1).

58. Timothy Zick, *Congress, the Internet, and the Intractable Pornography Problem: The Child Online Protection Act of 1998*, 32 CREIGHTON L. REV. 1147, 1173 (1999).

II. *ASHCROFT V. ACLU*

A. Procedural History

On October 22, 1998, various Internet content providers, such as Powell's Bookstore and Salon Internet, Inc., and civil liberties groups, such as the Electronic Frontier Foundation, the Electronic Privacy Information Center, and the American Civil Liberties Union (ACLU), brought suit to enjoin the enforcement of COPA.[59] The district court granted a preliminary injunction, concluding that the government had not met its "burden to prove that COPA is the least restrictive means available to achieve the goal of restricting the access of minors to [sexually explicit] material."[60] On appeal, the Third Circuit affirmed the preliminary injunction on a different ground, holding that the "community standards" language in COPA rendered the statute unconstitutionally overbroad.[61] The Supreme Court granted certiorari and reversed, holding that the community standards language did not alone render the statute overbroad, and remanded to the Third Circuit to reconsider the district court's granting of the preliminary injunction.[62]

On remand, the Third Circuit again affirmed, concluding that "the statute was not narrowly tailored to serve a compelling Government interest, was overbroad, and was not the least restrictive means available" to serve the goal of preventing minors from accessing harmful materials online.[63] The Supreme Court again granted certiorari to determine whether enforcement of COPA was properly enjoined because the statute "likely violates the First Amendment."[64]

B. The Supreme Court's Decision

In *Ashcroft v. ACLU*, the Supreme Court held that the district court did not abuse its discretion in granting a preliminary injunction against COPA.[65] The Court affirmed on the ground that the government had failed, in the district court, to rebut the plaintiffs' contention that there were plausible less restrictive alternatives which would be at least as ef-

59. ACLU v. Reno, 31 F. Supp. 2d 473 (E.D. Pa. 1999).
60. *Id.* at 497-98.
61. ACLU v. Reno, 217 F.3d 162 (3d Cir. 2000).
62. Ashcroft v. ACLU, 535 U.S. 564 (2002).
63. ACLU v. Ashcroft, 322 F.3d 240 (3d Cir. 2003).
64. Ashcroft v. ACLU, 124 S. Ct. 2783, 2788 (2004).
65. *Id.* at 2788-89.

fective as COPA.[66] The Court remanded the case to the district court for a full trial on the merits.[67]

The Court's reasoning largely mirrored that of the district court. The district court focused on the existence of plausible less restrictive alternatives to COPA, and determined that the plaintiffs were likely to prevail on this issue. The Court set out the relevant rule for considering content-based restrictions on speech:

> A statute that effectively suppresses a large amount of speech that adults have a constitutional right to receive and to address to one another . . . is unacceptable if less restrictive alternatives would be at least as effective in achieving the legitimate purpose that the statute was enacted to serve.[68]

Furthermore, once a complainant challenges a content-based restriction and points out alternatives, the burden is on the government to prove that the proposed alternatives will be less effective than the target of the challenge.[69] The Court found that the district court's granting of the preliminary injunction under these rules was not an abuse of discretion, because the factual record evidenced a number of plausible less restrictive alternatives to the statute, the effectiveness of which the government had failed to disprove.[70]

The Court focused primarily on blocking and filtering software as a plausible less restrictive alternative to COPA, because this was the main option considered by the district court.[71] The Court undertook a detailed description and exploration of the characteristics of filtering software, comparing its effectiveness at restricting "harmful" speech to that of the authentication and age verification requirements imposed by COPA. The Court stated that filters were less restrictive than the provisions of COPA because they imposed only selective speech restrictions at the "receiving end" as opposed to "universal restrictions at the source."[72] This technology would allow adults, both with and without children, to access speech to which they were constitutionally entitled. The chilling effect would be diminished, and no speech labeled as criminal. The Court even proposed that filters might be more effective than COPA, at least in part because

66. *Id.*
67. *Id.*
68. *Id.* at 2791 (quoting Reno v. ACLU, 521 U.S. 844, 874 (1997)) (internal quotation marks omitted).
69. *Id.* at 2791-92.
70. *Id.* at 2792.
71. *Id.*
72. *Id.*

they would prevent minors from accessing harmful content that COPA cannot reach, such as material that comes from outside the United States. The Court acknowledged that filtering software was not a perfect solution to the problem of children accessing harmful material online, but this point was not sufficient to defeat the granting of the preliminary injunction. The Court found that the government had only pointed out some flaws in the filtering software, and had not met its burden to show that this alternative was less effective overall.[73]

The government raised the objection that filtering software should not be considered a viable alternative because Congress could not require its use.[74] However, the Court found that if an alternative accomplished the same objectives, it could be considered regardless of whether or not Congress could mandate its use.[75] The Court pointed out that even without a mandate, by encouraging use of filtering software in schools and libraries (via the Children's Internet Protection Act)[76] and encouraging parents to use such software, Congress could achieve the same objective of preventing children from accessing harmful material.[77] The Court described the issues before it in this case and in *Playboy*[78] as presenting a "choice ... between a blanket speech restriction and a more specific technological solution that was available to parents who chose to implement it."[79]

Finally, the Court offered some "practical reasons" why the preliminary injunction should stand pending a full trial.[80] The most interesting of these was the assertion that "the factual record does not reflect current technological reality."[81] In other words, this case had been shifting between courts for so many years, since the suit was first filed in 1998. Because technology changes so quickly, the evidence introduced at the preliminary injunction stage had become all but irrelevant, and there may have been technological developments important to the First Amendment analysis that a court should be able to consider. Such a proposition presents interesting possibilities and considerations for many modern cases involving quickly changing technology.

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73. *Id.* at 2793.
74. *Id.*
75. *Id.*
76. *See infra* note 131 and accompanying text.
77. *Ashcroft*, 124 S. Ct. at 2793.
78. *See supra* notes 21-24 and accompanying text.
79. *Ashcroft*, 124 S. Ct. at 2794.
80. *Id.*
81. *Id.*

III. ANALYSIS

The government is constrained in its attempts to curtail children's access to sexually explicit materials on the Internet by both the legal circumscriptions and the technological space. The legal circumscriptions are drawn by general First Amendment doctrine and more specific cases regarding regulation of the Internet and of other media.[82] The technological space is defined by the technical and customary aspects of the way the Internet functions.[83] If Congress wishes to address the legitimate governmental purpose of protecting children from harmful sexually explicit content on the Internet, it must operate within these constraints. If Congress decides to rework the legislative approach, it will be held to a strict standard by the courts. On the other hand, if Congress abandons the search for a solution to this problem, constituents may not be pleased, and there may be no naturally developing solution. In devising a solution, Congress must be aware not only of these constraints, but of potential effects on the behavior of Internet users and content providers, and on these individuals' First Amendment freedoms.

Any attempted solution that does not take into account and leverage the power of existing and emerging technologies is not only likely to be invalidated by the courts, as in *Ashcroft* and *Playboy*, but is also likely to be ineffective. The best solution to this dilemma is a governmental scheme that avoids broadly applicable statutory restrictions, encourages the naturally developing use of technological solutions to the problem, and gives a large measure of control to local bodies and parents to choose which restrictions to impose on their children. For a guide to implementing this scheme, Congress should look close to home—in the report of the COPA Commission.[84]

A. Why Was Congress Unable to Craft a Constitutional Statute in COPA?

Congress carefully considered the Supreme Court's decision regarding the constitutionality of the CDA in *Reno*, and accordingly drafted COPA much more narrowly in response to the Court's specific concerns.[85] In fact, it addressed each of the main reasons the Court cited for holding the CDA unconstitutional.[86] First, COPA included an "exception" for provid-

82. *See* Lawrence Lessig & Paul Resnick, *Zoning Speech on the Internet: A Legal and Technical Model*, 98 MICH. L. REV. 395, 395-97 (1999).

83. *Id.*

84. *See* COPA REPORT, *supra* note 5.

85. *Ashcroft*, 124 S. Ct. at 2788.

86. *See supra* Part I.B.

ers that used age verification technology to prevent their material from reaching minors,[87] the use of which was no longer as burdensome or expensive as it was when *Reno* was decided.[88] Second, COPA applied only to commercial providers of web content.[89] Third, Congress defined the prohibited material using the standard upheld in *Ginsberg*.[90] Fourth, Congress limited COPA to the World Wide Web, whereas the CDA applied to all aspects of the Internet.[91]

Despite these changes, the Supreme Court in *Ashcroft* still found that COPA imposed impermissible burdens on adult speech.[92] In so ruling, the Court focused on the availability of filtering technology as a plausible, less restrictive alternative to COPA.[93] However, an analysis of the range of options available to Congress and other governmental actors for protecting children reveals other reasons why COPA, and indeed all statutes that attempt to directly regulate and proscribe pornography and sexually explicit content on the Internet, might be unable to pass constitutional muster.[94]

B. What Options Remain for Curtailing Sexually Explicit Speech on the Internet?

Because of the intense political and popular concern with pornography on the Internet, Congress is unlikely to abandon the search for a governmental solution to this problem. There is a range of options left open to Congress, spanning the spectrum from purely legislative to purely technical. Each set of options presents a unique set of legal problems, with different potential effects on First Amendment freedoms and the nature of the Internet. It is important to fully consider the challenges of the different options that legislators face, and the consequences of any particular regulatory strategy.[95]

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87. 47 U.S.C. § 231(c) (2000).

88. *Compare* ACLU v. Reno, 31 F. Supp. 2d 473, 487-91 (E.D. Pa. 1999), *with* ACLU v. Reno, 929 F. Supp. 824, 845-47 (E.D. Pa. 1996), *aff'd*, Reno v. ACLU, 521 U.S. 844 (1997).

89. It should be noted, however, that the content at issue need not have been provided commercially—the statute only required that the *site* through which the content is provided be a commercial enterprise. 47 U.S.C. § 231(e)(2)(B).

90. *See id.* § 231(e)(6); Ginsberg v. New York, 390 U.S. 629, 631 (1968).

91. *See* 47 U.S.C. § 231(a)(1), (e)(1); *cf.* 47 U.S.C. § 223.

92. Ashcroft v. ACLU, 124 S. Ct. 2783, 2792 (2004)

93. *Id.*

94. *See infra* Part III.B.1.

95. *See* Lessig & Resnick, *supra* note 82, at 396.

1. *Purely Legislative/Legal Proscription*

Even if, on remand, COPA is permanently enjoined by the courts, Congress may deem the problem of children's access to pornography on the Internet important enough to craft yet another statute imposing liability on providers of such content. In *Ashcroft*, the Supreme Court did not provide any guidance as to how the statute could be narrowed to be permissible because it did not reach the issues of overbreadth or vagueness.[96] However, in a world where the Internet exists, it would be difficult to narrow COPA to be constitutional—either by changing the definition of illegal speech or by providing more affirmative defenses—while still allowing the law to reach beyond obscene speech, which is already unprotected, to impose meaningful limits on providers of web content.

One reason for this difficulty is peculiar to the context of pornography and indecent speech, traditionally defined in terms of "community standards."[97] The definition of "illegal" speech in COPA is virtually identical to the obscenity standard in *Miller* but for its references, in each provision, to individuals who are minors.[98] Since the *Miller* standard is based on a regime whereby obscenity is defined with reference to the norms and standards of a real-world community, it may be impossible to apply this legal rule to the Internet at all.[99] The Supreme Court has made it clear that obscenity is to be judged on a *local* community standard, not a *national* one, to avoid effectively forcing all speakers to tailor their speech to the least tolerant or most sensitive listeners.[100] Although this inevitably leads to variations in the obscenity standard from community to community, the Court has reasoned that this variation is desirable, because "our Nation is simply too big and too diverse for this Court to reasonably expect that such standards could be articulated for all 50 States in a single formulation."[101]

In a non-Internet case involving the transmission of allegedly obscene materials, therefore, obscenity is adjudicated based on the community standards of the locality in which the material is received, assuming the

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96. *Ashcroft*, 124 S. Ct. at 2791 (affirming the district court's grant of a preliminary injunction based on the reasons relied on by that court, thus obviating the need to address the issues of overbreadth and vagueness, relied on by the court of appeals).

97. *See, e.g.*, Miller v. California, 413 U.S. 15, 24 (1973).

98. *Compare* 47 U.S.C. § 231(e)(6) (2000), *with Miller*, 413 U.S. at 24.

99. *See* Mark C. Alexander, *The First Amendment and Problems of Political Viability: The Case of Internet Pornography*, 25 HARV. J.L. & PUB. POL'Y 977, 1005-06 (2002).

100. *Id.*

101. *Miller*, 413 U.S. at 30.

sender knew the material would end up there.[102] With the structure of the World Wide Web as it is, it is all but impossible for a content provider to know where his or her content might "end up,"[103] thus leading to a serious case of the tailoring-to-the-most-sensitive-listener scenario described above. Professor Mark Alexander has suggested several possible regimes for determining where to "find" a community standard for the definition of obscene and indecent speech.[104] Alexander's options for pinpointing the relevant community are as follows: (1) where the material was downloaded; (2) where the material was uploaded; (3) a "virtual community standard"; and (4) a national standard.[105] Alexander ultimately concludes that none of these solutions are truly workable.[106] This impossibility creates severe problems for any scheme of regulating sexually explicit content over the Internet, for Congress has yet to write a constitutionally permissible definition of proscribed content that does not include reference to "community standards."

There is also some argument that the fundamental characteristics of the Internet as a medium make it effectively impossible for the government to target any broader range of speech than that which is already unprotected by the First Amendment. A statute that intends to reach more than obscenity must necessarily be written in somewhat broad terms. The architecture of the Internet in turn dictates that a broad content-based regulation imposed from without will likely always burden a large amount of lawful adult speech. Furthermore, a technical solution imposed by the user will almost always be less restrictive. Technological solutions, unlike purely legislative ones, both allow parents to have control over what their children view and can affect material coming from outside the legislative jurisdiction.[107] This observation squares with the results in *Ashcroft* and *Playboy*, both cases invalidating broad legislative restrictions where user-controlled protections imposed at the receiving end were available and accomplished the same goals as the statutory scheme.[108] In sum, the nature

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102. *See id.* at 30-34.

103. *See, e.g.*, Nitke v. Ashcroft, 253 F. Supp. 2d 587, 594 (S.D.N.Y. 2003) ("[I]t is currently impossible for website operators to make their sites accessible from some communities but not others.").

104. Alexander, *supra* note 99, at 1008-15.

105. *Id.*

106. *Id.* at 1015.

107. Recall that these two features formed the major basis for the Court's finding that there existed less restrictive and more effective alternatives to COPA. *See* Ashcroft v. ACLU, 124 S. Ct. 2783, 2792 (2004).

108. *Id.* at 2792; United States v. Playboy Entm't Group, Inc., 529 U.S. 803, 815 (2000).

of communications on the Internet means that applying a purely legislative solution will burden a large amount of protected speech and less restrictive technological solutions will be available.

In addition to the legal limits that may circumscribe Congress's efforts to legislate in this arena, there are some practical concerns that make legislative action infeasible. First, the interaction between laws enacted by Congress and independently developing technologies can be very complex. Both the CDA and COPA were invalidated for reasons having to do almost solely with technology—the CDA because workable age verification methods were not yet available, and COPA because a plausible, less restrictive means of accomplishing the government's goals existed in filtering technology. Even if Congress can act quickly enough to legislate around new technologies, more technological change is always right around the corner, often ready to alter the balance struck by Congress. It is axiomatic that technology often changes faster than Congress can make new laws to fit around it, and fit they must.[109]

In a similar vein, laws inevitably require interpretation by the courts, especially where the laws are the highly controversial regulations of indecency that have almost always been instantly challenged by civil liberties groups. The quickly-changing nature of technology presents significant obstacles to the judicial process due to the danger that appellate courts will rely on outdated trial court findings.[110] When the Supreme Court heard oral arguments in *Reno v. ACLU*, little more than a year had passed since the district court made its evidentiary findings.[111] However, during this short time period, the Internet had experienced a great deal of technological change, such as the proliferation of newsgroups, listservs, and chat rooms on the World Wide Web, and the development of age verification technologies.[112] The government urged the Court to take cognizance of these technological changes, arguing that they changed the constitutional calculus in the case.[113] Although the Court acknowledged the inaccuracies, it refused to consider facts not in the record, limiting its review to the outdated factual findings of the district court.[114] Similarly, in *Ashcroft*, the Court mentioned as a "practical consideration" the fact that the limited

109. *See* Stuart Minor Benjamin, *Stepping Into the Same River Twice: Rapidly Changing Facts and the Appellate Process*, 78 TEX. L. REV. 269, 271 (1999).

110. *Id.* at 270-72.

111. *Id.* at 290.

112. *Id.* at 291.

113. *Id.*

114. *Id.* at 292; Reno v. ACLU, 521 U.S. 844, 856-57 (1997) (stating that the record did not contain any evidence that the technological changes were effective).

factual record in this case was, by the time it reached the Supreme Court for the second time, five years old, due to delays in the appellate process.[115] The *Ashcroft* case is a somewhat extreme example of this occurrence but the principle remains the same: courts, like legislatures, cannot adapt or address issues quickly enough to keep up with changing technology. As one commentator put it, "the law, which generally is accustomed to leading, will, at least for the foreseeable future, have to follow and be guided by technology."[116]

Despite these concerns, a few commentators have suggested ways to write a proscriptive statute that would pass constitutional muster. First, despite the failure of Congress's efforts to narrow the CDA, there is still some opportunity to narrow COPA even further. One fairly simple approach would be to abandon the paradigm of criminal punishment, leaving in place the possibility of civil liability.[117] This approach can be criticized, however, on the grounds that the actors Congress most desires to punish, those who provide large quantities of pornographic material as their main line of business, would likely be able to accept civil penalties as merely a "cost of business," while smaller, less troublesome providers would be forced out of business.

Alternatively, the third prong of the definition of "harmful to minors,"[118] which roughly corresponds to a minor-focused version of the third prong of the *Miller* standard,[119] could be changed to more closely follow *Miller* and *Ginsberg*.[120] Specifically, this subsection could do the following: consider each image or graphic file on its own merits, instead of with respect to the communication as a whole; add "educational" and "medical" values to those already listed; and determine value with respect to any minor, not all minors.[121]

Some commentators have posited reasons why a fundamentally legislative alternative is preferable to a purely technological one. For example, government officials might be best suited to craft the proper controls because they "make it a point to know the issues relevant to the public" and because they are proactively informed, by citizens and lobbying groups,

115. Ashcroft v. ACLU, 124 S. Ct. 2783 (2004).

116. Zick, *supra* note 58, at 1149.

117. *Id.* at 1198-99.

118. 47 U.S.C. § 231(e)(6)(C) (2000) ("The term 'material that is harmful to minors' means any communication, picture, image, graphic image file, article, recording, writing, or other matter of any kind that is obscene or that . . . taken as a whole, lacks serious literary, artistic, political, or scientific value for minors.").

119. *See supra* Part I.A.

120. Zick, *supra* note 116, at 1198.

121. *Id.*

about relevant technological advances in the field.[122] In addition, government legislation comes with built-in enforcement mechanisms, unlike industry control or incentive techniques.[123]

Despite demonstrated problems with legislation targeting the Internet, Congress might insist on pursuing another legislative approach to this problem, due to perceived weaknesses in regimes allowing or even encouraging local and parental actors to implement their own protection measures. For example, Congress does not seem to have much faith in the ability of parents to adequately protect their children from the evils of sexually explicit material online. This concern does not seem to stem from lack of faith in the technological efficacy of filtering software—indeed Congress's own COPA Commission cited filtering as a favorable solution both on efficacy and restrictiveness grounds[124]—but rather from the fear that some parents will not know enough or care enough to protect their children when they surf the web.[125] Congress might also lack faith in a solution that does not carry the force of law. Finally, to please constituents and lobbying groups alike, Congress might simply be unwilling to let such a politically salient issue fall through the cracks.

2. *Imposing or Encouraging Implementation of Technological Solutions*

Another often-posited option for Congress to address these problems, which falls somewhere in the middle of the legislative action/inaction spectrum, is for Congress to encourage the implementation of various technological solutions that would at least partially, and sometimes completely, fulfill Congress's objectives. Since, as described above, technological solutions frequently trump legal ones in a constitutional challenge, Congress should explore ways to implement these technologies or to encourage their implementation by third parties.

Some commentators have suggested that Congress can effectively control harmful-to-minors content on the Internet, but in a different manner than in the CDA and COPA. One way of conceptualizing and contrasting two basic approaches is as "top-down" versus "bottom-up" approaches.[126] CDA and COPA are top-down approaches, attempting to prevent minors

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122. Melanie L. Hersh, Note, *Is COPPA a Cop Out? The Child Online Privacy Protection Act as Proof that Parents, Not Government, Should be Protecting Children's Interests on the Internet*, 28 FORDHAM URB. L.J. 1831, 1858-59 (2001).

123. *Id.* at 1859.

124. COPA REPORT, *supra* note 5, at 19-22.

125. *See* Ashcroft v. ACLU, 124 S. Ct. 2783, 2786 (2004).

126. *See* Alexander, *supra* note 99, at 1021.

from accessing harmful materials online by stopping the problem at the source—the content providers themselves. A bottom-up approach, such as filtering, would attempt to combat the negative consequences not at the source, but at the receiving end. Acceptance of a bottom-up approach over top-down led to the result in *Playboy*, where the Court invalidated an FCC regulation of cable providers because there was a plausible, less restrictive bottom-up alternative.[127] Scholars have noted the desirability of this switch from a "stick" to a "carrot" approach to regulating Internet behavior.[128]

In *Ashcroft*, however, the government objected to the Court's reliance on user-implemented Internet filtering as a plausible less restrictive alternative to COPA because Congress is unable to mandate the use of filters through legislation. The Court responded that while filtering could not be mandated, it could be strongly encouraged through a variety of means, and this possibility of encouragement was enough to satisfy this requirement.[129] In *Playboy*, the Court accepted a receiving-end solution which could be offered to cable subscribers but not mandated by the government, as a plausible less restrictive alternative that undermined the government's claim of narrow tailoring of the restriction imposed by the FCC.[130]

Despite its objections in *Ashcroft* to the substitution of filters for legislation, the government has recognized the viability of this approach to regulating minors' access to sexually explicit material on the Internet. The Children's Internet Protection Act (CIPA) imposes as a condition for the receipt of federal subsidies for Internet access and computer technologies that libraries must enable filtering software on all Internet-accessible computers.[131] CIPA's regime places restraints on children's access to the Internet in a certain space by empowering and requiring local libraries to make decisions and to take steps to combat this problem. CIPA has the benefits of being flexible (as local laws and implementations can change more quickly than federal ones) and adaptable to local community standards, while giving Congress a measure of control over the tackling of this problem.

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127. United States v. Playboy Entm't Group, Inc., 529 U.S. 803, 824 (2000) ("It is no response that voluntary blocking requires a consumer to take action.").

128. *See, e.g.*, Alexander, *supra* note 99, at 1021.

129. *Ashcroft*, 124 S. Ct. at 2793.

130. *Playboy*, 529 U.S. at 815.

131. Pub. L. No. 106-554, 114 Stat. 2763A-335 (2000) (codified at 20 U.S.C. § 9134(f) (2000) and 47 U.S.C. § 254(h) (2000)). *See generally* Felix Wu, Note, United States v. American Library Ass'n: *The Children's Internet Protection Act, Library Filtering, and Institutional Roles*, 19 BERKELEY TECH. L.J. 555 (2004).

Encouraging the use of filters, either through legislation such as CIPA or advertising campaigns, as suggested by the Supreme Court, is not the only bottom-up approach available. Two other schemes are creation of certificate authority and mandatory labeling.

One mixed legislative and technological approach, which has already been implemented by a group called the World Wide Web Consortium (W3C),[132] is a labeling scheme. W3C's project is called the Platform for Internet Content Selection (PICS).[133] PICS attempts to solve the problem of imprecise identification of objectionable sites, presented by available filtering software, by establishing a "language" through which all content on the Internet would be labeled, either through independent labeling services or by content providers themselves.[134] Thus, in theory users, by purchasing and implementing filtering software that "speaks the language" of the PICS rating system, would have much more control over the content flowing to their computer screens.

Congress could also use legislation to directly impose technological solutions. Even COPA itself indirectly acknowledges the appropriateness of a technological solution, effectively placing technological requirements on providers of web content by including the affirmative defense of age-verification screens. Professor Lawrence Lessig proposes a unique approach in this vein: a legislative solution imposed by Congress that would both restrict the distribution of undesirable speech directly and create a technological method of enforcing these restrictions.[135] His proposed statute would ban, under civil penalties, the distribution of *Ginsberg* speech (speech that is obscene with respect to minors) if it is either knowingly distributed to children or distributed without verifying the age of the recipient.[136]

The key second element of this regime, which clearly sets it apart from the CDA and COPA, is the establishment of a central "certificate authority" that would enable the age-verification procedures mandated in the statute.[137] The central authority would enable other private organizations to issue to an Internet user a technological mechanism known as a digital

132. *See* World Wide Web Consortium, *About the World Wide Web Consortium (W3C)*, *at* http://www.w3c.org/consortium (last updated Jan. 18, 2005).

133. *See* W3C, *Platform for Internet Content Selection (PICS)*, *at* http://www.w3c.org/PICS (last updated Oct. 22, 2003).

134. Lawrence Lessig, *What Things Regulate Speech: CDA 2.0 vs. Filtering*, 38 JURIMETRICS J. 629, 659 (1998); *see also* W3C, *PICS Statement of Principles*, *at* http://www.w3.org/PICS/principles.html (last visited Jan. 27, 2005).

135. Lessig, *supra* note 134, at 650-51.

136. *Id.*

137. *Id.* at 651.

certificate, an encrypted digital object that allows the holder to make credible assertions about him/herself without revealing his/her identity.[138] These certificates would be issued anonymously and could be verified by any site on the Internet at low cost.[139] Although this approach is essentially legislative in nature, its proscriptive provisions are bolstered by implementation of a technological solution.

The civil penalties imposed by this proposed statute would pose less of a threat to free speech and create less of a chilling effect than the criminal penalties of COPA. Moreover, integral to Lessig's proposed statute is a technological solution that would alleviate many of the concerns of a more broad and *purely* legislative approach such as COPA.[140] Thus, although the incentives, mandate, and implementation of the technology would come from above, the control over the technology and content would come from below—from providers and consumers of web content.

The question remains, however, whether despite the arguments that purely legislative approaches are more often than not too burdensome on freedom of expression, technological solutions might in fact be even more burdensome, whether their use is private or public, voluntary, or encouraged. There are threats to key values presented by a standardized, universal system of verifiable identification—anonymous speech, for example, could get lost in the shuffle, and the fundamental free-flowing and open nature of the Internet could be endangered. In addition, unless constraints were placed on the certificate authority's use of personally identifiable information, such a scheme could present huge threats to personal privacy.[141] Furthermore, in Lessig's own words, do we really want to allow Congress to "regulate the architecture of the Net to make its content more regulable"?[142]

Some scholars have also suggested that widespread use of filtering technology may be more damaging overall to free speech interests than would a rule of general applicability such as COPA or the CDA.[143] Lessig argues that a "CDA-like" regulation would "minimize the amount of speech subject to content discriminating technologies . . . [and] minimize

138. *Id.* at 649-50.

139. *Id.* at 650-51.

140. COPA, although it did indirectly impose technological requirements on providers of web contents, was not supported by any consideration or explanation of how these requirements were to be fulfilled, or whether it was even technically feasible to fulfill them. *See id.* at 648-49.

141. COPA REPORT, *supra* note 5, at 27.

142. Lessig, *supra* note 134, at 650.

143. *See, e.g.*, *id.* at 632.

the role the government has in facilitating this discrimination."[144] He finds filtering software to be damaging in both the public context (such as libraries) and in private (such as homes).[145] Lessig cites as a main problem with filtering technology the fact that the lists of "blocked" sites are privately created and held in secret, giving users no guarantees that "sites are not included [on the list] for the wrong reasons."[146] In addition, filtering algorithms are crude and imprecise, and often filter content that comes nowhere close to *Ginsberg* speech, which Congress has an interest in curtailing.[147] Furthermore, although the idealistic vision of filtering places control over a child's Internet consumption in the hands of his or her parents, private filtering technology passes this control to corporations, schools, libraries, and the government. Similarly, PICS is problematic because it is a generalized system, enabling labeling and blocking of content based on *any* criteria (not just that which might be offensive to children), and can be imposed invisibly at any point in the flow of information on the Internet.[148]

The report of Congress's own COPA Commission analyzes the relative benefits and burdens of various legal and technological approaches to the problem. Interestingly, this report, written by an entity created at the time of the passage of COPA to "identify technological or other methods that will help reduce access by minors to material that is harmful to minors on the Internet"[149]—contradicts Congress's choice of regulatory methods. The report takes into account the effectiveness and accessibility of various solutions, almost all of which were technological in nature, the characteristics of the Internet, and potential detrimental effects on the freedom of speech.[150] The COPA Commission report provides a useful analysis of the benefits and drawbacks of particular technological solutions. The report cites filtering technology as one of the most effective and accurate (that is, non-restrictive) protectors of children online.[151] On the other hand, age verification systems based on credit cards, the technology that could allow a web content provider to assert an affirmative defense under COPA, are described as an undesirable solution because of lack of effectiveness (for example, some children have access to credit cards), burden on web pro-

144. *Id.* at 646-47.
145. *Id.* at 652-58.
146. *Id.* at 655.
147. *Id.* at 654.
148. *Id.* at 658-60.
149. Pub. L. No. 105-277, § 1405(a), 112 Stat. 2681 (1998).
150. COPA REPORT, *supra* note 5.
151. *Id.* at 19-22.

viders, and the potentially huge impact on privacy and First Amendment values.[152] The report provides some informative criticisms of Lessig's type of solution, an age verification system based on an independently issued ID, noting burdens on web providers in establishing a verification system, burdens on consumers in procuring identification, and adverse effects on privacy.[153] Although Lessig's particular proposal may avoid some of these issues, through requirements for data security and anonymity to protect privacy, these critiques remind us that no technological solution is perfect. As a result, Congress must be careful if it chooses to impose or encourage such a solution.

3. *Hands-Off, Non-Legislative Solutions*

Even if Congress fails to follow COPA with yet a third attempt, it is simply not the case that children would inevitably run rampant in accessing harmful sexually explicit materials on the Internet. Congress may well not remain idle: despite having its efforts curtailed in this arena on numerous occasions, "[s]till the voters cry for protection for their children."[154] However, Congress's ability and tendency to respond to such public desires can prove troubling where speech is concerned. To uphold the fundamental First Amendment goal of protecting the people from the dangers of government suppression of unpopular ideas, a legislature "must be prepared to put aside popular political positions and defend the rights of those who say things of which the public thoroughly disapproves . . . [such as] pornographers."[155] As mentioned above, Congress is also ill-suited to address these issues because of the quickly-changing nature of technology. Some have argued that Congress should give up, to avoid its recurring "faulty regulatory approaches to incendiary expressive activity," which are often driven more by politics than by a considered approach to the problem.[156] Indeed, there are myriad ways these problems can be addressed without any official assistance on the part of the legislative branch.

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152. *Id.* at 25-26. It would, at first, seem strange that Congress chose to include age verification systems as an integral part of COPA, given this unfavorable analysis by the group Congress created to study the effectiveness of these technologies. However, it should be noted that the COPA Commission was created *at the time of passage* of COPA, when these legislative decisions had already been made.

153. COPA REPORT, supra note 5, at 27.

154. Alexander, *supra* note 99, at 1021.

155. *Id.* at 1000 (quoting Floyd Abrams, *Clinton vs. the First Amendment*, N.Y. TIMES, Mar. 30, 1997, at F42).

156. *Id.*

Congress could entrust localities to deal with the problem, either by formal or informal means.[157] This method, unlike the one described above, would, without incentives, entrust local governmental bodies to determine what is acceptable for their communities and create and apply their own laws accordingly.[158] Action at the state level has proven to be varied, evidence that the states are taking matters into their own hands and taking the action they deem appropriate. Some states have developed their own legislation, often mimicking CIPA's approach; some have encouraged filters more narrowly, say in public schools but not public libraries; and others have merely passed resolutions encouraging the federal legislature to explore other avenues of protection, such as top-level domain controls.[159]

Congress could also leave it up to individual parents, schools, and libraries to deal with the problem, with no legislative action on Congress's part. Parents would be given the autonomy to decide what should and should not be viewed by their own children, while adults without children would be free to exercise their First Amendment rights to access constitutionally protected material. While this theory does not account for parents who do not realize or comprehend the gravity of the problem of indecent material online as Congress sees it, the Court has recognized parents' right to determine the manner of upbringing of their own children.[160] Furthermore, the fear that parental cooperation will not emerge when leaving a plausible, less restrictive solution in the hands of parents does not disqualify that solution.[161]

Finally, stepping back and allowing the development of industry-based self-regulation or market-driven solutions could be quite effective.[162] In a way, this method has already been implemented. For example, pornography is now quite frequently protected behind credit card verification schemes, for the simple reason that providers want users to pay for it.

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157. For formal means of "encouraging" localities to apply controls, see *supra* Part III.B.2.

158. Alexander, *supra* note 99, at 1021-24. However, to avoid the above-mentioned problems with community standards, even local enforcement should be limited to the "extent that any online pornographer has minimum contacts with the locality . . . ." *Id.* at 1025.

159. *Id.* at 1026.

160. Ginsberg v. New York, 390 U.S. 629, 639 (1968) (noting that "parents' claim to authority in their own household to direct the rearing of their children is basic in the structure of our society").

161. Ashcroft v. ACLU, 124 S. Ct. 2783, 2793 (2004) (stating that the "need for parental cooperation does not automatically disqualify a proposed less restrictive alternative").

162. *See* Alexander, *supra* note 99, at 1027-30.

However, there are still many commercial websites providing free explicit content,[163] arguably the only content providers targeted by the statute because non-free content is age verified by the very nature of e-commerce. Additionally, many user-based filtering programs are now available for purchase at reasonable prices, with new technological advances occurring all the time, presumably in response to heightened consumer demand for such products.

The COPA Commission's recommendations exemplify a superb balance between the government's impetus to regulate access to sexually explicit materials on the Internet and the constraints of law and technology placed on it. The Commission's recommendations call for four activities: "aggressive efforts toward public education, consumer empowerment, increased resources for enforcement of existing laws, and greater use of existing technologies."[164] None of these solutions would require official action by Congress.

These recommendations blend voluntary and encouraged activities with options for affirmative acts on the part of governmental bodies that remain less drastic than broadly written legislation or congressional mandate of technological solutions. For example, the Commission recommends encouraging voluntary action on the part of consumers and industry, such as through collaboration between government and the private sector on an informational campaign "to promote public awareness of technologies and methods available to protect children online."[165] The report outlines a plan for the promotion of ISP-based acceptable use policies, which are binding contractual terms to which consumers of Internet services (including hosting and serving services) must adhere.[166] It also recommends allocation of public funds to assess and even develop new technologies of "child protection," and collaboration with the private sector in doing so.[167] As far as legal action is concerned, the Commission recommends only enforcement of existing laws against obscenity and child pornography, categories of speech that are already unprotected by the First Amendment, not devising new statutes to target other types of speech.[168] Finally, the Commission recommends encouragement of volun-

163. *See id.* at 982 ("The great majority of pornographic websites are actually free and serve as 'bait' or 'teasers' meant to lure people into commercial websites.").

164. COPA REPORT, *supra* note 5, at 39.

165. *Id.* at 40.

166. *Id.* at 39-41.

167. *Id.* at 41-42.

168. *Id.* at 43.

tary self-regulation on the part of Internet service and content providers and the adult entertainment industry.[169]

Although this type of scheme may initially appear to be at an extreme of the spectrum, it should not be dismissed merely because it does not require any positive regulation by Congress. It simply takes advantage of a variety of preexisting mechanisms and impetuses—natural advances in technology, market forces and business actors, thorough law enforcement, and perhaps most importantly, parental desire to protect their children from harmful materials on the Internet.

IV. CONCLUSION

The problems that have plagued Congress and the courts in addressing the constitutionality of the CDA and COPA are unlikely to be alleviated. The development of Internet technologies will continue to outpace the legislative and judicial processes, and it is hard to imagine a change to the structure of the Internet so fundamental as to dramatically alter the relative restrictiveness of top-down regulations versus bottom-up solutions.

Due to the ease and effectiveness with which technology can "regulate" the Internet, a solution that does *not* thoroughly consider and integrate technological methods is unlikely to be even marginally effective, let alone constitutionally permissible. The COPA Commission's four-part plan potentially presents the best balance between satisfying Congress's evident desire to regulate sexually explicit speech on the Internet, and protecting the rights of Internet users. In addition, it has the potential to fully integrate the technological solutions that courts have often cited as plausible, less restrictive alternatives to broad proscriptive statutory controls. Indeed, preserving the somewhat chaotic nature of the Internet in the absence of strict government regulation is preferable to the "adoption of repressive forms of order that would constitute a cure worse than the disease."[170] If Congress does make a third attempt to craft legislation preventing children from encountering sexually explicit materials on the Internet, Congress should keep in mind the fundamental values of freedom of expression and individual autonomy, and should learn to harness the power of emerging technology in service of its goals.

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169. *Id.* at 45-46.

170. Hersh, *supra* note 122, at 1861 (quoting Peter Johnson, *Pornography Drives Technology: Why Not to Censor the Internet*, 49 FED. COMM. L.J. 217, 218 (1996)).

ADDITIONAL DEVELOPMENTS—CONSTITUTIONAL LAW

CASHATT V. FLORIDA

873 So. 2d 430 (Fla. Dist. Ct. App. 2004)

A Florida court of appeals upheld a state law criminalizing the use of the Internet to knowingly solicit underage sex, ruling that even if the law was a content based restriction, it satisfied strict scrutiny.

In 2001, Florida passed a statute criminalizing the use of the Internet to knowingly lure or solicit children to commit illegal sexual acts. Defendant Cashatt was caught attempting to set up a face-to-face meeting with a detective posing online as a fourteen-year-old boy. Cashatt pleaded *nolo contendre* to violation of the act but challenged the constitutionality of the statute. Cashatt argued that the statute was an impermissible content-based restriction on free speech, that it was overbroad and vague, and that it violated the Commerce Clause of the U.S. Constitution. The court rejected all constitutional claims and upheld the statute.

The court held that even if the statute was considered a content-based restriction on speech, it satisfied strict scrutiny, the analysis normally undertaken for such restrictions. First, the state had a compelling interest in protecting children from luring or solicitation to commit illegal actions. Second, the statute was found to be narrowly tailored, prohibiting not generally indecent or obscene content, but only communications intended to lure a child into committing illegal acts. The court further noted that the statute was not overbroad insofar as it allows consenting adults to exchange sexually oriented information, that it does not proscribe using the Internet to declare a "predilection to have sex with children," and that it limits the act to those who "knowingly" engage in the prohibited conduct.

The court also rejected a Commerce Clause challenge to the statute, holding that the effect of the law on interstate commerce is incidental at best in comparison with the state's strong interest in preventing harm to children.

HIIBEL V. SIXTH JUDICIAL DISTRICT COURT

124 S. Ct. 2451 (2004)

The Supreme Court upheld Nevada's "stop and identify" statute requiring a person briefly detained by police to disclose his name, ruling that it violated neither the Fourth nor the Fifth Amendment.

Larry Hiibel was approached by a police officer as part of a *Terry* stop—a brief police detention and investigation authorized under the reasonable suspicion that a person is involved in criminal activity. Nevada police had received a call reporting an assault on a woman inside a pick-up truck matching that of Hiibel. The officer asked Hiibel several times to state his name, but Hiibel refused. The officer eventually arrested and charged Hiibel with "willfully resisting, delaying, or obstructing a public officer" for not stating his name. Hiibel challenged his conviction as violating his Fourth and Fifth Amendment rights.

The Court ruled that conviction under Nevada's "stop and identify" statute did not violate Hiibel's constitutional rights. The Court set out the standard for Fourth Amendment questions, which requires determining the reasonableness of a seizure by weighing promotion of legitimate government interests against intrusion on Fourth Amendment interests. The Court first noted that obtaining the identification of a suspect is a routine and accepted part of a *Terry* stop. Such identification serves important government interests, such as allowing the law enforcement officer to determine whether the suspect has an outstanding arrest warrant and to clear the suspect of suspicion. In contrast, the Court noted that the request for identification did not change the nature of the already permissible *Terry* stop, leaving intact all the requirements for constitutionality of such a stop.

The Court also held that Hiibel's conviction did not violate his Fifth Amendment right against self-incrimination. The Court reasoned that the mere disclosure of identification presented no reasonable danger of incrimination. The Court found it highly unlikely that a name would "furnish a link in the chain of evidence needed to prosecute" a suspect, while also noting that Hiibel had articulated no reasonable belief that disclosing his name would incriminate him.

MAINSTREAM MARKETING SERVICES V. FTC

358 F.3d 1228 (10th Cir. 2004)

The Tenth Circuit held that implementing an opt-in national do-not-call registry that restricts commercial sales calls is a valid commercial speech regulation and not barred by the First Amendment. The court noted that it was unsure of the constitutionality of such a registry if it were to restrict political or charitable callers.

The do-not-call registry is a product of regulations promulgated by the Federal Trade Commission and the Federal Communications Commission and allows for consumers to place their phone number on a list to prohibit commercial telemarketers from calling. Telemarketers are required to pay a fee to obtain the list and have three months to remove the numbers from their call lists. The restrictions of the registry apply only to calls made by or on behalf of sellers of goods or services, not to charitable or political fundraising calls. Numerous telemarketing companies and their trade association challenged the validity of the registry. After conflicting rulings in the district courts, the appeals were consolidated.

The Tenth Circuit upheld the do-not-call registry on all grounds. On the primary issue, validity under the First Amendment, the court found the registry to be a restriction on commercial speech and applied the *Central Hudson* test, which requires that a regulation on commercial speech be (1) narrowly tailored (2) to directly advance (3) a substantial government interest. *Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y.*, 447 U.S. 557 (1980). The court held that enacting the do-not-call registry reasonably furthered the government interests of protecting the privacy of individuals in their homes and protecting consumers against the risk of fraudulent and abusive solicitation. The registry was narrowly tailored because it blocked calls that presented the type of problems the government was trying to avoid and because it was an opt-in program that protected those who had explicitly requested not to be called by telemarketers. Consumers who do not mind being contacted can refrain from placing their name on the list or affirmatively give consent to certain groups to receive calls. Likewise, telemarketers can still reach consumers through mailings or other advertisement and may even reach those on the registry with whom they have an established business relationship unless the consumer has requested to be placed on the company's do-not-call list. The court rejected a number of alternatives proposed by telemarketers to use a system of company-specific lists, finding these individual lists overly burdensome to consumers.

The court also found that the fee charged to obtain the lists is permissible because it defrays the cost of implementing, maintaining, and enforcing the registry, that the business relationship exception was not adopted in an arbitrary and capricious manner, and that the Federal Trade Commission had statutory authority to enact the national do-not-call registry.

PSINET, INC. V. CHAPMAN

362 F.3d 227 (4th Cir. 2004)

The Fourth Circuit upheld a district court ruling that Virginia's attempt to limit the online dissemination of pornographic materials harmful to children violated both the First Amendment and the Commerce Clause of the U.S. Constitution.

In 1985, Virginia banned "brick and mortar" stores from knowingly displaying indecent materials in a way accessible to juveniles, a statute upheld by the Fourth Circuit in 1989. In 1999 and again in 2000, seeking to ensure the prohibition reached cyberspace, Virginia amended the statute to cover visual materials including any "electronic file or message." A coalition of business interests and individuals challenged the statute, arguing it was facially unconstitutional. Virginia contended that because the statute merely "clarified" a law already upheld, a facial challenge was prohibited.

In invalidating the statute, the court first noted that the 1999 and 2000 amendments were not merely redundant or meaningless, but constituted a "purposeful extension of the [original law] to a new area of communication." The court then found that the amended statute was overbroad and penalized constitutionally protected speech. In particular, the court found that the narrow construction of the statute urged by the states—that adult websites need only use age-verification PIN technology to immunize themselves from prosecution—violated the First Amendment. Moreover, a still-narrower construction of the statute exempting all bulletin boards and chat rooms from regulation would leave the law "virtually powerless" and thus unconstitutional for failing to advance a compelling state interest.

The court also upheld the district court's invalidation of the law under the Commerce Clause. First, the court noted that if the statute was interpreted to force out-of-state websites to comply with Virginia law, it clearly constituted an impermissible direct regulation of interstate commerce. Second, if the statute were interpreted narrowly to apply only to websites operating within Virginia, it would nonetheless be an invalid indirect regulation of interstate commerce. Even a slight burden on interstate commerce outweighs a nonexistent local benefit, and no local benefit exists because regulating Virginia websites would do nothing to staunch the flow of online pornography accessible to juveniles from myriad other out-of-state sources.

VIDEO SOFTWARE DEALERS ASS'N V. MALENG

325 F. Supp. 2d 1180 (W.D. Wash. 2004)

The district court invalidated a Washington state law curbing the distribution of violent video games to minors on the grounds that the law violated the First Amendment.

In 2003, the Washington legislature enacted Wash. Rev. Code § 9.91.180, which imposed penalties for the sale or rental of violent video or computer games to minors. The new law defined "violent" games as those containing realistic depictions of "aggressive violence" by the player towards a character identifiable as a law enforcement officer. A number of industry associations representing video game creators, distributors, and retailers sued for an injunction against enforcement of the new law, contending that it violated the First Amendment by controlling the distribution of video games to minors based solely on their content and viewpoint.

The district court granted plaintiffs' motion for summary judgment. The court applied strict scrutiny to analyze Washington's new law. First, the court noted that the evolution of video games towards increasingly complex narratives, graphics, and musical scores supplied the expressive element required for First Amendment protection of the games. The court refused defendants' request that the court expand the definition of "obscene material" not subject to First Amendment protection to include graphic portrayals of violence.

Under strict scrutiny, the court reasoned that the law failed to serve a compelling state interest. The legislature's stated intent was to curb hostile youth behavior, including violence toward law enforcement officers. However, the court found that the legislature's reliance on studies that correlated exposure to violent video games with "various forms of hostile and antisocial behavior" was insufficient to establish a causal relationship between video games and violent acts against officers. The court also found that the law's language was not narrowly tailored to further the state's alleged interest. The law would, for example, proscribe games portraying "laudable struggles against evil authority figures" or containing "disincentives for violence against law enforcement officers."

VO V. CITY OF GARDEN GROVE

9 Cal. Rptr. 3d 257 (Ct. App. 2004)

The California court of appeals ruled that a city ordinance regulating cybercafes was facially unconstitutional because it gave excessive discretion to city officials to issue permits, thus violating First Amendment protections. However, the portions of the statute that enumerated specific restrictions on the operation of the cafes survived facial review.

In response to police reports of criminal activity at cybercafes in Garden Grove, California, the city council passed an ordinance requiring all cafes to obtain conditional use permits. In reviewing the permit applications, city officials were empowered to attach new regulations to the issuance of the permits. Additionally, officials could deny an application if the applicant failed to substantiate that the cybercafe "would not jeopardize the general welfare." The ordinance also imposed a daytime curfew on unsupervised minors in the cafes, required a security guard on Friday and Saturday nights, and mandated video surveillance of the premises. Plaintiff cybercafe owners sought a preliminary injunction, arguing that the ordinance infringed on free speech and privacy protections under the United States and California Constitutions. The trial court granted the injunction, and the city appealed.

The appellate court first recognized that the Garden Grove ordinance implicates First Amendment protections, analogizing cybercafes, which provide access to the Internet, to book publishers, movie theatres, and other businesses engaged in information dissemination. The court reasoned that any restrictions on cybercafes' activities must thus be content-neutral and narrowly tailored, and leave open other means of information dissemination. The requirement that cybercafes obtain a conditional use permit failed constitutionality under this test. The court referenced a long line of decisions invalidating licensing ordinances for activities protected by the First Amendment where administrative officials were granted too much discretion in determining the grant or denial of the licenses. Because Garden Grove officials could deny permits based on ambiguous criteria, they had the implicit power to limit access to content and regulate speech, in violation of the First Amendment.

The court found that the specific restrictions on cybercafes enumerated in the city ordinance did, however, survive the constitutional test. The curfew on minors advanced a legitimate government interest in the protection of minors, was narrowly tailored, and did not foreclose alternate means of communication. Similarly, the requirement to post guards had only "tenuous" First Amendment implications.

The requirement to conduct video surveillance posed a more complicated question, especially to the degree that video cameras might record patrons' on-screen actions. The court noted, however, that the ordinance instructed cybercafes to record simply the "activity and physical features" of patrons, not their on-screen conduct, and thus the degree of surveillance required did not jeopardize First Amendment privileges. The court also rejected the contention that the surveillance requirement violated the privacy protections of the California constitution, stating that a person's activities in a "public retail establishment" are not confidential and enjoy no legally protected privacy right. Furthermore, the potential observation of on-screen activities does not intrude on the right to make "intimate personal decisions."

The court expressly rejected the dissent's argument that, because of the unique role cybercafes play in furnishing information in the twenty-first century, their regulation imperils freedom of expression and association, and thus government restrictions should be held to strict scrutiny. The court contended that such a generous construction of the activities of cybercafes was not rooted in law.

BERKELEY TECHNOLOGY LAW JOURNAL
ANNUAL REVIEW OF LAW AND TECHNOLOGY

BUSINESS LAW

GOING DUTCH: THE GOOGLE IPO

By Eugene Choo

The initial public offering (IPO) by Internet search giant Google was arguably the most talked about IPO of 2004. In April 2004, Google founders Larry Page and Sergey Brin announced their intention to take the company public. They surprised investors when they revealed that Google would use a Dutch auction[1] process for its IPO, rather than a traditional, investment bank-led offering. Bidding for shares closed on August 18, 2004, and trading commenced on August 19, 2004.

GOOG's debut at $85 per share was accompanied by plenty of publicity and press coverage. The IPO price had dropped from an initial estimated range of $108-$135, yet Google still managed to raise $1.67 billion. Of this amount, $1.2 billion went to the company and $473 million went to Google executives and investors selling their shares.[2] Page, Brin, CEO Eric Schmidt, senior Google managers and directors, and long-term Google employees gained potential millions through the value of their stock and stock options. Driven by market hype and strong investor interest, the stock price surged in the following weeks, and traded as high as $210.86 on February 3, 2005.[3]

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1. Dutch auction IPOs are fairly uncommon. At the time of the Google IPO, only ten U.S. companies had gone public using a Dutch auction process. Dutch auction IPOs differ from traditional IPOs in that the initial share price is determined largely through a pre-IPO bidding process, instead of being pre-set by underwriting investment banks. *See, e.g.*, *Completed Auctions*, WR Hambrecht + Co., *at* http://www.wrhambrecht.com/ind/auctions/completed.html (last visited Mar. 12, 2005); WR Hambrecht + Co., *Open IPO: How It Works*, *at* http://www.openipo.com/ind/auctions/openipo/index.html (last visited Mar. 10, 2005) [hereinafter *Open IPO*]; *see also* PAUL MILGROM, PUTTING AUCTION THEORY TO WORK 26, 241 (2004).

2. The IPO price adjustment resulted from several factors, among them a perception by market analysts that the initial price range overvalued the company. *See, e.g.*, *Google IPO Priced at $85 a Share*, CNN.COM, Aug. 19, 2004, *at* http://edition.cnn.com/2004/BUSINESS/08/19/google.ipo; Paul La Monica, *Google Goes Low: IPO Set at $85 a Share*, CNN.COM, Aug. 19, 2004, *at* http://money.cnn.com/2004/08/18/technology/googleipo; Andrew Ross Sirkin & Gary Rivlin, *SEC Approves Google IPO, Company Cuts Share Price*, N.Y. TIMES, Aug. 18. 2004, *available at* http://www.nytimes.com/2004/08/18/technology/18CND-GOOGLE.html?ex=1095998400&en=54af74a3266605c4&ei=5070.

3. *See, e.g.*, Les Christie, *The ABCs of a Unique IPO: The Hottest Tech IPO in Years Will Be Run as a Dutch Auction*, CNN.COM, Apr. 29, 2004, *at* http://money.cnn.com/2004/04/29/technology/googleauction. For stock quotes and trends, see, for exam-

Google's IPO was very lucrative and generally successful, especially considering its unconventional Dutch auction process. Despite various criticisms by observers and initial missteps by the company, Google's modified Dutch auction set an appropriate price for the offering and satisfied the company's business and cultural goals. The Google example also shows that Dutch auction IPOs can work for larger companies. However, as is discussed below, Google's success may have been unique to the circumstances. Because most companies (especially smaller privately-held firms) will not enjoy the same advantages that Google had, a significant increase in Dutch auction IPOs is unlikely to occur in the near future. Instead, most IPOs will likely continue to take place under the traditional model.

This Note examines several questions brought up by the Google IPO: (1) Why did Google management opt to use a Dutch auction, and how successful was it? (2) How does the Google IPO compare with traditional IPOs and other Dutch auction IPOs? (3) Did Google's modified Dutch auction[4] really make the offering more "democratic"—that is, more accessible to average investors and the general public? (4) Are Dutch auction IPOs a viable alternative to the traditional IPO model? (5) Can other companies successfully emulate Google's approach when going public? Part I includes a synopsis of Google's corporate history and an overview of IPOs in the technology age. Part II outlines Google's goals and its IPO process. Finally, Part III discusses and evaluates the Google IPO and its subsequent effects.

I. BACKGROUND: THE GOOGLE STORY AND IPOS IN THE TECHNOLOGY AGE

A. Google's History

Google founders Larry Page and Sergey Brin met in 1995, while they were computer science graduate students at Stanford University. In 1998, Page and Brin founded Google Inc., after securing $100,000 from an "angel"[5] investor. The company was incorporated and officially began opera-

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ple, Bloomberg.com, *at* http://www.bloomberg.com (last visited Mar. 10, 2005); Yahoo! Finance, *at* http://finance.yahoo.com (last visited Mar. 10, 2005).

4. The distinction between a pure Dutch auction and Google's modified Dutch auction is explained *infra* Part III.

5. Angel investors provide the initial financing necessary for a startup company. "Angels are typically successful business people with a high net worth that invest in and often advise start-up companies." Richard Mann et al., *Starting From Scratch: A Lawyer's Guide to Representing a Start-up Company*, 56 ARK. L. REV. 773, 823 (2004).

tions on September 7, 1998, in Menlo Park, California. Google's search engine began in Beta status, but achieved full operation by 1999. The same year, Google secured $25 million in first-round financing from premier venture capital firms Sequoia Capital and Kleiner Perkins Caufield & Byers.[6]

Page and Brin took pride in the fact that they were able to build a unique corporate culture based on collegiality and innovation.[7] As of 2000, Google.com was handling more than 100 million search queries a day. Google also partnered with online portal Yahoo! to provide Yahoo! with search engine technology and services, although this partnership ended in early 2004.[8] By 2002, Google had overtaken Yahoo! as the market leader in search technology and won several industry awards for its search engine. In the following two years, Google further solidified its status as the top search engine and became an established brand name on the Internet and beyond.[9]

In contrast to many Internet startups, Google was a financial success enjoying a steady revenue stream based on advertising, while simultaneously providing technologically-sound products.[10] In 2004, Google also

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6. *See Google History*, *at* http://www.google.com/corporate/history.html (last visited Feb. 18, 2005).

7. *Id.*

8. Jim Hu & Stephanie Olsen, *Yahoo Dumps Google Search Technology*, CNET NEWS.COM, Feb. 17, 2004, *at* http://news.zdnet.com/2100-3513_22-5160710.html. Yahoo! dropped Google after acquiring search engine companies Inktomi, Overture, Altavista, and Alltheweb in 2003. Yahoo! and Google quickly became fierce competitors, as evidenced by Yahoo!'s recent patent infringement lawsuit against Google. Prior to Google's IPO, Yahoo! agreed to drop the suit, in exchange for 2.7 million Google shares, worth up to $300 million at the $85/share IPO price. *See Google's IPO Rollercoaster*, ECONOMIST, Aug. 20, 2004, *available at* http://www.economist.com/agenda/displayStory.cfm?story_id=3103916; Deborah Lohse, *Google IPO to Offer More Shares*, SAN JOSE MERCURY NEWS, Aug. 9, 2004, *available at* http://www.mercurynews.com/mld/mercurynews/business/special_packages/google/9357106.htm.

9. Google currently receives over 200 million search requests a day. *See, e.g.*, *The Amazing Shrinking Google IPO*, CBS MARKETWATCH, Aug. 18, 2004, *at* http://www.cbsnews.com/stories/2004/08/18/tech/main636869.shtml (Aug. 18, 2004). *See generally* Paul La Monica, *Google Sets $2.7 Billion IPO*, CNN.COM, Apr. 30, 2004, *at* http://money.cnn.com/2004/04/29/technology/google. Google further strengthened its brand name when it won dismissal of a trademark infringement suit by Geico. Stefanie Olsen, *Google Wins in Trademark Suit with Geico*, CNET NEWS.COM, Dec. 15, 2004, *at* http://www.wrhambrecht.com/ind/auctions/completed.html.

10. In its first report as a public company, Google declared revenues of $805.9 million for third quarter 2004, more than double the $394 million figure for third quarter 2003. Google Investor Relations, *Google Announces Record Revenues for Third Quarter 2004*, *at* http://investor.google.com/releases/2004Q3.html. *See generally* Google Finan-

began beta-testing an advertising-based webmail product—Gmail. Other presently offered technologies include Google Toolbar, Google Desktop, Froogle (a comparison shopping search engine), and Newsgroups, Images, and News search engines.[11] By early 2004, Google had firmly positioned itself as the market leader in search engine technology. Page and Brin felt that the company was ready to go public, and in April 2004, they announced their decision to take that route.[12]

B. The Dot-Com Boom: Venture Capital and IPOs

The dot-com boom brought the rise of the startup funding model for nascent technology companies. Initially funded by angel investors, and further financed by subsequent rounds of venture capital, these companies—particularly in Silicon Valley—went public during the bull market of the mid-to-late 1990s. Companies such as Amazon.com, Yahoo!, and eBay raised millions through their IPOs, and are still viable today despite the dot-com crash following the turn of the millennium. Other companies, such as Pets.com, EToys, and Webvan, were not as successful.[13] Although such companies raised millions at the IPO stage, their business plans were not sustainable in the long run. Still others, such as America Online, either merged with or were eventually acquired by traditional media companies.[14]

Technology companies helped fuel both the late 1990s boom and the downturn that followed. Stock indices soared as investors poured money into hot new stock issues, many of which were by high-tech or Internet startups. Overvaluation of companies, short-term stock speculation, and

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cial Data, *at* http://investor.google.com/fin_data.html. For a discussion of Google's key revenue sources, see *Google's IPO Rollercoaster*, *supra* note 8.

11. Google also recently announced an ambitious plan to digitize the collections of five major libraries: Stanford University, University of Michigan, Harvard University, University of Oxford, and the New York Public Library. *See* Barbara Quint, *Google and Research Libraries Launch Massive Digitization Project*, INFO. TODAY, Dec. 20, 2004, *at* http://www.infotoday.com/newsbreaks/nb041220-2.shtml.

12. *See Google History*, *supra* note 6; *see also Google's IPO Rollercoaster*, *supra* note 8 (describing Google's key revenue sources).

13. *See, e.g.*, Elizabeth Blakey, *Venture Capital's Biggest Losers*, ECOMMERCENEWS.COM, Apr. 26, 2001, *at* http://www.ectnews.com/story/9180.html.

14. America Online (now AOL Time Warner) acquired Netscape in 1998, and eventually merged with Time Warner. *See, e.g.*, Sandeep Junnarkar & Tim Clark, *AOL Buys Netscape for $4.2 Billion*, CNET NEWS.COM, Nov. 24, 1998, *at* http://news.com.com/2100-1023-218360.html?legacy=cnet.

post-IPO "pops" of 300% were not uncommon.[15] The majority of emerging companies were backed by significant amounts of venture capital. Major venture capital firms such as Sequoia Capital, Kleiner Perkins Caufield & Byers, Accel Partners, and Hummer Winblad provided the funding necessary for hundreds of startups, as well as secondary financing for more established technology companies.[16]

1. *The Venture Financing Process*

The venture financing process generally involves three steps.[17] First, the recipient company's founders come up with an idea and a business plan, usually committing their own financial resources prior to seeking outside funding. The company principals then search for additional seed and startup capital, usually provided by an angel investor, in exchange for an equity interest in the company in the form of preferred stock. Seed capital provides funds necessary for research and market testing, while startup capital funds the purchase of equipment and infrastructure and the hiring of employees. Finally, for successive rounds of financing,[18] venture capitalists provide funds in exchange for one or a combination of: preferred stock, convertible debt, warrants, and options.[19]

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15. Software company VA Linux surged almost 700% on the first day of its IPO. *See, e.g.*, Mark Gimein, *Dissecting the VA Linux IPO*, SALON.COM, Dec. 10, 1999, *at* http://archive.salon.com/tech/log/1999/12/10/va_linux (Dec. 10, 1999).

16. *See, e.g.*, Joseph Bankman & Ronald Gilson, *Why Start-ups?*, 51 STAN. L. REV. 289, 289 (1999) ("The prototypical start-up involves an employee leaving her job with an idea and selling a portion of that idea to a venture capitalist."). Some successful VC-backed companies include Amazon, AOL, Apple, Cisco, Sun, VeriSign, and Yahoo!. For a more detailed description of venture capital, fund formation, and financing, see OREN FUERST & URI GEIGER, FROM CONCEPT TO WALL STREET (2003); STEVE HARMON, ZERO GRAVITY 2.0: LAUNCHING TECHNOLOGY COMPANIES IN A TOUGHER VENTURE CAPITAL WORLD (2001); PRIVATE EQUITY AND VENTURE CAPITAL: A PRACTICAL GUIDE FOR INVESTORS AND PRACTICIONERS (Rick Lake & Ronald Lake eds., 2000); National Venture Capital Association, *at* http://www.nvca.org (last visited Feb. 18, 2005); *Venture Capital*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, *at* http://en.wikipedia.org/wiki/Venture_capital (last visited Feb. 18, 2005).

17. Venture capital firms are usually formed as limited/limited-liability partnerships, with a pool of resources drawn from pension funds, university endowments, insurance companies, and other large institutional funds. *See* sources cited *supra* note 16. *See generally, e.g.*, Kleiner Perkins Caufield & Byers, *at* http://www.kpcb.com (last visited Feb. 18, 2005); Sequoia Capital, *at* http://www.sequoiacap.com (last visited Feb. 18, 2005).

18. Successive financing rounds are referred to as "second-stage" and/or "mezzanine" financing. *See* sources cited *supra* note 16.

19. *See* sources cited *supra* note 16; *see also* Mann et al., *supra* note 5, at 824 ("VCs differ from angels in that they typically invest other investors' capital in start-ups.").

Because there is a substantial risk of venture failure, venture capital firms typically take measures to help offset that risk. This includes retaining an equity interest (preferred stock) in the company, as well as charging financing fees and/or securing convertible debt against the company. Other negotiable instruments include warrants and stock options.[20] Key company assets such as capital stock (buildings, equipment, and infrastructure) and intellectual property[21] are often used as collateral when securing debt.

Venture capital firms structure investment agreements to create significant rights in recipient companies' governance.[22] When negotiating a financing deal, both the venture capital firm and the recipient company must address several key terms, including level of control, offsetting risk, fees, technology/intellectual property, and harvesting/exit strategy. Most venture capital firms reserve the power to hire and fire certain managers, to buy out existing partners or owners, and to provide operational and technical guidance.[23]

Venture capital firms will also negotiate either a harvesting agreement or an alternative exit strategy.[24] If the recipient company is successful, its venture backers expect to "harvest" their initial investment by selling their stock, warrants, options, convertibles, or other forms of equity in three to ten years. The harvesting process becomes more complicated if the company merges with or is acquired by another firm.[25] A venture capital

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20. *See supra* notes 16-19 and accompanying text. For a definition of stock options, warrants, and other instruments, see, for example, *Stock Option*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, *at* http://en.wikipedia.org/wiki/Stock_option (last visited Feb. 18, 2005) ("A stock option is a specific type of option with a stock as the underlying [security] . . . [I]t is a contract to buy . . . or sell . . . shares of stock, at a predetermined or calculable . . . price.); *Warrant (finance)*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, *at* http://en.wikipedia.org/wiki/Warrant_%28finance%29 (last visited Feb. 18, 2005) ("A warrant is the right—but not the obligation—to buy or sell a certain quantity of an underlying instrument at an agreed-upon price").

21. Intellectual property is a valuable asset for technology companies. Mann et al., *supra* note 5, at 775-90.

22. *Id.* at 804.

23. *See* sources cited *supra* note 16; *see also* Ronald Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1082 (2003) (Venture capital firms have an "incentive to make the investment in monitoring necessary to evaluate the portfolio company's overall performance over the initial funding period."). *See generally* Mann et al., *supra* note 5, at 804-05.

24. A privately-held company may also eventually choose to go public. Harvesting agreements and alternative exit strategies—for example, merger/acquisition or IPO—allow venture capital firms to "cash out" at the end of their investment. *See* sources cited *supra* note 23 and accompanying text.

25. *See* Mann et al., *supra* note 5, at 839.

firm's exit strategy also "provides the means to give the entrepreneur an important performance incentive: a call option on control, the exercise of which is implemented by the venture capital fund's realization of its investment in the portfolio company by means of an IPO."[26]

2. *Going Public: The Traditional Model*

Companies typically go public to raise substantial new capital for further growth; at the same time this creates liquidity for the company's private shareholders and venture backers.[27] An IPO also gives the company exposure to the market, thus facilitating future financing opportunities.[28] Prior to the IPO, company management must file a series of documents with the Securities and Exchange Commission (SEC), including a Form S-1 (initial registration statement).[29] The IPO is subject to the 1933/1934 Securities Acts and SEC rules, including Regulation FD and Rule 10b-5.[30]

When going public, the majority of privately-held companies utilize the traditional book-building IPO model.[31] In this model, investment banks serve as middlemen or gatekeepers between the company and the banks' "book of business"—large institutional investors, insurance and

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26. Gilson, *supra* note 23, at 1091.

27. Gregory Lederman, Note, *Initial Public Offerings in the Age of the Internet*, 2 J. LEGAL ADVOC. & PRAC. 43, 44-45 (2000).

28. Mann et al, *supra* note 5, at 840. Significant benefits "of going public include the prestige, visibility, and credibility associated with public companies." *Id.* There are also significant costs, including the hiring of "underwriters, securities lawyers, accountants, and financial printers." *Id.* Nor does going public guarantee business success—investors may avoid IPOs when the economy is in a recession; public companies are also more vulnerable to hostile takeovers. Thus, private companies must carefully consider these benefits and costs before deciding to go public. *Id.* at 839-43.

29. The S-1 includes required disclosures and prospectus. Additional documents include the Form 10-Q (quarterly report). *See Form Types Used for Electronic Filing on EDGAR*, U.S. Securities and Exchange Commission, *at* http://www.sec.gov/info/edgar/forms/edgform.htm (last visited Mar. 10, 2005).

30. *See* Mann et al., *supra* note 5, at 829-33, 842-44; *see also* Andres Rueda, *The Hot IPO Phenonmenon and the Great Internet Bust*, 7 FORDHAM J. CORP. & FIN. L. 21, 22-24 (2001). Regulation Fair Disclosure ("Regulation FD") addresses selective disclosure. Secs. & Exch. Comm'n, *at* http://www.sec.gov/rules/final/33-7881.htm (last visited Mar. 17, 2005). Rule 10b5 addresses insider trading liability, either on the basis of a trader's "'use' or 'knowing possession' of material nonpublic information" (Rule 10b5-1) or misappropriation resulting from a breach of a duty of trust or confidence. Secs. & Exch. Comm'n, *at* http://www.sec.gov/rules/final/33-7881.htm (last visited Mar. 17, 2005). It requires that "when an issuer intentionally discloses material information, it do so publicly and not selectively." Secs. & Exch. Comm'n, *at* http://www.sec.gov/news/extra/seldsfct.htm (last visited Mar. 17, 2005).

31. Mira Ganor, A Proposal to Restrict Manipulative Strategy in Auction IPOs 5-6 (2004), *available at* http://ssrn.com/abstract=572243.

pension funds, and wealthy individual clients. For most securities offerings, investment banks serve as underwriters.[32] They synthesize financial statements, accounting reports, and market research about the company for potential investors. The company and its lead underwriter determine an initial share price and number of shares. The banks then generate interest by promoting the issue to their preferred clients.[33]

In larger public offerings, the lead underwriter, along with company management, is responsible for coordinating publicity and market interest for the issue. This is usually accomplished by a road show, where representatives of the underwriters, along with key officers of the issuing company, solicit and advertise the company to potential investors.[34] The lead underwriter may adjust the initial share price after gauging market demand following the road show. Underwriters often reserve shares of "hot" issues for their preferred customers, before allowing the remaining shares to sell on the open market. Alternatively, they may agree to help a lukewarm issue by supporting the share price (by buying back shares on the open market) for a set period of time after the IPO.[35] Underwriters typically receive a fee of 5-10% of the aggregate value of the IPO.[36]

Underwriters typically take pre-IPO orders only from their clients and other large investors, at a different (often discounted) price than post-IPO

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32. *See id.* For large offerings, investment banks will pool together and form an underwriting syndicate, with one or more lead underwriters. Most securities offerings are coordinated by investment banks. *See* Rueda, *supra* note 30, at 29-30. Solicitation and marketing is sometimes conducted over the Internet. *See* Lisa Mondschein, *The Solicitation and Marketing of Securities Offerings through the Internet*, 65 BROOKLYN L. REV. 185 (1999). Other alternatives include direct public offerings (DPOs) and small-issue public offerings conducted via Internet. *See generally* Anita Indira Anand, *The Efficiency of Direct Public Offerings*, 7 J. SMALL & EMERGING BUS. L. 433 (2003); Jeffrey Hass, *Small Issue Public Offerings Conducted Over the Internet: Are They Suitable for the Individual Investor?*, 72 S. CAL. L. REV. 67 (1999); William Sjostrom Jr., *Going Public through an Internet Direct Public Offering: A Sensible Alternative for Small Companies?*, 53 FLA. L. REV. 539 (2001).

33. *See* Rueda, *supra* note 30, at 29-43. *See generally* Ganor, *supra* note 31, at 5-6.

34. *See* Rueda, *supra* note 30, at 29-43.

35. *See id.*, at 49 ("[T]he price for an under-subscribed IPO can easily collapse. In that case, the underwriter must either subscribe itself to the issue or sell the stock at a deflated price, incurring substantial per share losses."). For a more detailed description of IPO pricing and mechanics, see JASON DRAHO, THE IPO DECISION: WHY AND HOW COMPANIES GO PUBLIC (2004); ROSS GEDDES, IPOS AND EQUITY OFFERINGS (2003); TOM TAULLI, INVESTING IN IPOS V2.0 (2001).

36. Mann et al., *supra* note 5, at 842. Investment bank Merill Lynch typically charges a 7% commission. John Shinal, *Google IPO: No Merrill, Bank May Not Have Liked Fee Structure*, S.F. CHRON., Jun. 22, 2004, *available at* http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2004/06/22/BUGRK79OT41.DTL&type=business.

shares available on the open market. The lead underwriters are instrumental in negotiating and setting the initial share price and allocation. Prior to the IPO, the underwriters will have often negotiated sales with their preferred clients—typically institutional investors and high net-worth individuals—which ideally will generate sufficient market demand by the time of the offering. Average investors, on the other hand, are typically not able to purchase shares until after the stock officially goes public. If it is a "hot" IPO, the stock price will "pop"[37] on the first day, and individual investors often end up paying a premium for shares compared to the banks' preferred clients.[38] Some economists and analysts argue that this is due to "underpricing"[39] of the issue prior to the IPO, which often creates an artificial "trader's surplus"[40]—an overvaluation of the stock—in the days or weeks following the IPO.

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37. *See* Gimein, *supra* note 15. Underwriters often agree to "underprice" an issue pre-IPO, in order to increase the chances of a first-day pop. *See* Rueda, *supra* note 30, at 24-35 ("[An] investment bank will have a near-monopoly in aftermarket trades for the first few weeks following an IPO, a period during which the stock has not yet been disseminated widely enough to allow other banks to freely offer it to their customers. . . . [The] investment bank will rely on its analysts' expertise . . . for due diligence . . . [and thus], the investment banker will usually have a good indication beforehand whether an IPO will be 'hot'.").

38. For some hot IPOs, the stock price might be quite volatile in the days following the IPO—the price surges as buyers rush in; later on, the price may drop considerably as investors "flip" (sell) in search of quick profits. *See* Rueda, *supra* note 30, at 26-27, 47.

39. *See* Rueda, *supra* note 30, at 24-35. Mira Ganor argues that auction IPOs, however, may also cause underpricing rather than a more efficient IPO pricing at the outset. *See* Ganor, *supra* note 31, at 11-19. Paul Murphy writes,

> What's interesting and applicable about this is the underlying theory. An acre of land is an acre of land; value that acre based on its real earnings potential and a cornfield in Iowa should be worth more than a lot in Manhattan.
>
> In reality, however, that acre in Manhattan is worth more, not because it will grow more crops or make a nicer park, but because society as a whole has decided to build a city around it—and it's this social decision that gives the land in Manhattan its value advantage. . . .
>
> . . . .
>
> . . . Get the market buzz on-side from the start, and we'll get that $100 valuation for our $10 share . . .

See Paul Murphy, *Pricing an Imaginary IPO*, LINUXINSIDER.COM, Dec. 12, 2004, *at* http://www.linuxinsider.com/story/Pricing-an-Imaginary-IPO-38537.html.

40. *See* Murphy, *supra* note 39 ("[T]he resulting distortions affect every major decision management makes . . . [including the exaggeration of] real earnings potential during upswings and [a] focus on very short term decision making . . . during downswings.").

C. The Dutch Auction Model

Dutch auction IPOs differ from traditional IPOs in that the Dutch auction ostensibly allows the market to set the initial share price. All investors, individuals as well as institutions, have a chance to place bids on a stock issue. This transfers a significant amount of price-setting power and market influence away from the investment banks, which results in greater autonomy for corporate management and a more "democratic" offering. Instead of the traditional IPO, where shares generally are sold first to favored investors, a Dutch auction theoretically allows any investor to enter a bid.[41]

1. Economic Theory: First-Price versus Second-Price Auctions

A Dutch auction essentially reverses the mechanics of the traditional English auction. Economists refer to Dutch auctions as an open, first-price auction: the seller sets an opening price, and then units are sold beginning from the highest bidder downward, until the market clears. This is in contrast with the traditional (second-price, or English) auction, where units are sold when the last (highest) bid is made.[42] A normal auction on Ebay or at a traditional auction house such as Lloyd's illustrates the second-price auction: the seller may choose to set a reserve price (the lowest price at which she is willing to sell), then potential buyers place successively higher bids, until there are no more bidders. The unit sells at the last, highest bid.[43]

Dutch auctions are less common but can in fact be found on popular Internet auction sites such as eBay and Amazon.com. In eBay Dutch auctions, current high bids are always displayed after the item description. The complete bidding history, including unsuccessful bids, is available as well.[44]

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41. *See, e.g.*, Rueda, supra note 30, at 90 ("[I]POs could be distributed according to the Dutch auction system . . . [where] stock would go to the highest bidder, and not to the underwriter's preferred customer."); *see also* Ravi Bapna et al., *Insights and Analyses of Online Auctions*, 44 COMMUNICATIONS OF THE ACM 42 (2001). In practice, investors having a brokerage account or preexisting relationship with the "right" bank will have an advantage even in Dutch auctions. *See generally Completed Auctions*, *supra* note 1.

42. *See* MILGROM, *supra* note 1, at 26, 241; *see also* Paul Milgrom, *Auctions and Bidding: A Primer*, 3 J. ECON. PERSPECTIVES 3, 6-7 (1989).

43. *See* MILGROM, *supra* note 1, at 26, 241; *see also* Milgrom, *supra* note 42, at 6-7.

44. The Dutch auctions held on eBay are not true Dutch auctions, but the core concept is the same: multiple identical items may be sold in one auction. *See* Bapna et al., *supra* note 41, at 49-50 ("The so-called Dutch auction used by eBay is an ascending open uniform price auction that differs from the original version of Dutch auctions, which originated in Dutch Flower markets. . . . [It] can be most loosely identified with a multi-

2. *Dutch Auction IPO Mechanics*

Traditional IPOs are not properly auctions, since the bulk of the shares are privately sold at a price predetermined by the underwriters. In a Dutch auction IPO, on the other hand, the IPO price is determined by investor bids. Bidders submit the highest price that they are willing to pay and the number of shares desired at that price. The highest bidders (or the earliest, if investors submit bids at the same price) get first priority on the shares, which are then allocated in order from highest to lowest bid, until all the shares are sold. The final price is uniform, however: all bidders receive shares priced at the lowest accepted bid.[45]

A Dutch auction IPO has several benefits. It reduces transaction costs by bypassing investment banks and thus allows the market to set the price. Investors receive shares more efficiently, based on what they are willing to pay rather than preexisting relationships between investment banks and their clients. Moreover, a Dutch auction "ensures that the company going public is [not] going to leave too much money on the table by going public

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item extension of what is classically known as a Vickrey auction. . . . It should be noted that Vickrey's original version of this auction was designed to be a sealed-bid auction, in contrast to eBay's open and progressive version where all bids are posted and can be revised. . . . [T]his revised mechanism offers discriminating prices in contrast to the original mechanisms' uniform pricing."); Michael Giberson, *The Other Dutch Auction IPO*, KNOWLEDGE PROBLEM, Aug. 23, 2004, *at* http://www.knowledgeproblem.com/archives/-000906.html.

45. James Surowiecki, *How to Do an IPO*, SLATE.COM, Dec. 9, 1999, *at* http://slate.msn.com/id/1004150; *see also Dutch Auction IPO*, Marginal Revolution, *at* http://www.marginalrevolution.com/marginalrevolution/2004/08/dutch_auction_i.html (quoting N.Y. TIMES, Aug. 21, 2004) (last visited Mar. 10, 2005). To illustrate further, consider the following example:

> Imagine the Dutch auction of a 100 share offering. The auctioneer begins by calling out a prohibitively high price per share that he knows will attract no bids. He then calls out lower and lower prices until someone decides to buy a few shares (eight, for example). The auctioneer continues to lower the price until someone agrees to buy more shares (12, for example). So far, bidders have bought 20 shares, one-fifth of the total IPO, and they've bid different prices.
>
> The auctioneer continues to lower the price until all 100 shares are spoken for. At auction's end, bidders get the number of shares they agreed to buy, but at the price bid by the last bidder. If the first guy bid $100 per share for the eight shares, and the second guy bid $75 per share for the 12 shares, they only pay what the last guy bid—say, $50 per share.

Bruce Gottlieb, *What Is a Dutch Auction IPO?*, SLATE.COM, May 6, 1999, *at* http://slate.msn.com/id/1002736.

at a lower price than the one the market was willing to pay."[46] Furthermore, if the auction is conducted over the Internet, it gives the average investor "who lacks the resources to spend on brokerage fees and information finding, a chance to invest on even ground with richer investors."[47]

A Dutch auction IPO decreases the role of underwriters in the IPO process. The pricing is ostensibly more transparent, as the initial share price is determined according to the public's bids.[48] Although the investment banks fill orders and sell shares, they have much less control over the price.[49] The end result for the offering company is a tradeoff: lower fees for the investment bank, but the risk of a lukewarm market for the stock issue. A small privately-held company without sufficient brand recognition, resources, and market share to generate sufficient interest on its own may find that it is in its best interest to hire underwriters to manage its IPO. Although the offering company gives up pricing control and must pay the investment banks a considerable fee, this helps insure against the risk of a cold issue.[50] The traditional model IPO allows a company to leverage the investment banks' expertise in order to build interest and credibility for its stock issue, in exchange for giving up control over price and initial share allocation.[51]

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46. Surowiecki, *supra* note 45.

47. Daniel Weisenfeld, Note, *IPOs on the Internet: The Need for the Next Step*, 22 HASTINGS COMM. & ENT. L.J. 529, 541 (2000).

48. Dutch auction IPOs do not necessarily eliminate underpricing, however. *See* Ganor, *supra* note 31, at 11-19. Ganor reasons that "some sophisticated investors can maximize their wealth by choosing to bid in a strategic way that causes under-pricing. This outcome is contrary to the conventional wisdom that postulates that auction IPO[s] will always prevent under-pricing." *Id.* at 21.

49. *See, e.g.*, Rueda *supra* note 30, at 90-91 ("For example, [WR] Hambrecht's 'OpenIPO' system sells to . . . the highest bidders . . . at the price of the lowest bid accepted."). Typical orders for IPO shares are usually made in blocks of 1,000 or more. *See* Shinal, *supra* note 36.

50. Compare this to the real estate market: A seller of property gains a higher potential profit if she chooses not to hire a realtor. But if the seller cannot, on her own, generate enough interest in the property, she risks a loss—either because she must sell at a discount or because she cannot sell the property at all. Hiring a realtor helps insure against this risk. This idea is attributed to Professor Peter Menell, Univerity of California at Berkeley, School of Law (Boalt Hall) (Oct. 20, 2004).

51. *See supra* notes 31-35 and accompanying text. Companies often negotiate agreements with underwriters to keep an issue above the initial IPO price for a set period of time—banks will manage the supply of shares according to market demand.

Table 1: Differences between Traditional and Dutch Auction IPOs[52]

	Traditional IPO	Dutch Auction IPO
Pricing Mechanism & Share Allocation	Coordinated by underwriting investment banks	Determined by market via investor bids
Role of Underwriters	Underwriters set the IPO price, market the IPO, and support the price in the event of an undersubscribed offering	Underwriters' price-setting power virtually eliminated; lower transaction costs; underwriters still market the IPO
Post-IPO Price Effect	Potential for a larger pop, because the stock is "underpriced" prior to the IPO	Less potential aftermarket pop, due to relatively more efficient pricing and share allocation

San Francisco's WR Hambrecht is the only major U.S. investment bank that offers Dutch auction IPOs. Its Open IPO product utilizes a "uniform price auction in which large and small investors are all subject to the same auction rules."[53] WR Hambrecht's website describes OpenIPO as "an innovative auction process for distributing stock to individuals and institutions through a more efficient and equitable process. The auction

52. *See supra* notes 31-35 and accompanying text. In addition, see *IPO Watch: Morningstar in Dutch*, RED HERRING, Jan. 10, 2005, *at* http://www.redherring.com/Article.aspx?a=11128&hed=IPO+Watch%3A+Morningstar+in+Dutch, which states:

> The Dutch auction is just that—an auction with the merchandise going to the highest bidder. In the world of IPOs, it is as straightforward as this: "Here's the deal. What do you want to pay for it?" [¶] The Dutch auction IPO's offering price is the highest bid it takes to sell all of the shares. It is called the clearing price. [¶] In a true Dutch auction, all the higher bids are swallowed up into the clearing price. As a result, there are no aftermarket orders to drive the stock higher once the IPO starts trading. [¶] In a Dutch auction the investment banker acts as an auctioneer. [¶] In a traditional Wall Street underwriting, the investment bankers agree to buy all the shares from the issuer and re-offer them to the buyers. In the process, they negotiate the IPO's terms between the buyers and the issuer. If the deal is not a sell-out, then the investment bankers are stuck with the unsold shares. [¶] The investment bankers are underwriters. A Dutch auction IPO is, nevertheless, an auction. It has more in common with the goings-on at Sotheby's or Aunt Mabel's estate sale than it does with business as usual in the IPO market. [¶] A traditional Wall Street underwriting is a negotiated sale, with some similarities to real estate transactions.

53. MILGROM, *supra* note 1, at 26; *see also Open IPO*, *supra* note 1.

process allows shares of an initial public offering to be allocated in an equal and impartial way. All successful bidders pay the same price per share."[54]

OpenIPOs take place on the Internet, and its claimed benefits include: equal access to shares, fair and impartial allocation (no preferences), flexibility (including multi-tiered bids at different amounts of interest for shares at different prices), and equal pricing.[55] WR Hambrecht typically charges a commission of 4% for its OpenIPO services.[56] As of December 2004, ten U.S. companies had gone public using a Dutch auction IPO. WR Hambrecht, through its OpenIPO product, underwrote all ten offerings.[57]

II. THE GOOGLE IPO: COMPANY GOALS AND THE IPO PROCESS

Google management's decision to use a Dutch auction IPO represents a break from the pack in Silicon Valley and beyond. As the most popular Internet search engine,[58] Google possessed key advantages which helped make the Dutch auction work—namely, a strong, widely-known brand name and a broad user/customer base. This allowed the company to publicize its IPO to a broad range of potential investors. In interviews and SEC filings, Larry Page and Sergey Brin made clear their desire to open up the offering to the investing public. They asserted that the Dutch auction process made the IPO accessible to the average investor; all investors theoretically had the opportunity to enter bids prior to the IPO, which in principle placed individual investors on par with investment banks, mutual fund managers, and large institutional investors.[59]

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54. *See Open IPO*, *supra* note 1. Anyone with $2000 and Internet access can open an account. *Id.*

55. *Id.*

56. *See* Shinal, *supra* note 36.

57. *See Open IPO*, *supra* note 1. The ten firms who used the OpenIPO are: Andover.net (acquired by VA Linux), Briazz, Genitope, New River Pharmaceuticals, Nogatech, Overstock.com, Peet's Coffee & Tea, Ravenswood Winery, Red Envelope, Salon.com. *See Completed Auctions*, *supra* note 1.

58. *See, e.g.*, Evan Hansen & Jim Hu, *AskJeeves Denounces Paid Inclusion*, CNET NEWS.COM, Jan. 14, 2004, *at* http://news.com.com/Ask+Jeeves+denounces+paid+inclusion/2100-1024_3-5168805.html.

59. *See* Google Inc., *Letter from the Founders: "An Owner's Manual" for Google's Shareholders*, *in* Amendment No. 9 to Forms S-1 Registration Statement Under the Securities Act of 1933, at 27 (filed with the SEC on Aug. 18, 2004) [hereinafter Google Amended Form S-1], *available at* http://www.sec.gov/Archives/edgar/data/1288776/000119312504142742/ds1a.htm; *see also* Securities and Exchange Commission Form 10-Q for Google Inc. (Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Ex-

A. The Google Vision

Larry Page and Sergey Brin sought to make a statement with the Google IPO. They recognized that taking the company public presented a unique opportunity to use an unconventional open IPO model which followed their philosophy and appealed to their users, customers, and potential investors. Page and Brin described their vision in a letter to investors, contained in their Form S-1/prospectus:

> Google is not a conventional company. We do not intend to become one. Throughout Google's evolution as a privately held company, we have managed Google differently. We have also emphasized an atmosphere of creativity and challenge, which has helped us provide unbiased, accurate and free access to information for those who rely on us around the world.[60]

Page and Brin sought to institute a unique, dual-class corporate structure that would preserve managing control for its founders, but still in the long run maintain a stable company for its shareholders, employees, customers, and users. They saw the IPO as an ideal opportunity to extend their long-term goals:

> If opportunities arise that might cause us to sacrifice short term results but are in the best long term interest of our shareholders, *we will take those opportunities*. . . .
>
> . . . .
>
> We will not shy away from high-risk, high-reward projects because of short term earnings pressure. . . .
>
> . . . .
>
> We are creating a corporate structure that is designed for stability over long time horizons. By investing in Google, you are placing an unusual long term bet on [our] team . . . and on our innovative approach.[61]

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change Act of 1934 for the Quarterly Period Ending September 30, 2004) [hereinafter Google 10-Q], *available at* http://investor.google.com/pdf/20040930_10-Q.pdf.

60. Google Inc., *Letter from the Founders: "An Owner's Manual" for Google's Shareholders*, *in* Forms S-1 Registration Statement Under the Securities Act of 1933, at i (filed with the SEC on Apr. 29, 2004) [hereinafter Google S-1 Form], *available at* http://www.sec.gov/Archives/edgar/data/1288776/000119312504073639/ds1.htm.

61. *Id.* at i-iii. In addition, see Google Amended Form S-1, *supra* note 59, at 31:

> It is important to us to have a fair process for our IPO that is inclusive of both small and large investors. It is also crucial that we achieve a good outcome for Google and its current shareholders. This has led us to pursue an auction-based IPO for our entire offering. Our goal is to

Page and Brin also wanted to minimize the speculation, small initial share float, and stock price volatility that plagued technology IPOs in the past. Their goal was to have both the IPO price and aftermarket price reflect an efficient market value set by "rational and informed buyers and sellers."[62] They also wanted to secure a relatively stable stock price in the days following the IPO by offering enough shares to meet investor demand at the time of and after the IPO.[63] There was no guarantee, however, that all interested investors would receive shares.[64]

B. The Google IPO: Process and Metrics

Google's auction and offering took place in five stages, and investors were required to order at least five shares:

1) Qualification: Investors obtained a Bidder ID on www.ipo.google.com, after reading and following the instructions in the prospectus.[65]

2) Bidding: All qualified investors submitted their bids through one of the underwriters, including lead underwriters Morgan Stanley and Credit Suisse First Boston, as well as WR Hambrecht and a syndicate of other investment banks. Investors were required to identify the number of shares they wished to purchase and price per share they were willing to pay.[66]

3) Auction closing: Google reserved the right to close the auction at any time, but investors were allowed to modify, withdraw, and re-enter their bids until they were accepted.[67]

4) Pricing: The bidding process generated a clearing price for the shares of Class A common stock offered in the auction. The clearing price was the highest price at which all of the shares offered could be sold to potential investors, based on bids in the master or-

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have a share price that reflects an efficient market valuation of Google that moves rationally based on changes in our business and the stock market.

62. Google Amended Form S-1, *supra* note 59, at 31.

63. *Id.* Whether the actual IPO price, and aftermarket price, was indeed more stable is somewhat contested. See *infra* Part III.A for further discussion.

64. Google Amended Form S-1, *supra* note 59, at 31. In fact, Google was unable to fill 100% of its pre-IPO orders. See *infra* Part III.B for a discussion on how this affected the outcome of the IPO.

65. Google Amended Form S-1, *supra* note 59, at 34-35.

66. *Id.* at 35-37.

67. *Id.* at 38.

der book that had not been withdrawn or rejected at the time the auction closed.[68]

5) Allocation: Once the IPO price was determined, all investors who submitted successful bids received an allocation of shares at the IPO price. The allocation process did not give any preference to successful bids based on bid price. Google and its underwriters also set a maximum share allocation.[69]

Bidding closed on August 18, 2004, and the offering commenced the next day.

Table 2: Google IPO Metrics[70]

IPO Date:	August 19, 2004
Price:	$85.00
Method:	Modified Dutch Auction[71]
Lead Underwriters:	Morgan Stanley, Credit Suisse First Boston
Stock Symbol:	GOOG
Exchange:	NASDAQ
Number of Shares Offered:	19,605,052
Value of Offering:	$1.67 billion
Initial Market Cap:	$23.1 billion
Total Initial Shares Outstanding:	271.2 million
(33.6 million class A, 237.6 million class B)	
Allocation Percentage:	74.2% of bid shares
Initial SEC Filings:	Form S-1 Prospectus (amended 9/30/04)
	Form 10-Q Quarterly Report (amended 8/18)

68. *Id.* at 38-40.

69. *Id.* at 40-41.

70. Table and data modified from *Initial Public Offering Details*, GOOGLE IPO CENTRAL, *at* http://www.google-ipo.com (last visited Feb. 18, 2005).

71. Google's IPO was a modified Dutch auction: not all 100% of the shares were allocated through the bidding process, and Google retained the ability to adjust the initial share price (in a true Dutch auction, the market would set the price). Some shares were reserved for the Yahoo! Settlement, *see supra* note 8, and another portion was allocated to the underwriters; only about 75% of the shares were offered directly to the investing public. Google agreed to give Yahoo! 2.7 million shares—worth up to $300 million. Yahoo! sold more than 1 million shares, adding to the 24.6 million shares initially offered. *See Google's IPO Rollercoaster*, *supra* note 8; Lohse, *supra* note 8. In its IPO prospectus, Google also reserved the right to change the auction from a pure to modified Dutch auction. *See* Google Form S-1, *supra* note 60.

III. DISCUSSION: THE GOOGLE IPO WAS AN OVERALL SUCCESS

Google's IPO was very lucrative and generally successful, especially considering its unconventional Dutch auction process. Despite various criticisms by observers and initial missteps by the company, Google's modified Dutch auction set a relatively accurate and appropriate price for the offering and satisfied the company's business and cultural goals. The Google IPO also showed that Dutch auction IPOs can work on a large scale. However, Google's success may have been somewhat unique to the circumstances. Thus, most IPOs will likely continue under the traditional model, and a significant rise in Dutch auction IPOs is not expected to occur any time in the near future.

The Google IPO was not without its share of problems, however. The company and its management encountered several hurdles in the weeks leading up to the auction. Among them were allegations of SEC disclosure violations, a re-accounting of and offer to buy back employee stock options (nearly 23 million[72]), and the downward adjustment of its final IPO price estimate (from $108-$135 to $85-$95).[73] Pressure from investment banks and market analysts, along with settlement of a pending patent infringement suit by rival Yahoo!, led Google management to switch to a hybrid, or *modified Dutch auction*. It changed the number of shares offered, and lowered the IPO price to $85 a share. This last-minute price change generated the most controversy in the weeks leading up to the issue.[74]

> . . . Google initially scared individual investors with a price range topping out at $135. "The goal was to get a different mix of shareholders that wouldn't flip the IPO. . . . Instead, it scared

72. Google began repurchasing 23.4 million shares of common stock on November 30, 2004, along with additional options that it may have issued improperly between September 2001 and July 2004. Google also offered to buy back unexercised options on about 5.22 million common shares. Associated Press, *Google to Start Buyback of Shares*, SAN JOSE MERCURY NEWS, Nov. 30, 2004, *available at* http://www.mercurynews.com/mld/mercurynews/news/local/states/california/northern_california/10306197.htm.

73. *See Google's IPO Rollercoaster*, *supra* note 8. Google's initial market capitalization of $23.1 billion (at $85/share) amounted to less than top rival Yahoo!'s valuation of $39 billion at the time. *See Google IPO Priced at $85 a Share*, *supra* note 2. Alleged (but unsubstantiated) disclosure violations included the controversy stemming from a Playboy magazine interview with founders Page and Brin. *See, e.g.*, Associated Press, *Play Boys: Google IPO a Go Anyway*, WIRED NEWS, Aug. 14, 2004, *available at* http://www.wired.com/news/business/0,1367,64588,00.html?tw=wn_story_top5.

74. *See supra* note 73 and accompanying text; *see also* Hu & Olsen, *supra* note 8 (discussing settlement of Yahoo! lawsuit).

> off retail investors and got mostly institutional buyers on the first day [of bidding]. Most individual investors couldn't afford 100 shares." To compound matters, institutional buyers didn't go for the auction system. Scare off retail investors with a high price tag and annoy Wall Street, and you get an auction below your initial price range.[75]

These apparent missteps in the public eye may reflect a level of inexperience with the Dutch auction IPO model, not only on the part of Google management, but also by the investment banks. Moreover, the price adjustments prior to the IPO may reflect uncertainty with respect to pricing: a shift in pricing risk when moving from the traditional IPO model (path dependence) to the Dutch auction (setting an independent price). Market pressure to ensure a first-day "pop" is another plausible explanation.[76] However, the IPO was generally deemed a success by the investing and business communities. Within a month of the IPO, Google's stock price had risen to $117 (on September 21, 2004); at the six-month mark, Google shares traded at $198 (as of February 18, 2005).[77]

A. Pre-IPO Pricing and Post-IPO Trend

Google's modified Dutch auction generated a relatively accurate but flexible initial share price. Many critics argued that Google's hybrid auction was flawed[78] because the company reset the initial price range and allocation of shares after the auction began:

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75. *Lessons from Google's IPO*, KNOWLEDGE@WHARTON, Oct. 20, 2004 (quoting Professor Raffi Amit), *at* http://knowledge.wharton.upenn.edu/index.cfm?fa=viewArticle&id=1036.

76. *See, e.g.*, Dan Gillmor, *Naysayers Are Wrong: Google IPO Was A Success*, Siliconvalley.com, Aug. 20, 2005, *at* http://www.siliconvalley.com/mld/siliconvalley/9449507.htm. *See generally The Buzz on Google's IPO*, KNOWLEDGE@WHARTON, May, 19, 2004 ("Especially for companies where nobody knows what their shares are worth and where different investors might have vastly different opinions of what shares should trade at, a Dutch auction allows companies to raise more money for a given amount of shares because the people [willing to bid the most] for these shares end up getting them the first day. . . . People who buy the Google IPO thinking there will be a first-day pop [in the stock price] will be really disappointed and they might even lose money in the first week or two as speculation gets taken out of [the price of the shares].") (quoting Professor David Croson), *at* http://knowledge.wharton.upenn.edu/index.cfm?fa=viewArticle&id=981.

77. For stock quotes and trends, see, for example, Bloomberg.com, *supra* note 3; Yahoo! Finance, *supra* note 3.

78. *See* Giberson, *supra* note 44 ("Strictly speaking, I wouldn't call the Google process a Dutch auction . . . Google . . . collected information about investor demands and then picked the price at which they wanted to sell at. The price eventually chosen was lower than the price at which quantity demanded would have equaled quantity sup-

> Google substantially reduced the amount of shares offered after the auction had already started. Dutch auctions are supposed to have fixed inventories. Fixing the inventory assures investors that the issuer won't be able to manipulate the clearing price by simply reducing inventory. This is of course exactly what Google did. They . . . cut the size of the offering by 24%.[79]

This flexibility, however, was an advantage of Google's *modified* Dutch auction process, not a weakness. Rather than binding Google to a set offering price as in a traditional IPO, the hybrid auction allowed Google to:

> set a price such that supply equaled . . . investor demand as revealed through the bidding process.
>
> If a Dutch auction allows firms to set a market clearing price, why did the Google price pop from $85 per share to $100.34 per share on the first day of trading on the Nasdaq? . . . [T]he Dutch auction gave Google the ability to set a market clearing price for its shares, [but] the modified Dutch auction as described in the prospectus did not require Google to do so. Google chose to go public at a price with unsatisfied demand.[80]

Google's first-day increase of 18% reflects this unsatisfied demand. However, this increase was not "so great as to encourage and reward 'flipping'

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plied, with the resulting run up in price on the first day. . . . I can see why the company would prefer this approach to a strict Dutch auction, the company is in a better position to maximize the IPO's value to the firm. But would consumers tend to bid lower in a price-discriminator's auction (Google's approach) than they would bid in a strict Dutch auction?").

79. Bill Burnham, *Dutch Auctions and Democracy: Two Things That Don't Make Sense For IPOs*, Sep. 15, 2004, *at* http://billburnham.blogs.com/burnhamsbeat/2004/09/dutch_auctions_.html.

80. Laurie Simon Hodrick, *Google's IPO: A Dutch Auction Works, If You Let It* (Fall 2004), *at* http://www-1.gsb.columbia.edu/hermes/fall2004/article_google.cfm.

in which the stock is sold for a quick profit."[81] The modest increase indicates a lack of volatility in the immediate (first-day) aftermarket.[82]

Google's post-IPO trend, however, suggests a somewhat more volatile stock. Google's stock price increased to $149 on October 21, 2004, when the company announced its third quarter earnings report. Revenues of $503.9 million for Q3 2004 exceeded analyst expectations by 11%.[83] On November 16, Google's second "lockup" period expired,[84] allowing the sale of 38.5 million shares owned by employees and early investors—almost double the 19.6 million shares offered in the IPO. The price subsequently dropped that day by almost 7%—to $172.55, with a trading volume of 21 million shares—considerably higher than the previous daily average of 9 million shares.[85]

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81. Ed Zwirn, *Did Google IPO Invalidate Dutch Auctions?*, CFO.COM, Aug. 23, 2004 ("If in the beginning there were irrational expectations about Google's pricing, that does not reflect adversely on the Dutch-auction process. . . . Despite a bad market, the Google IPO was well priced and the shares were distributed fairly. The Google IPO shows that the market is smarter than any individual investment banker. . . . It appropriately discounted the stock because of risk; there were no hidden balls. Compare the Google offering to so many of the technology IPOs of the late '90s, when in hours or days after its IPO a stock would rocket up to huge multiples of its initial price, or would open at an enormously inflated price only to collapse.") (quoting Bruce Mann), *at* http://www.cfo.com/article.cfm/3122873/c_3122901?f=home_todayinfinance

82. *Id.*

83. "We're very pleased with our performance," noted CEO Eric Schmidt. Michael Liedtke, *Google's Third-Quarter Profit More Than Doubles*, S.F. CHRON., Oct. 21, 2004, *available at* http://sfgate.com/cgi-bin/article.cgi?file=/news/archive/2004/10/21/financial1658EDT0341.DTL; *see also* Paul La Monica, *Gaga for Google*, CNN.COM, Oct. 22, 2004, *at* http://money.cnn.com/2004/10/21/technology/google; Sarah Lacy, *For Google, A White-Knuckle Ride*, BUSINESSWEEK, Nov. 17, 2004, *at* http://www.businessweek.com/bwdaily/dnflash/nov2004/nf20041117_6651_db016.htm.

84. Lockup periods prevent private shareholders (for example, company principals, executives, venture backers) from cashing out immediately after the IPO. Most IPOs have a single lockup period which expires 180 days after the IPO. *See* Rueda, supra note 30, at 30 ("During the lock-up period, certain investors are prohibited from selling their stock in the open market in order to prevent a potential run on the stock and a destabilization of its price."). Google, however, had five staggered lockups. Its first, which expired on Sept. 2, 2004, had little impact—only 4.7 million shares were released; GOOG was up 1.26%, at $101.51. The third, which released 24.9 million shares, expired on Dec. 16, 2004; GOOG was down only 48 cents. The fourth, also 24.9 million shares, took place on Jan. 15, 2005; GOOG actually rose by $3.93 the next trading day. The last, and largest lockup, expired on Feb. 14, 2005, releasing 176.8 million shares. Lacy, *supra* note 83; *see also* Bloomberg.com, *supra* note 3 (for stock quotes and trends); Yahoo! Finance, *supra* note 3 (same).

85. Bloomberg.com, *supra* note 3; Yahoo! Finance, *supra* note 3 (same)

Table 3: Post-IPO Price Trend[86]

	Aug. 19	Sept. 21	Oct. 21	Nov. 16	Dec. 16	Jan. 18	Feb. 3	Feb. 18
Price	$85	$117	$149	$172	$176	$203	$210	$197

Although these figures indicate a general upward trend, as a whole, Google's day-to-day price fluctuations have been greater than recent IPOs.[87] Analysts predicted that Google's last lockup expiration, on February 14, 2005, would lead to further volatility and possible downward pressure on its stock price as more shares would be available on the open market.[88] In the ten trading days prior to the lockup expiration, Google's daily average trading volume rose to 16.3 million shares, which was 65 percent higher than the previous daily average.[89] Indeed, on the morning of February 14, Google shares initially fell by 3.5 percent to $181 when the market opened for trading. The stock rebounded by that afternoon, however. Google stock closed at $192.99—an increase of $5.59 from the previous trading day, with a volume of 38.5 million shares, about 3.6 times its new

86. Table indicates prices at the close of trading. For stock quotes and trends, see, for example, Bloomberg.com, *supra* note 3; Yahoo! Finance, *supra* note 3.

87. Lacy, *supra* note 83 ("[T]he average IPO in 2003 was up 16.9% from its initial price to the lockup expiration. Google's price: up a whopping 103%. The typical IPO traded down 1.8% on its lockup expiration from its price a month earlier . . . [but] Google shares were up 20%. The typical IPO traded down 2.4% on its lockup expiration from its price two weeks earlier, while Google has traded down 11%. . . . In early after-hours trading on Nov. 16, it was already trading back up by 0.38%.").

88. *Id.*; *see also* Reuters, *Investors Focus on Last Google Lockup Expiry*, CNET NEWS.COM, Feb. 11, 2005 ("'It has been a pretty volatile stock,' said Barry Randall, portfolio manager of the $100 million First American Technology Fund, which has a small Google stake. 'I don't feel like the unlocking of shares on Monday adds materially to the risks.'"), *available at* http://news.com.com/Investors+focus+on+last+Google+lockup+expiry/2100-1030_3-5573351.html.

89. Mark Schwanhausser, *Google Insiders Facing Option: Sell Stock Now or Bide Time*, SAN JOSE MERCURY NEWS, Feb. 13, 2005, *at* http://www.mercurynews.com/mld/mercurynews/news/10890006.htm?1c.

daily average of 10.8 million.[90] By the end of that week, Google's price had risen further to $197.95.[91]

Despite any indications of stock volatility, Google's auction process arguably gave a more accurate or appropriate IPO price, as compared to a traditional IPO. Many investment bankers and analysts initially declared the auction a failure, due to the last minute price range adjustment to $85 per share. However,

> Google founders Larry Page and Sergey Brin were more concerned about conducting an offering that was fair to small investors than with getting the highest possible price for the company's shares. "[T]he intent was to find the fairest price, not the highest price [. . .] where everyone, including their very loyal customers, had the right to compete for shares on an equal footing."[92]

By opening up the pricing mechanism to investor bids, the initial share price was more reflective of market demand. Underwriters had less influence in determining the final price outcome. On the demand side, more bidders arguably resulted in a more efficient distribution of Google shares, both at the time of the IPO and in the days immediately following. The lack of volatility in the immediate aftermarket also validates the Dutch auction process as a pricing system.[93]

B. A Democratic IPO, But Not Entirely

There is considerable debate as to whether Google's Dutch auction was truly open to the public. First, Google was unable to satisfy all bids for its shares. Google indeed switched from a pure Dutch auction to a modified version, where successful bidders received only 75% of their re-

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90. *See* Associated Press, *Update 1: Google Shares Rebound After Lockup Expires*, Feb. 14, 2005, *available at* http://www.forbes.com/technology/personaltech/feeds/ap/2005/02/14/ap1825586.html; Eric Hellweg, *Google's St. Valentine's Day Massacre?*, CNN.COM, Feb. 18, 2005, *at* http://money.cnn.com/2005/02/07/technology/techinvestor/hellweg/?cnn=yes; Reuters, *Google Rises Despite Lockup Expiry*, CNN.COM, Feb. 14, 2005, *available at* http://money.cnn.com/2005/02/14/technology/google.reut.

91. $92 was GOOG's closing price on February 18, 2005, with a trading volume of about 8.5 million shares.

92. John Shinal, *Lifting the Google Lid: Leaders of WR Hambrecht Can Finally Talk About IPO*, S.F. CHRON., Sep. 15, 2004 (quoting investment banker Bill Hambrecht), *available at* http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2004/09/15/BUG0F8OUAL1.DTL&type=business.

93. Zwirn, *supra* note 81 (citing Richard Mann).

quested shares.[94] Thus, many skeptics assert that Google's hybrid auction failed to fully democratize the IPO process.[95] The critics blame the complexity of the Dutch auction process for inhibiting access to the average individual investor. However, others disagree and also point to limitations typically placed on small investors by underwriters in traditional IPOs:

> [M]any investors that historically had been precluded from participating in hot IPOs did have the possibility of buying into the Google IPO. While the offer was not accessible to everyone, the limitation on small-investor participation arose at the underwriter level and was based on the underwriters' interpretation of SEC restrictions that protect small investors from making unsuitable investments. The barrier to entry was not the auction's complexity: small investors who were provided with access typically did not find the bidding complicated. Further, the fact that many of the trades on the first day were small lots contradicts the assertion that all small investors were denied access.[96]

Despite criticism of Google's hybrid auction, the fact that "[e]veryone who bid $85 or higher got the shares is a remarkable achievement in a world where hot issues are doled out in a favored way."[97] Instead of catering exclusively to institutional investors, Google management abided strictly by SEC rules, refusing to share any proprietary financial information with fund managers during its road show presentations.[98] Post-IPO interviews suggested that institutional investors were nevertheless satisfied with the results: "We got shares, the shares went up, we're happy,"[99] said one fund manager. Another fund manager was "pleasantly surprised. The investors benefited through this IPO process, even though there was negative sentiment. A lot of that culminated in what the deal was: a fair-market

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94. This suggests that Google used a pro rata percentage allocation method, one of two models disclosed in the IPO prospectus—to be used in the event of a modified rather than pure Dutch auction—whereby investors would receive as many requested shares as possible, should they meet the clearing price. *See* Dawn Kawamoto & Stefanie Olsen, *Google Storms onto Wall Street*, CNET NEWS.COM, Aug. 20, 2004, *at* http://news.zdnet.co.uk/business/0,39020645,39164220,00.htm.

95. *See* Hodrick, *supra* note 80.

96. *Id.*

97. Shinal, *supra* note 92 (quoting Bill Hambrecht).

98. *Id.* ("If they wanted a higher price, they would have treated the big investors with kid gloves. . . . [In an auction], the allocation of shares doesn't depend on what kind of commissions [are generated] for the investment bankers.") (quoting Professor Jay Ritter, University of Florida).

99. Kawamoto & Olsen, *supra* note 94. The fund manager also added that had Google used a pure Dutch auction, its shares would have traded flat after their opening.

price . . . [but] . . . looking back, Google's management and early investors probably think it's less of a success."[100]

On balance, Google's modified Dutch auction was "a compromise between the interests of the bankers and the interests of the company."[101] The hybrid auction allocated as many shares as reasonably possible to the investing public, while also satisfying demand from institutional investors. Because of the size and structure of Google's offering, and the large number of underwriters, Google was able to negotiate a fee of only 2.8%.[102] Had Google used a traditional IPO, lead underwriters Morgan Stanley and Credit Suisse First Boston would have received the largest portion of banking fees—around 7% of the IPO's value.[103]

C. A Financial Success?

The Google IPO is generally regarded as financially successful, at least on the surface.[104] Google raised $1.67 billion through the offering, and its stock price has more than doubled since. Furthermore, despite Google management's highly publicized pre-IPO miscues, the IPO took place without any major problems and received generally favorable press afterwards.[105] Post-IPO reports indicate that the majority of Google insiders and investors were pleased with the results.[106] And partly due to the

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100. *Id.*

101. Shinal, *supra* note 92 ("It wasn't an IPO auction in the purest sense, [but] I think it worked almost in spite of itself.") (quoting Bill Hambrecht); *see also* John Shinal, *Google IPO Achieved Its Major Goal: It's All about Raising Cash for the Company and Rewarding Employees, Early Investors*, S.F. CHRON., Aug. 22, 2004 [hereinafter Shinal, *Google IPO Achieved Its Major Goal*] ("[I]t was really a hybrid auction that was managed in a very intelligent way.") (quoting venture capitalist Richard Kramlich), *available at* http://sfgate.com/cgi-bin/article.cgi?file=/c/a/2004/08/22/BUGCL8BS201.DTL.

102. Gary Rivlin, *After Months of Hoopla, Google Debut Fills the Norm*, N.Y. TIMES, Aug. 20, 2004, *available at* http://nytimes.com/gst/abstract.html?res=F20E12F7345B0C738EDDA10894DC404482&incamp=archive:search.

103. *See* Shinal, *supra* note 36; Rivlin, *supra* note 102.

104. *See, e.g.*, Shinal, *Google IPO Achieved Its Major Goal*, *supra* note 101.

105. Page and Brin's pre-IPO interview in Playboy magazine occurred during the initial post-S-1 quiet period—a potential violation of SEC disclosure rules. The SEC restarted the clock on the quiet period, and then allowed the auction (and issue) to proceed. Management's misaccounting of employee stock options resulted in Google buying back almost 23 million options, and then amending its S-1 to reflect the changes. *See Google's IPO Rollercoaster*, *supra* note 8; *see also supra* note 9 and accompanying text.

106. In a December 1, 2004 interview, Google CEO Eric Schmidt stated that the company was "very proud" of the IPO. He also indicated that despite initial "grumbling about the process, investors were well served. 'In every case, these are the happiest people on the planet.'" Reuters, *Google CEO Proud of Auction-Style IPO*, CNET

IPO's strong performance, Google earned record revenues of $805.9 million for the third quarter of 2004 (up 105% from Q3 2003), and $1.032 billion for the fourth quarter (up 101% from Q4 2003).[107] Google's revenue growth rate is currently outpacing that of Yahoo!, its primary rival.[108] Some industry experts, however, assert that it might be too early to conclude that the Google IPO is an unambiguous success.[109]

NEWS.COM, Dec. 1 2004, *available at* http://news.com.com/Google+CEO+proud+of+auction-style+IPO/2100-1030_3 5473724.html.

107. Financial Release, Google Inc., Google Announces Record Revenues for Fourth Quarter and Fiscal Year 2004 (Feb. 1, 2005), *at* http://investor.google.com/releases/2005 0201.html. The publicity generated by the IPO arguably contributed to strong traffic and advertising growth in both Q3 and Q4 2004. *Id.* ("Google had an exceptional quarter. Revenues and profits increased significantly, our execution was solid across the company and most importantly, our relationship with our users, partners and advertisers became even stronger. . . . All of this happened while we continued to innovate, expand around the world and make strategic, long-term investments.") (quoting Google CEO Eric Schmidt); *see also* Financial Release, Google Inc., Google Announces Record Revenues for Third Quarter 2004 (Oct. 21, 2004), *at* http://investor.google.com/releases/2004Q3.html; Ben Elgin, *Google's First Report Is a Goodie*, BUSINESSWEEK, Oct. 22, 2004, *available at* http://www.businessweek.com/technology/content/oct2004/tc20041022_05-19_tc119.htm. *See generally* Google Press Center, *at* http://www.google.com/press/index.html.

108. Michael Liedtke, *Google Surges to Sevenfold Improvement in Fourth-Quarter Profit*, Associated Press, Feb. 1, 2005, *available at* http://sfgate.com/cgi-bin/article.cgi?f=/news/archive/2005/02/01/financial1630EST0268.DTL. Liedtke writes:

> Google's lofty opinion of itself looks reasonable now, said . . . analyst John Tinker. "Everybody thought they would take the eye off the ball after the IPO, but what they are showing is that they are just getting stronger." . . . [¶] "The model that we have built over the years is working very, very well right now," Google CEO Eric Schmidt . . . . [¶] [Google's] fourth-quarter revenue rose 28 percent from the third quarter, an unusually robust growth rate for a company its size. [¶] . . . Yahoo's fourth-quarter revenue increased 19 percent from the third-quarter. [¶] For all of 2004, Google earned $399.1 million, or $1.46 per share, on revenue of $3.19 billion. In 2003, the company earned $105.6 million, or 41 cents per share, on revenue of $1.47 billion.

Id.

109. See *Lessons from Google's IPO*, KNOWLEDGE@WHARTON, Oct. 20, 2004, *at* http://knowledge.wharton.upenn.edu/index.cfm?fa=viewArticle&id=1036, which states:

> The jury is still out on whether the IPO is a success or not," says . . . professor Raffi Amit. "The fact that Google did a Dutch auction is a good thing. The company managed to float an offering when 10 deals were cancelled in the two weeks before. Google managed an IPO in a soft tech market."
>
> Professor Peter Fader agrees, to a point. He says the way individual investors chased Google like lovelorn puppies the first day of trading is a sign that some folks will never learn. But if they can't remem-

1. *Comparing Google with Recent Dutch Auction IPOs*

Comparing the Google IPO to recent (but smaller) Dutch auction IPOs shows that Google outperformed other companies that chose the Dutch auction route, both in terms of capital raised and first-day pop. These companies include Salon.com (1999), Overstock.com (2002), and New River Pharmaceuticals (August 2004), all of whom used WR Hambrecht's OpenIPO to go public.[110] Table 4 summarizes the figures for the four companies.

Table 4: Google vs. 3 OpenIPOs[111]

	Salon.com[112] (1999)	Over-stock.com[113] (2002)	New River[114] (8/2004)	Google[115] (8/2004)
IPO Price Per Share	$10.50	$13.00	$8	$85

ber lessons from the dot-com boom, maybe they can pick up a few in the aftermath.

See also Hodrick, *supra* note 80.

110. *See Open IPO*, *supra* note 1.

111. Andover.net (1999) also used a Dutch auction IPO. Andover.net experienced a first-day pop of 252%. First-day increases of this magnitude are extremely rare for Dutch auction IPOs. *See* Dawn Kawamoto, *Andover.net Success Boosts OpenIPO Concept*, CNET NEWS.COM, Dec. 13, 1999, *at* http://news.com.com/2100-1040-234289.html?legacy=cnet. See also *IPO Watch: Morningstar in Dutch*, *supra* note 52, which states:

> Since April 1999, there have been 11 IPO Dutch auctions held in the United States . . . . With the exception of two deals, the rest have racked up an average opening-day loss . . . of 0.25 percent. [¶] The two exceptions were: The Google IPO of August 2004 [which] closed its opening day up $15 per share from its initial offering price [and the] Andover.net IPO of December 1999 [which] closed its opening day up 252.1 percent from its initial offering price. [¶] The successful Google bidders at $85 per share got about 75 percent of the stock they bid for . . . . For this to have happened, the deal had to have been priced below its clearing price . . . . That left "orders on the table" and resulted in a big opening-day pop . . . . [¶] There were no reports concerning the allocation of the 1999 Andover.net offering. However, judging from its screaming opening-day pop, the deal had to have been priced below its clearing price.

112. James Surowiecki, *Salon.com Breaks IPO Ground*, SLATE.COM, Jun. 23, 1999, *at* http://slate.msn.com/id/1003073.

113. Clay Corbus, *Changing Behavior: Finding Investors, Not Traders*, WR Hambrecht + Co., July 17, 2002, *at* http://www.wrhambrecht.com/comp/equity/corbus.

114. *IPO Watch: Hanging On*, RedHerring.com, Aug. 10, 2004, *at* http://redherring.com/article.aspx?a=10789&hed=IPO%2BWatch:%2BHanging%2Bon.

115. *See, e.g.*, *Initial Public Offering Details*, *supra* note 70.

Value of Offering	$25M	$39M	$33.6M	$1.67M
First-day Close	$10.00	$13.03	$7.50	$100
Net Change	-4.8%	+0.2%	-6.25%	+18%

These data indicate that Google performed quite well in the immediate (first day) aftermarket. The negligible or negative first-day pops for Salon.com, Overstock.com, and New River Pharmaceuticals suggest that Dutch auctions can indeed reveal more accurate IPO prices.[116] Google's modified, rather than pure, Dutch auction likely explains the modest 18% first-day increase.[117] Google's stock also performed very well in the extended aftermarket, as shown by a near-doubling within three months. New River's stock, however, "flopped" in the aftermarket.[118] Its IPO took place on August 5, 2004—two weeks before Google—and New River stock ended its first week down 11.8% from its opening price.[119]

2. *Comparing Google with Yahoo! and AskJeeves*

Google's Dutch auction IPO achieved a very modest first day pop when compared to the IPOs of two of its competitors—Yahoo! (1996)[120]

116. The lack of a "pop" implies a relatively accurate opening price. Corbus, *supra* note 113 ("We believe the data demonstrate two things: OpenIPO finds the right price and finds the right buyers . . . . The OpenIPO . . . . is designed to find the highest price at which all shares can be sold. This does not necessarily mean that an OpenIPO offering will always get more money for the company, but it will deliver a fair price . . . ."). Andover.net's 252% pop is likely an aberration, as it was only the third company to use WR Hambrecht's OpenIPO.

117. *See* Giberson, *supra* note 44.

118. *IPO Watch: Hanging On*, *supra* note 114. New River Pharmaceuticals is a specialty pharmaceutical company developing safer and better versions of widely prescribed drugs.

119. Jerry Knight, *Google Not the First to Go Dutch*, WASH. POST, Aug. 23, 2004 ("Like Google, New River did not get the price it was seeking in the Dutch auction, taking $8 a share rather than the $10 to $12 it was seeking . . . . New River completed its offering during a week in which 17 IPOs were scheduled and only three were completed. 'But it got done, in a really bad market,' said Bruce Mann . . . one of the creators of the Dutch auction IPO . . . . Mann argues that New River's success in selling stock when other deals were being delayed shows that the Dutch auction process can succeed where conventional IPOs fail."), *at* E01, *available at* http://www.washingtonpost.com/ac2/wp-dyn/A25070-2004Aug22?language=printer.

120. *See* Rose Aguilar, *Yahoo IPO Closes at $33 After $43 Peak*, CNET NEWS.COM, Apr. 12, 1996, *at* http://news.com.com/2100-1033-209413.html?legacy=cnet; *see also Yahoo Set to Go Public at $13*, CNET NEWS.COM, Apr. 11, 1996, *at* http://news.com.com/2100-1033-206991.html?legacy=cnet.

and AskJeeves (1999)[121]—although Google's IPO raised a significantly larger amount of capital. Both Yahoo! and AskJeeves, however, went public utilizing the traditional IPO model, relying on investment banks to publicize and price the stock issue.

Table 5: Yahoo!, AskJeeves, and Google[122]

	Yahoo! (1996)	AskJeeves (1999)	Google (2004)
Type	Traditional IPO	Traditional IPO	Modified Dutch Auction
IPO Price	$13	$14	$85
Value of Offering	$33.8 million (2,600,000 shares @ $13/share)	$42 million (3,000,000 shares @ $14/share)	$1.67 billion (19,605,052 shares @ $85/share)
First-day Pop	$13 to $33 = $20 +154%	$14 to $65 = $51 +364%	$85 to $100 = $15 +18%

The key statistic in Table 5 is the first-day pop. These data reflect two trends: (1) Using a Dutch auction generated less of a pop in the immediate aftermarket, and (2) Google went public in a slower market, which helps explain the smaller increase; but due to its established presence and pre-IPO publicity, it garnered enough interest to offer over 19 million shares worth more than $1.6 billion[123]—a much higher figure than Yahoo! and AskJeeves.

In Google's IPO, individual investors who were able to secure shares at the $85 IPO price did not pay a substantial premium—trader surplus, or alternatively, underwriter payoff. Had Google used a traditional IPO, these investors would have had to wait to purchase shares, by which time the price would have increased, presumably as high as $100. Critics of

121. Tim Richardson, *IPO Bags AskJeeves A Tidy Sum*, REGISTER, Jul. 2, 1999, *at* http://www.theregister.co.uk/1999/07/02/ipo_bags_askjeeves_a_tidy.

122. See sources cited *supra* note 121. *See also* Dawn Kawamoto & Stefanie Olsen, *Google Gets to Wall Street and Lives*, CNET NEWS.COM, Aug. 19, 2004, *at* http://news.com.com/Google+gets+to+Wall+Street--and+lives/2100-1038_3-5317091.html.

123. *See, e.g.*, Steve Gelsi, *Google Delivers Pop Despite Auction*, CBS.MARKETWATCH.COM, Aug. 19, 2004, *at* http://cbs.marketwatch.com/news/story.asp?guid=%7B00D4FA7B-543F-4BD7-B433-97E4779AF61%7D&siteid=google&dist=google.

Google's modified auction argue that Google could have raised more money had they not lowered the initial share price to $85. This implies that Google left "money on the table" and failed to realize the full potential value of the IPO.[124]

All successful bidders benefited from the first day increase of 18%, however. Google management may well have intentionally lowered the IPO price in order to generate more post-IPO upside for investors while also alleviating underwriter concerns about an overpriced issue.[125] Investment banks usually become nervous when an IPO issue trades down on its first day, because "investors sometimes take that as a sign that the stock is 'broken.'"[126] Alternatively, this may indicate that the stock was initially overpriced. Thus, "[a]ny time a stock trades up from the offering on the day of the IPO . . . it's a success . . . . So, if I wear my investment-banking hat, [the Google IPO] was perfectly executed at the end, despite the other wiggles and waggles . . . . If I wear my investor's hat, time will tell if it was successful."[127]

3. *Upside for Google and Its Insiders*

On a purely financial level, Google insiders and venture backers gained the most from the IPO. Founders Page and Brin became billionaires, long-term employees possessing stock and options became millionaires, and venture capital firms Kleiner Perkins Caufield & Byers and Sequoia Capital were in a position to realize a significant return on their initial investments. At the time of the offering, Page and Brin sold nearly 500,000 shares each, and CEO Eric Schmidt sold 369,000 shares; Kleiner Perkins and Sequoia sold none.[128] When the second (90-day) lockup period expired on November 16, 2004,[129] Sequoia and Kleiner Perkins had

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124. Scott Reeves, *Google's Flub, Flop, and Bomb*, FORBES.COM, Sep. 17, 2004, *at* http://www.forbes.com/home/strategies/2004/09/17/cx_sr_0917ipooutlook.html. Had Google opened at $105, it would have raised an additional $390 million ($20 x 19.6 million shares offered).

125. *See generally* Associated Press, *Wait-and-See Outweighs Hype Over Google IPO*, Siliconvalley.com, Jul. 29, 2004, *available at* http://www.siliconvalley.com/mld/siliconvalley/news/9274644.htm?template=contentModules/printstory.jsp.

126. Kawamoto & Olsen, *supra* note 122 (quoting fund manager Bruce Lupatkin).

127. *Id.* Lupatkin also noted that during the late 1990s, traditional IPOs were [under] priced to accommodate a potential 10-15% first-day pop. *Id.*

128. Initial SEC filings had the figures at approximately 500,000 each for Page and Brin, 738,000 for Schmidt, and 2 million each for Kleiner Perkins and Sequoia. *The Amazing Shrinking Google IPO*, CBSMARKETWATCH.COM, Aug. 18, 2004, *at* http://www.cbsnews.com/stories/2004/08/18/tech/main636869.shtml.

129. *See* Lacy, *supra* note 83.

the opportunity to sell shares.[130] By November 26, several Google officers had either sold or announced their plans to sell additional shares.[131] By February 11, 2005—one trading day before Google's last (February 14) lockup expiration—both Sequoia and Kleiner Perkins had "taken steps to enable their investors to cash in more than $5 billion worth of Google stock."[132]

Google as a whole also benefited from the IPO. The IPO generated considerable publicity and additional interest in the company. For example, an investment bank with no underwriting links to Google began research coverage of the company just one day after the IPO. "Typically, underwriters are the first out of the gate with coverage."[133] More importantly, Google's founders and management were able to retain voting control. They accomplished this by restricting the type of shares offered in the IPO: only Class B shares were offered; Class A shares, retained by Google insiders, held all the voting power.[134] This issue structure reflects Page and Brin's stated goals: to preserve Google's corporate culture and long-term prospects for shareholders, employees,[135] customers, and users. Finally, Google management realized the need for continuing innovation in order

130. As of November 16, Sequoia Capital owned 8.7% of Google, worth $4.42 billion. Kleiner Perkins Caufield & Byers owned 7.7%, worth $3.89 billion. *Google May Decline as Restrictions End on Selling Shares*, Bloomberg.com, Nov. 16, 2004, *at* http://bloomberg.com/apps/news?pid=10000103&sid=abhgtZm8TUXM&refer=us.

131. These trades were subject to SEC Rule 10b5-1, which regulates insider trading. Associated Press, *Three Google Executives Sell Shares*, S.F. CHRON., Nov. 26, 2004 ("[T]hree officials, including CFO George Reyes, sold more than 300,000 Class A shares . . . for $162.68 to $168.78 each . . . Company founders Sergey Brin and Larry Page intend to each sell 7.2 million shares, or about 19 percent of their holdings, under Rule 10b5-1 trading plans. CEO Eric Schmidt plans to sell about 2.2 million shares, about 15 percent of his stake in the company."), *at* http://sfgate.com/cgi-bin/article.cgi?f=/news/archive/2004/11/26/financial1139EST0071.DTL.

132. Schwanhausser, *supra* note 89.

133. *Lessons from Google's IPO*, *supra* note 109. Analyst Youssef Squali estimated Google's worth at $115/share. *Id.*

134. *Id.* The prospectus explains Google's Class A and Class B share structure. "[Google's prospectus] was extremely complicated. . . . [It is] clear that the owners didn't want to lose control." *Id.* (quoting Professor Raffi Amit). This was a source of controversy among some investors.

135. *Id.* ("We provide many unusual benefits for our employees, including meals free of charge, doctors and washing machines. We are careful to consider the long-term advantages to the company of these benefits.") (quoting Google prospectus). *See generally* Google Form S-1, *supra* note 60.

to remain the market leader, ahead of Yahoo! and MSN. The IPO raised substantial financial resources to help pursue this objective.[136]

D. Learning From The Google Experience

The Google IPO provides three key insights: (1) Dutch auctions work "if you let them,"[137] but they are not the solution to underpriced IPOs and underwriter payoffs; (2) even successful IPOs can have their share of problems; (3) a significant rise in Dutch auction IPOs is unlikely to occur any time in the near future.

1. Dutch Auctions Can Work, If Executed Properly

If executed properly, Dutch auction IPOs provide an economically efficient pricing and allocation mechanism where share price equals demand.[138] In theory, a true Dutch auction sets a fair market price and allows the issuing company to raise more capital. However, Google's first-day pop of $15 indicates that the auction did not close at the actual market-clearing price. In addition, only 75% of the shares were allocated through the bidding process, and the company retained the ability to adjust the initial share price. In a true Dutch auction, there would have been little or no first-day increase, and the issuer does not change the offering price; only the market does. When compared to many of the technology IPOs of the late 1990s—where the common pattern was either a huge opening pop, or a freefall resulting from an overly inflated opening price—the Google IPO

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136. *See Google's IPO Rollercoaster*, *supra* note 8. Google's current strength is its network of sponsored websites, which bring in traffic and advertising revenue. Google generates most of its income from sponsored links on web searches. Gathering more information about users and making them more loyal to Google's services will help keep Google ahead of Yahoo!. Fending off MSN, however:

> [requires] that . . . Google turn its technology into a new operating system that will run over the Internet rather than on a desktop, making Windows irrelevant. As a first step, Google unveiled Gmail . . . offering huge online storage capacity. The idea is to make money from sending out carefully targeted ads, based on information found in emails. But the service is controversial: privacy advocates have accused Google of Big Brother-style snooping . . . . [¶] [T]he prospect of a battle with Microsoft is not enticing. [Microsoft] has long been adept at copying technologies and then crushing the companies that first developed them. It is also awash with cash. The $1.7 billion that Google has raised from selling a slice of itself on the stock market is small change compared with Microsoft's war chest.

Id.

137. Hodrick, *supra* note 80.

138. *Id; see also* Zwirn, *supra* note 81 (quoting Mann: "[T]he Google IPO was well priced and the shares were distributed fairly").

was much more stable. Those who called Google's auction a failure were usually parties with a vested interest in the traditional system—bankers and high-value investors.[139]

2. *Even Successful IPOs Can Have Problems*

On balance, Google's IPO strengthened its name recognition and company prestige.[140] After the IPO, however, Google's overall image also experienced some negative effects. Many managers and employees became paper millionaires,[141] and a number of Google insiders have since realized a significant profit on their initial investments.[142] Cashing out by insiders and employees could also affect the company's maverick image: "Do-gooders can't get any better by going public. . . . Whenever there's an IPO, people wonder if you are selling out. You can't escape that perception."[143]

Going public also opened up Google's business processes to closer public scrutiny. Management's pre-IPO miscues—the Playboy interview, the announcement of a share/option buyback, and the last minute IPO price adjustment—raised questions about its handling of the IPO.[144] Its

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139. *See* Hodrick, *supra* note 80.

140. *See Lessons from Google's IPO*, *supra* note 109 ("The Google brand needs no introduction . . . . The name, which has become a verb, represents the top destination for searching online, and one of the top destinations on the Web overall.") (quoting analyst Youssef Squali).

141. *Id.* Or billionaires, in Page and Brin's cases. Many Google insiders became "real [millionaires] since they [were] allowed to cash out shortly after the IPO—the company's image took a hit." *Id.* (quoting Professor Peter Fader). Google's lockup provisions allowed the sale of 4.6 million shares 15 days after the IPO, an additional 39.1 million after 90 days, and a total of 260 million after 180 days. *Id.*; *see also* Lacy, *supra* note 83.

142. *See* Schwanhausser, *supra* note 89. During the week of February 7-11, 2005, John Doerr, a Google director and managing partner at Kleiner Perkins, sold 150,000 shares worth about $30 million. *Id.* To purchase their stock options, Google insiders "paid an average of 30 cents in 2000 and $3.67 as recently as 2003." *Id.*; *see also* Reuters, *supra* note 88 ("Google co-founder Sergey Brin and director Ram Shriram, an early investor, also have sold shares under a previously announced executive selling plan."); Hui-yong Yu, *Sequoia Rolls With Google*, BLOOMBERG NEWS, Feb. 12, 2005 ("Sequoia Capital investors are expecting to receive about $3 billion of shares in Google Inc. from the U.S. venture capital firm, the profit from a $12 million investment in the Internet search company six years ago."), *available at* http://www.insidebayarea.com/businessnews/ci_2566063.

143. *See Lessons from Google's IPO*, *supra* note 109 ("Usually, such profits wouldn't be a big deal. But Google claims to be different. In the letter in its prospectus, one of Google's chief tenets is to 'Do no evil.'"); *see also* Google's Form S-1, *supra* note 60.

144. *See Lessons from Google's IPO*, *supra* note 109 ("Google executives [came] off as 'a little naïve.'") (quoting Professor Raffi Amit). Google did not provide institutional

refusal to share proprietary financial information during road show presentations did not help perceptions about the company among bankers and institutional investors. To counter these critiques, and to maintain its reputation, Google management must continue to be innovative, proactive, and assertive: "Ultimately success or failure resides with management [and the founders] . . . You have to put a great deal of faith in their ability to create and execute."[145] This is especially important considering the intense competition from Google rivals Yahoo! and MSN.[146]

3. *A Viable Model for Future IPOs?*

Some market observers believe that Google's IPO sets a new precedent for future U.S. IPOs.[147] For example, Morningstar recently decided to change its IPO from a traditional offering to a Dutch auction.[148] However, Morningstar and Google are different in several key respects, which suggests that there is no guarantee that Morningstar's IPO will be as successful as Google's:

> Although Morningstar is well known in the world's financial circles, it is hardly a household name. [¶] Over the last three years, Morningstar has shown steady revenue growth. That is always a plus. But its business model has not been profitable. That can be a minus. . . . Google [on the other hand] is a household name. Period. [¶] Over the last three years, Google has recorded explo-

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investors with an adequate estimate of future growth and earnings. This lack of financial guidance exposes Google stock to potential volatility. *Id.*; *see also* Shinal, *Google IPO Achieved Its Major Goal*, *supra* note 101.

145. *See Lessons from Google's IPO*, *supra* note 109 (quoting Professor Peter Fader).

146. *See id.* ("Although Google enjoys faster growth and higher profitability, we see several risks to its valuation, which may mean the stock ultimately trades at a discount to its peers.") (quoting analyst Marianne Wolk).

147. Associated Press, *Google Sets Possible Precedent for IPOs*, Aug. 20, 2004, ("No matter where they stood on the success or failure of Google's IPO, most experts and insiders agreed that other companies would attempt IPO auctions in the future, and would try to involve the public to one degree or another. And Wall Street would continue to be, at best, ambivalent about the concept."), *available at* http://abcnews.go.com/wire/Business/ap20040820_1863.html; *see also* Joanna Glasner, *Google IPO Sets Odd Precedent*, WIRED NEWS, Aug. 11, 2004, *at* http://www.wired.com/news/business/0,1367,64508,00.html?tw=wn_story_top5.

148. *See IPO Watch: Morningstar in Dutch*, *supra* note 52. On January 7, 2005, Morningstar announced that it switched underwriters from Morgan Stanley to WR Hambrecht, more than six months after the company initially announced its intent to go public. *Id.*; *see also* Kristen French, *Morningstar Readies Itself for Surprise IPO*, May 6, 2004, http://www.financial-planning.com/pubs/fpi/20040506104.html.

> sive growth in revenues. That is always a plus. And the company's business model has been profitable. That's also a plus.[149]

Thus, although the Google IPO proves that auction IPOs can work for larger companies, most IPOs will likely continue under the traditional model—at least for the time being.[150]

Google's hybrid auction worked because a large number of potential investors knew the company, its strong brand, and sound products. Google's long-term vision, business strategy, and strong corporate culture afforded the company sufficient credibility among the investing public. In addition, the company's strong financials and unique market position provided sufficient negotiating leverage against underwriters and institutional investors. Most companies do not have the resources or leverage to induce investment banks (other than WR Hambrecht) to conduct a Dutch auction IPO. And smaller, lesser-known companies such as New River Pharmaceuticals do not have the name recognition, marketability, or financial resources to garner as much market interest as Google did.[151]

Mass adoption of Dutch auction IPOs is unlikely for another key reason: investment banks would be extremely averse to relinquishing their influence and discretion in offerings, along with associated commissions and transaction fees.[152] Moreover, while Dutch auctions maximize initial share pricing, they do not guarantee "a strong syndicate of stable, long-term shareholders which should be one of the primary goals, if not the primary goal, of any IPO."[153] Yet this does not preclude the future viability of Dutch auction IPOs:

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149. *IPO Watch: Morningstar in Dutch*, *supra* note 52.

150. *See Lessons from Google's IPO*, *supra* note 109 ("I do feel the Dutch auction is the way to go because it's more transparent . . . but I don't see it emerging as a popular method. . . . I'm skeptical about the IPO process in general . . . The IPO process brings out the worst in the stock buying. It's gambling. No matter what the ultimate number Google trades at, it has nothing to do with the value of the firm.") (quoting Professor Peter Fader).

151. Justin Hibbard, *Q&A with Bill Hambrecht: Not Too Many Googles Going On*, BUSINESSWEEK, Sep. 16, 2004, *at* http://www.businessweek.com/bwdaily/dnflash/sep2004/nf20040916_2332_db049.htm. Even Google CEO Eric Schmidt is unsure whether "Google had changed the way IPOs work—responding to an often-asked question in venture capital circles." Reuters, *supra* note 106.

152. Investment banks will very likely maintain their central role in securities offerings, at least until finance, technology, and information-sharing progress to the point where new models (such as the Internet direct public offering) become more common and viable.

153. Burnham, *supra* note 79.

> Had the Google IPO been viewed as an unambiguous success, there is no doubt that it would have been followed by a flood of additional Dutch auction IPOs. Given the controversy now surrounding its outcome, what can we expect in the future? [We] expect to see noteworthy Dutch auction IPOs executed in the future, though at a slower rate of adoption than if the outcome had been an indisputable triumph. . . . [T]he future use of the Dutch auction for IPOs was never predicated on the success of this particular deal.[154]

A potential alternative is to use the Dutch auction model as a non-binding way to improve the IPO pricing process. Instead of only taking share orders, underwriters could ask investors directly regarding their willingness to pay for particular IPO issues, and then make the data available to issuing companies. This is essentially the pricing process that lead underwriters Morgan Stanley and Credit Suisse employed for the Google IPO.[155] This intermediate Dutch auction alternative may also serve "to better educate [issuing companies] about their rights and responsibilities when it comes to determining the issue price and allocating shares."[156] This would require issuers to closely monitor share orders and also determine "which investors they [would] really like to have at their annual meetings."[157]

IV. CONCLUSION

The Google IPO is generally regarded as a success, as it raised nearly $1.7 billion, despite contentions that Google could possibly have made more. The IPO also generated more publicity for Google, strengthening its brand recognition and company prestige. The decision to use a modified Dutch auction complemented Google's vision and long-term strategy: to be innovative and creative, while providing value for its investors, employees, and customers. Private companies considering Dutch auction IPOs should approach them with caution. Companies with strong brand recognition, a sound long-term business plan, and the resources available

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154. Hodrick, *supra* note 80. Google's successful IPO does not necessarily indicate a return of the technology IPO boom. Professor Andrew Metrick reasons that "there are no signs indicating that technology [stocks] will see a renaissance like five years ago, which was clearly an investment bubble." *Tug of War over Tech Stocks: Are They Heading Up, or Down?*, KNOWLEDGE@WHARTON, Nov. 17, 2004, *at* http://knowledge.wharton.upenn.edu/index.cfm?fa=viewArticle&id=1070.

155. Burnham, *supra* note 79.

156. *Id.*

157. *Id.*

to negotiate favorable terms from underwriters and financiers will be in a better position when deciding whether to use a Dutch auction to go public.

SHARE AND SHARE ALIKE: UNDERSTANDING AND ENFORCING OPEN SOURCE AND FREE SOFTWARE LICENSES

By Brian W. Carver

On September 27, 1983, Richard M. Stallman began a software revolution with a post to the Usenet newsgroup,[1] net.unix-wizards.[2] He announced his plan to write a complete software system called GNU that would be compatible with the UNIX computer operating systems in wide use at the time.[3] At the time, Stallman could not have known that the engine of his revolution was not going to be the free software that he and others would write, but a free software license that he would develop to implement his vision, the GNU General Public License (GPL).[4]

This Note describes the history and the commonly used software licensing terms of the free software and open source movements in Parts I and II, respectively. Next, the Note explains the GPL in Part III. Part IV discusses the recent attempts to enforce the GPL. The GPL is a revolu-

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1. Usenet is one of the oldest computer network communications systems still in wide use. Users read and post email-like messages, called articles, to a number of distributed newsgroups. However, whereas email may be used for one-to-one communication, Usenet is a one-to-many medium. *See Usenet*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, *at* http://en.wikipedia.org/wiki/Usenet (last modified Feb. 6, 2005).

2. Initial Announcement, *at* http://www.gnu.org/gnu/initial-announcement.html (last visited Mar. 6, 2005) (posting from Richard M. Stallman, Programmer, MIT Artificial Intelligence Lab, to net.unix-wizards (Sept. 27, 1983)) [hereinafter net.unix-wizard Announcement].

3. *Id.*; *see* David Bennahum, *Interview with Richard Stallman*, MEME 2.04 (1996), *at* http://hammer.prohosting.com/~runlinux/stallman.shtml. UNIX systems are portable, multi-task, and multi-user computer operating systems. On the wide use of UNIX systems at the time, see Marshall Kirk McKusick, *Twenty Years of Berkeley Unix: From AT&T Owned to Freely Redistributable*, *in* OPEN SOURCES: VOICES FROM THE OPEN SOURCE REVOLUTION 31, 36-39 (Chris DiBona et al. eds., 1999) [hereinafter OPEN SOURCES], *available at* http://www.oreilly.com/catalog/opensources/book/kirkmck.html.

4. References herein to the GNU General Public License (GPL) will refer to version 2 of that license unless otherwise indicated. GNU General Public License, *at* http://www.fsf.org/licensing/licenses/gpl.html (last visited Feb. 16, 2005) [hereinafter GNU GPL].

tionary copyright license that has allowed software developers to use existing law to copyright their work, while allowing licensees the freedoms to use, copy, modify, and distribute their work, but not to turn the work into a proprietary derivative. This year brought two notable efforts to enforce the license in court. A district court in Munich, Germany has declared the GPL valid and enforceable. Meanwhile, ongoing litigation between The SCO Group (SCO) and International Business Machines (IBM) may clarify how U.S. courts will interpret the GPL.

I. HISTORICAL BACKGROUND OF THE FREE SOFTWARE AND OPEN SOURCE MOVEMENTS

A. Richard Stallman and the Free Software Foundation

The free software movement traces its beginning to a jammed printer.[5] In the 1970s, while Richard Stallman was working as a programmer at MIT's Artificial Intelligence (AI) lab,[6] the environment surrounding software development was quite different from today.[7] Prior to the appearance of the personal computer in the 1980s, large mainframes with dumb terminals were the norm.[8] In this hardware-driven world, software was an afterthought and was often provided with human-readable source code[9] at no

5. *See* SAM WILLIAMS, FREE AS IN FREEDOM: RICHARD STALLMAN'S CRUSADE FOR FREE SOFTWARE 1-12 (2002), *available at* http://www.oreilly.com/openbook/freedom.

6. While what follows traces the thread of the free software community beginning with Stallman, another segment of the free software community traces its roots to the work done on the Berkeley Software Distribution (BSD), which was an important early UNIX system. That story is ably told by McKusick, *supra* note 3, at 31-46. Today BSD development continues under a free software license of the same name, the Modified BSD license, primarily through the efforts of the FreeBSD, NetBSD, and OpenBSD projects.

7. *See generally* STEVEN LEVY, HACKERS: HEROES OF THE COMPUTER REVOLUTION (Updated ed. 2001).

8. For an account of working with some of the earliest computers, such as the UNIVAC and UNIVAC II, see DAVID E. LUNDSTROM, A FEW GOOD MEN FROM UNIVAC (1987). A "dumb" terminal is merely a display and keyboard with little or no independent processing ability that allows one to connect to a remote server or mainframe.

9. WILLIAMS, *supra* note 5, at 1-12; Ira V. Heffan, Note, *Copyleft: Licensing Collaborative Works in the Digital Age*, 49 STAN. L. REV. 1487, 1492-93 (1997). A binary is an executable file read by the computer. The source code, in contrast, is human-readable, and the normal means by which developers interact with software.

additional cost, with the purchase of the machines. Software was rarely sold separately.[10]

In this environment, Stallman was free to solve a problem the lab faced with sharing a centralized printer—paper jams. With access to the printer's source code, Stallman was able to improvise a solution by modifying the printer software to send everyone a message any time the printer jammed. Anyone who was hoping to receive a printout would then know to go fix the problem.[11]

However, the AI lab received a new Xerox printer that did not include the source code, so Stallman could not implement a similar fix without that source code. When Stallman visited a professor whom he knew had worked on the printer in question, he requested the source code. But the professor could not give it to Stallman because the professor had signed a nondisclosure agreement with Xerox.[12]

Stallman was stunned. While not the first time Stallman had encountered proprietary software, he marks it as a turning point.[13] Stallman embraced the culture of sharing that had developed around software.[14] From his perspective, it was a sharing with no losers, because the digital nature of software enables one to share perfect copies without relinquishing the original.[15] Hence, to the extent the law allows, you ought always to share software.[16] To do otherwise, according to Stallman, was unethical and a violation of "the golden rule."[17]

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10. WILLIAMS, *supra* note 5, at 4. For another helpful history of this period, see Eric S. Raymond, *A Brief History of Hackerdom*, *in* OPEN SOURCES, *supra* note 3, at 19-30, *available at* http://www.oreilly.com/catalog/opensources/book/raymond.html.

11. WILLIAMS, *supra* note 5, at 1-5.

12. *Id.* at 4-9.

13. *Id.* at 10. In free software and open source circles, "proprietary software" means something closer to "software for which no access to the source code is provided." It does not mean what many attorneys might first assume, namely, "owned software" or "copyrighted software" for, as discussed later, free software is also owned and copyrighted. *See* Jonathan Zittrain, *Normative Principles for Evaluating Free and Proprietary Software*, 71 U. CHI. L. REV. 265, 271 (2004) ("Releasing the object code without the source code has been a hallmark of proprietary software, complementing the creator's exercise of a legal right to prevent the use of source code in new works with a technical barrier to unauthorized use.").

14. WILLIAMS, *supra* note 5, at 5, 12.

15. *Id.* at 5.

16. *Id.* Stallman does not advocate breaking the copyright laws to share software. Rather, he has used copyright law through the GPL to achieve the goal of the widespread sharing of software.

17. *Id.* at 12. Stallman wrote:

Stallman recognized a trend that was changing software culture.[18] Fellow programmers were joining companies that were asking them to sign nondisclosure agreements.[19] Stallman's solution was to create a computing environment, an operating system, where he could guarantee that the source code would always be available.[20] At that time, UNIX systems were the standard and so Stallman wanted to write a compatible operating system.[21] He called it "GNU" (pronounced *guh-noo*), a recursive acronym for GNU's Not UNIX.[22]

Stallman was concerned that his employer might try to claim the work he did on his new GNU system, so he quit his job to guarantee himself control over his code.[23] He soon founded the Free Software Foundation (FSF),[24] now a world-wide organization advocating the freedoms Stallman believes all software users should have.[25] While working on the GNU system, Stallman experimented with different copyright licenses, each designed to maximize sharing of and access to the source code.[26] By February 1989, these licenses had evolved into the first version of the GNU General Public License.[27]

> I consider that the golden rule requires that if I like a program I must share it with other people who like it. I cannot in good conscience sign a nondisclosure agreement or a software license agreement.
>
> So that I can continue to use computers without violating my principles, I have decided to put together a sufficient body of free software so that I will be able to get along without any software that is not free.

net.unix-wizards Announcement, *supra* note 2.

18. *Id.*

19. *Id.* at 11; Richard Stallman, *The GNU Operating System and the Free Software Movement*, *in* OPEN SOURCES, *supra* note 3, at 53, 53-56, *available at* http://www.oreilly.com/catalog/opensources/book/stallman.html.

20. net.unix-wizards Announcement, *supra* note 2.

21. *Id.*; Bennahum, *supra* note 3.

22. The GNU Operating System, *at* http://www.gnu.org (last updated Feb. 26, 2005); *see also* The Free Software Foundation, *at* http://www.fsf.org/index.html (last visited Feb. 16, 2005).

23. WILLIAMS, *supra* note 5, at 102; Stallman, *supra* note 19, at 57.

24. WILLIAMS, *supra* note 5, at 106; The Free Software Foundation, *supra* note 22.

25. The Free Software Foundation, *supra* note 22; *Free Software Foundation Europe*, Free Software Foundation, *at* http://www.fsfeurope.org (last visited Feb. 16, 2005); *Free Software Foundation of India*, Free Software Foundation, *at* http://www.fsf.org.in (last modified Feb. 9, 2005); *Free Software Foundation France*, FSF France, *at* http://www.fsffrance.org (last updated Oct. 22, 2003).

26. WILLIAMS, *supra* note 5, at 124.

27. *Id.* at 126. Version 1 of the GNU GPL, which has since been superseded by Version 2, is available at *GNU General Public License Version 1*, *at* http://www.gnu.org/

B. The GNU General Public License

Stallman's work on various GNU programs was critical to the project's continuing development, but it was the unique copyright license he developed that would prove to have the greatest influence on the free software movement. Currently, two of the most prominent online repositories of free software, freshmeat.net and SourceForge.net, have 68% and 69% respectively of their software licensed under the GPL. The next most commonly-used free software license only garners between a 6-11% share.[28] The features of the GPL that most prominently contributed to its widespread adoption were the license's motivating philosophy of software freedom, the fact that most software available under the license was available at no cost,[29] and most importantly, that the license's reciprocal nature encouraged further use of the license.

First, the philosophy Stallman outlined, now embodied in the Free Software Definition, appealed to many software developers and users just as the Internet was enabling this disparate group to collaborate across previously insurmountable distances.[30] Many believed that source code should be available for copying, modification, and subsequent distribution

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copyleft/copying-1.0.html (last modified Feb. 12, 2001). There are other "General Public Licenses" such as the Affero GPL. *Affero General Public License*, *at* http://www.affero.org/oagpl.html (last visited Feb. 16, 2005). To avoid confusion, reference to the "GPL" will mean the GNU GPL Version 2. For further information on the GPL and especially on other licenses, see ROD DIXON, OPEN SOURCE SOFTWARE LAW (2003); LAWRENCE ROSEN, OPEN SOURCE LICENSING: SOFTWARE FREEDOM AND INTELLECTUAL PROPERTY LAW (2004); ANDREW M. ST. LAURENT, UNDERSTANDING OPEN SOURCE AND FREE SOFTWARE LICENSING, (2004), *available at* http://www.oreilly.com/catalog/osfreesoft/book.

28. As of February 2005, over 68% of the projects at freshmeat.net were licensed under the GPL. *See freshmeat.net: Statistics and Top 20*, *at* http://freshmeat.net/stats (last visited Mar. 17, 2005). At SourceForge.net, of projects having OSI-approved licenses, over 69% were GPL. *See SourceForge.net: Software Map*, *at* http://sourceforge.net/softwaremap/trove_list.php?form_cat=13 (last visited Feb.8, 2005) (showing 59,837 projects under OSI-approved licenses as of Feb. 8, 2005), and *at* http://sourceforge.net/softwaremap/trove_list.php?form_cat=14 (last visited Feb. 8) (showing 41,445 projects licensed under the GPL and 6,670 under the LGPL as of Feb. 8, 2005). OSI is the Open Source Initiative that will be discussed below in Part I C. The next most commonly-used license, after the GPL, at freshmeat.net was the GNU Lesser General Public License (LGPL) at under 6%. *See freshmeat.net*, *supra*. At SourceForge.net, of projects having OSI-approved licenses, the LGPL was the next most-used license, after the GPL, and the LGPL constituted just over 11%. *See SourceForge.net*, *supra*.

29. It is critical to distinguish between "free" in the sense of "freedom" and "free" in the sense of "no cost." Free software, to be free software, must be free in the former sense, but is often not free in the latter sense. *See* Stallman, *supra* note 19, at 56-57.

30. *Id.* at 56, 60.

in order to facilitate innovation and improvements with and within the software.[31] Second, software licensed under the GPL was usually provided at no cost or at a very low cost to cover the expense of the transfer.[32] Not surprisingly, quality software available at no cost attracted significant attention. Finally, the minimal barriers to acquiring and modifying the software generated their intended effect: improved versions of the software, which in turn attracted more users and developers.[33] The GPL's requirement that any distributed modifications must themselves be licensed under the GPL also helped to perpetuate both the license and the underlying software.[34] This self-perpetuating feature of the GPL is its most unique feature and is likely primarily responsible for its widespread adoption.

C. The Open Source Initiative

While Stallman started a social movement based upon an ethical conviction, others found that providing source code to users and developers had other more practical advantages.[35] In January 1998, Netscape announced its decision to release the source code to its web browser, Navigator.[36] The binary form of Netscape's browser had been available for download, at no cost for non-commercial uses, since its inception in 1994, but the underlying source code had never been so provided.[37] The promise of browser-based applications had led to "the browser wars" and by 1998

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31. See STEVEN WEBER, THE SUCCESS OF OPEN SOURCE 116 (2004), stating that:

> This is not to say that creating the open source definition signed away anyone's belief in or commitment to the underlying 'good' of the process. Many developers believe as strongly as ever that their values around cooperation and sharing in knowledge production are the fundamental reasons why they do what they do.

32. Stallman notes that he used to charge $150 for a copy of his EMACS software as a way to support himself, but he encouraged those who received such copies to share their copies with others. *See* Stallman, *supra* note 19, at 58.

33. *Id.* at 62, 66.

34. The GPL also requires that a copy (digital or otherwise) of the license's text itself be included with any software distributed under the GPL. GNU GPL, *supra* note 4, at Section 1. While the stated purpose of this requirement is to inform users of their rights and responsibilities regarding the software, it also serves to perpetuate knowledge of the GPL itself.

35. This is best summarized in ERIC RAYMOND, THE CATHEDRAL AND THE BAZAAR: MUSINGS ON LINUX AND OPEN SOURCE BY AN ACCIDENTAL REVOLUTIONARY (1999), *available at* http://www.catb.org/~esr/writings/cathedral-bazaar/cathedral-bazaar.

36. For one version of this story, see Jim Hamerly et al., *Freeing the Source: The Story of Mozilla*, *in* OPEN SOURCES, *supra* note 3, at 197-206, *available at* http://www.oreilly.com/catalog/opensources/book/netrev.html.

37. *See Browser Wars*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, *at* http://en.wikipedia.org/wiki/Browser_wars (last modified Feb. 3, 2005).

Microsoft's Internet Explorer web browser had surpassed Navigator's market share.[38] Netscape's announcement cited as the rationale for releasing the source code the ability "to harness the creative power of thousands of programmers on the Internet by incorporating their best enhancements into future versions" of Netscape's software.[39]

Hoping to capitalize on Netscape's move, a group of free software developers and advocates met to address a perceived problem with the *free software* label.[40] They believed that businesses were not embracing the term or the philosophy because of the word *free*. While Stallman and the FSF explained that they meant *free as in freedom*; it also inevitably suggested *free as in no cost*.[41] Businesses and investors rarely understood the intended meaning and wrongly assumed that all free software had to be provided at no cost.[42]

One of the meeting's attendees, Eric Raymond, had popularized the practical benefits of Linus Torvalds' development process for the Linux kernel and of the free software development process generally.[43] Raymond

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38. *Id.*

39. *See* Press Release, Netscape Communications Corp., *Netscape Announces Plans to Make Next-Generation Communicator Source Code Available Free on the Net* (Jan. 22, 1998), *at* http://wp.netscape.com/newsref/pr/newsrelease558.html.

40. *History of the OSI*, Open Source Initiative, *at* http://www.opensource.org/docs/history.php (last visited Mar. 6, 2005) ("The people present included Todd Anderson, Chris[tine] Peterson (of the Foresight Institute), John "maddog" Hall and Larry Augustin (both of Linux International), Sam Ockman (of the Silicon Valley Linux User's Group), and Eric Raymond.").

41. Stallman has famously quipped, "To understand the concept, you should think of 'free' as in 'free speech,' not as in 'free beer.'" *The Free Software Definition*, Free Software Foundation, *at* http://www.fsf.org/licensing/essays/free-sw.html (last modified Feb. 12, 2005).

42. On the contrary, the GPL itself speaks of when you "distribute copies of such a program, whether gratis or for a fee." GNU GPL, *supra* note 4, at Preamble, and says "You may charge a fee for the physical act of transferring a copy, and you may at your option offer warranty protection in exchange for a fee." *Id.* at Section 1. License fees are more complicated. *Frequently Asked Questions About the GNU GPL*, *at* http://www.fsf.org/licensing/licenses/gpl-faq.html#TOCDoesTheGPLRequireAvailabilityToPublic (last visited Feb. 16, 2005), explains that you could technically charge a licensing fee, but "if someone pays your fee and gets a copy, the GPL gives them the freedom to release it to the public, with or without a fee. For example, someone could pay your fee, and then put her copy on a web site for the general public." Consequently, software under the GPL is often not a source of recurring licensing fees. More likely, and allowed, are fees for distribution, service, warranty protection, and indemnification.

43. *See* RAYMOND, *supra* note 35. A "kernel" is the core of an operating system that controls the accessing of the hardware by other programs. *See Kernel (computer science)*, WIKIPEDIA: THE FREE ENCYCLOPEDIA *at* http://en.wikipedia.org/wiki/Kernel_(computer_science) (last modified Feb. 14, 2005). The Linux kernel can be added to the

noted the benefits of a collaborative environment involving freely available source code, including the ability to find and fix bugs more quickly.[44] Raymond and others saw that Netscape was going to release its source code for these same pragmatic business reasons, and indeed Netscape informed Raymond that his views had been influential in its decision.[45] To encourage other businesses to see these advantages, a new label for such software was sought.[46] The term "open source" was suggested and adopted, as well as an Open Source Definition, written by Bruce Perens, which defines what counts as open source software.[47] The Open Source Initiative (OSI), a California public benefit corporation, was founded to oversee the definition and to promote understanding of the various open source licenses.[48] The adoption of the phrase "open source" has been extremely effective.[49]

II. UNDERSTANDING OPEN SOURCE AND FREE SOFTWARE LICENSES

A. Comparing the Free Software Definition and the Open Source Definition

Richard Stallman and the FSF have taken a stand against the "open source" label because in their view it minimizes the most important part of the concept: the user's freedom.[50] Consequently, what the FSF considers a "free software" license is based on the Free Software Definition,[51] while what the OSI considers an "open source" license is based on the Open Source Definition.[52]

GNU tools developed by Stallman's GNU Project, along with other free software, to create a complete free software operating system, called GNU/Linux. For more on Torvalds and the development of the Linux kernel, see LINUS TORVALDS & DAVID DIAMOND, JUST FOR FUN: THE STORY OF AN ACCIDENTAL REVOLUTIONARY (2001).

44. RAYMOND, *supra* note 35.

45. *Id.* at 61-63.

46. *History of the OSI*, *supra* note 40.

47. *See id.*; Bruce Perens, *The Open Source Definition*, in OPEN SOURCES, *supra* note 3, at 171-188, *available at* http://www.oreilly.com/catalog/opensources/book/perens.html; *The Open Source Definition*, Open Source Initiative, *at* http://www.opensource.org/docs/definition.php (last visited Feb. 16, 2005).

48. *History of the OSI*, *supra* note 40.

49. *See, e.g.*, Eric Raymond, *A Fan of Freedom: Thoughts on the Biography of RMS* (Nov. 11, 2003), *at* http://www.catb.org/~esr/writings/rms-bio.html.

50. *Why "Free Software" Is Better Than "Open Source"*, *at* http://www.gnu.org/philosophy/free-software-for-freedom.html (last updated Oct. 6, 2004).

51. *The Free Software Definition*, *supra* note 41.

52. *The Open Source Definition*, *supra* note 47.

The Free Software Definition is largely comprised of the four freedoms:

> 0. The freedom to run the program, for any purpose.
> 1. The freedom to study how the program works, and adapt it to your needs. Access to the source code is a precondition for this.
> 2. The freedom to redistribute copies so you can help your neighbor.
> 3. The freedom to improve the program, and release your improvements to the public, so that the whole community benefits. Access to the source code is a precondition for this.[53]

In contrast, the Open Source Definition contains ten criteria, requiring, among other things, free redistribution rights, access to source code, permission to modify and distribute modifications, and forbidding discrimination against persons, groups, or fields of endeavor.[54] The first criterion reads:

> 1. Free Redistribution
>
> The license shall not restrict any party from selling or giving away the software as a component of an aggregate software distribution containing programs from several different sources. The license shall not require a royalty or other fee for such sale.[55]

This is indicative of the style of the other nine criteria. In general, the Open Source Definition is more detailed than the Free Software Definition

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53. *The Free Software Definition*, *supra* note 41. The text following the four freedoms is equally important to predicting what the FSF will consider a free software license.

54. There are several other requirements. *See The Open Source Definition*, *supra* note 47. References to the Open Source Definition will mean version 1.9, the most recent incarnation as of this writing. The Open Source Definition was adapted from the Debian Free Software Guidelines, also written by Bruce Perens, mainly by removing references to Debian. *See Debian Social Contract, Version 1.0*, Debian Project, *at* http://www.debian.org/social_contract.1.0 (last modified Mar. 3, 2005). "The Debian Project is an association of individuals who have made common cause to create a free operating system. [The] operating system that [they] have created is called Debian GNU/Linux, or simply Debian for short." *About Debian*, Debian Project, *at* http://www.debian.org/intro/about (last modified Mar. 4, 2005). Debian GNU/Linux is one of the most popular and widely-used GNU/Linux distributions and is used as a starting point or basis for many other popular distributions. The readers of Linux Journal magazine have voted Debian GNU/Linux their favorite distribution in both 2003 and 2004. *2004 Reader's Choice Awards*, LINUX J., Nov. 2004, at 80, *available at* http://www.linuxjournal.com/article/7724. Debian-based distributions include KNOPPIX, Libranet, Linspire, MEPIS, Ubuntu, and Xandros. *Software Distributions Based on Debian*, Debian Project, *at* http://www.debian.org/misc/children-distros (last modified Mar. 4, 2005).

55. *The Open Source Definition*, *supra* note 47. Read carefully, distributing copies of a program for a fee is *allowed*, but a royalty cannot be *required*.

and arguably provides clearer direction to those hoping to write a software license about what features such a license should and should not contain.[56]

Software licensed under the GPL, such as the Linux kernel, satisfies both definitions and hence may accurately be called both "free software" and "open source" software. Indeed, the vast majority of Free Software and Open Source licenses satisfy both definitions, however, this is not always the case.[57] However, this is not always the case.

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56. In defense of the Free Software Definition, the four freedoms are not the entirety of the definition. The FSF provides explanatory text that, while not organized into ten bullet points, provides explanations that give further guidance as to what the four freedoms must entail. *See The Free Software Definition*, *supra* note 41.

57. Another license often used in the free software community, the Modified BSD license, also satisfies both the Open Source Definition and the Free Software Definition. *See The Approved Licenses*, Open Source Initiative, *at* http://www.opensource.org/licenses (last visited Mar. 6, 2005); *The BSD License (in template form)*, *at* Open Source Initiative, http://www.opensource.org/licenses/bsd-license.php (last visited Mar. 6, 2005); *Various Licenses and Comments About Them*, Free Software Foundation, *at* http://www.fsf.org/licensing/licenses/license-list.html (last modified Feb. 28, 2005). "Free software" licenses could likely be a subset of open source licenses if someone were to take the time to apply to OSI to receive approval to use the "open source" appellation for the already FSF-approved free software licenses.

While occasionally the disagreements between the OSI and the FSF are disputes about which words will best promote the same goals, sometimes the disagreements go deeper and result in substantively different stances. This is best illustrated through an example where the two groups reached a different conclusion about the same license. When Apple Computer released its Apple Public Source License 1.0 (APSL) neither the FSF nor the OSI felt it satisfied their definitions and both groups voiced their concerns. For the FSF's complaints on APSL versions 1.0, 1.1, and 1.2 see *The Problems with Older Versions of the Apple Public Source License*, *at* http://www.gnu.org/philosophy/historical-apsl.html (last modified May 21, 2004). Members of the open source community, were led by Bruce Perens. *See The Apple Public Source License – Our Concerns*, *at* http://www.perens.com/Articles/APSL.html (last modified Oct. 11, 2000). Apple responded to some of these concerns, and the OSI approved APSL 1.1 and 1.2 as open source licenses. *See The Apple Public Source License Ver. 1.2*, *at* http://www.opensource.org/licenses/apsl.php (last visited Feb. 16, 2005). Apple's changes did not initially fully satisfy the FSF, so while the OSI approved APSL 1.1 and 1.2 as "open source" the FSF did not consider them "free software." Apple apparently took the FSF's remaining concerns seriously as it modified the license yet again. *See Apple Public Source License Version 2.0*, *at* http://www.opensource.apple.com/apsl (last visited Feb. 16, 2005). When Apple announced APSL 2.0, which incorporated the changes, it trumpeted the fact that the license was now an FSF-approved free software license. *Apple Public Source License 2.0 Now a "Free Software License"* (July 29, 2003), *at* http://www.opensource.apple.com/news/2.0-announce.html. OSI certification carries some tangible benefits, but the adoption of APSL 2.0 seems driven primarily by the FSF's concerns. Why would Apple care enough to make such changes? The answer lies in the goals that businesses, such as Apple, have in their "open source" strategy. The primary business benefit of releasing source code to the public is the resulting access to a community of users and developers

B. Classifying Software Licenses: Copyleft and GPL-Compatibility

There are several features of a software license that can be useful in classifying it. First, a license may be a proprietary license, a free software license, or an open source license. Secondly, within free software and open source licenses, the license might also be a copyleft, or reciprocal, license. A copyleft license requires that any derivative work made from the copyleft-licensed work be itself licensed under the same copyleft license, preserving all the same rights and responsibilities the original licensee had to downstream licensees.[58] Third, it is useful to classify licenses according to whether they are compatible with the GPL, since it is the most widely-used free software license. A license is "compatible" with the GPL if that license allows licensees to combine a module that was released under that license with a GPL-covered module to make one larger program.[59] Note that neither the Free Software Definition nor the Open

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who freely contribute back to the project. Businesses that fail to understand or refuse to respect that community do not receive that benefit to as great an extent. While this community contains many who find the FSF's ethical stands out of place in what they see as the practical world of software development, there are also many who agree with and adhere to the FSF's positions. *See e.g.*, JOACHIM HENKEL & MARK TINS, MUNICH/MIT SURVEY: DEVELOPMENT OF EMBEDDED LINUX (2004) (surveying developers working on embedded platforms), *at* http://www.linuxdevices.com/files/misc/MunichMIT-Survey_Embedded_Linux.pdf; INTERNATIONAL INSTITUTE OF INFONOMICS ET. AL., FREE/LIBRE AND OPEN SOURCE SOFTWARE: SURVEY AND STUDY FLOSS FINAL REPORT, Part IV: Survey of Developers (2002), *at* http://www.infonomics.nl/FLOSS/report. In a community where one's standing is built in large part on reputation and respect, one ignores the views of the FSF and its adherents at one's peril. Apple understood this and its press release said, "We are grateful to Richard Stallman for his many helpful comments in this process." *APSL 2.0 Announcement*, *supra*.

58. *See* Heffan, *supra* note 10, at 1491. Copyleft licenses can also be called licenses with a "share alike" clause, because while the licensor allows you to share both the original work and your own modifications, the licensor requires that you share alike, that is, that you offer the same terms to others that were offered to you. Some Creative Commons licenses use such "share alike" terms for copyrighted works other than software, such as photographs or sound recordings. *Licenses Explained*, Creative Commons, *at* http://creativecommons.org/learn/licenses (last visited Mar. 6, 2005). The GPL's copyleft provision is found primarily in Section 2(b) which reads, "You must cause any work that you distribute or publish, that in whole or in part contains or is derived from the Program or any part thereof, to be licensed as a whole at no charge to all third parties under the terms of this License." GNU GPL, *supra* note 34, at Section 2(b). This does not rule out the possibility of dual, triple, or even *n*-tuple licensing schemes, wherein a work is licensed under the GPL as well as under some other license(s). *See infra* note 103 (discussing example of MySQL).

59. Various Licenses and Comments About Them, *supra* note 57 *at* http://www.fsf.org/licensing/licenses/license-list.html#Introduction.

Source Definition requires a license to be either a copyleft license or to be GPL-compatible in order to qualify as a free software or open source license, respectively.[60] Access to source code and the freedoms to use and modify that code are distinct issues, separable from copyleft status or GPL-compatibility.

Proprietary	© All Rights Reserved	Permission from copyright-holder required to copy, modify or distribute covered software. No access to source code. Examples: Licenses for Adobe's Photoshop or Intuit's TurboTax.
Open Source Free Software	© Some Rights Reserved	Permission is granted to copy, modify, and distribute the software under the license's terms. Copyleft and non-copyleft licenses exist. For both, one must provide access to the source code. Distributing copies for a fee must be allowed, but a royalty cannot be required. Licenses may be GPL-compatible or not.[61]
		Copyleft: derivative works allowed only under same license. License example: GNU GPL; Software example: Linux kernel
		Non-copyleft: derivative works under different licenses allowed. License example: Modified BSD[62]; Software example: OpenSSH
Public Domain	No copyrights	Everyone is free to copy, modify, or distribute, such software without asking permission from anyone. Almost no software has reached the end of its copyright term, but some code has been donated to the public domain, fails the statutory originality requirement, or was written by the U.S. Government, which generally cannot receive copyrights.[63]

60. *The Free Software Definition*, *supra* note 41; *The Open Source Definition*, *supra* note 47.

61. The FSF maintains a list of licenses that are compatible with the GPL. *Various Licenses and Comments About Them*, *supra* note 57, *at* http://www.fsf.org/licensing/licenses/license-list.html#GPLCompatibleLicenses.

62. *The BSD License (in template form)*, *supra* note 57. The FSF calls it the Modified BSD License while the OSI calls it the New BSD License. It is the same license. It is "New" and "Modified" because it no longer contains the "advertising clause." *See Letter of William Hoskins to All Licensees, Distributors of Any Version of BSD* (July 22, 1999), *at* ftp://ftp.cs.berkeley.edu/pub/4bsd/README.Impt.License.Change.

63. 17 U.S.C. § 105 (2000) ("Copyright protection under this title is not available for any work of the United States Government, but the United States Government is not

As summarized in the chart, the disputes about terminology belie underlying agreement about the nature of the most widely-used licenses in both categories. However, both groups accept that the GPL satisfies their respective definitions and so it is accurately called either an "open source" or a "free software" license.

III. THE GNU GENERAL PUBLIC LICENSE

A. Key License Terms

The Preamble to the GPL is indicative of its intended audience. While the GPL is a legal document and a copyright license, it is not written primarily with a legal audience in mind. Instead, Stallman intended software developers to use this license on their software and for software users to think about software freedoms.[64] Consequently, the GPL is written in clear language that anyone can understand.[65] The Preamble concisely explains the FSF's philosophy and the key terms of the license, which are specified in detail later.[66]

1. Copyleft

The GPL's Preamble explains the notion of copyleft without introducing the term.[67] Instead the Preamble states that if you distribute copies of a program licensed under the GPL, "you must give the recipients all the rights that you have."[68] This explains the idea behind copyleft: Something, in this case, software, will be shared with you and you must share alike. Copyleft software is copyrighted, and, indeed, the exclusive rights provided by copyright enable a copyleft license to impose the share alike pro-

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precluded from receiving and holding copyrights transferred to it by assignment, bequest, or otherwise.").

64. *See* GNU GPL, *supra* note 34, at Preamble ("You can apply it to your programs, too."); *id.* at "How to Apply These Terms to Your New Programs." The FSF intends the GPL to be a mere license and not a contract. *See* Eben Moglen, *Freeing the Mind: Free Software and the Death of Proprietary Culture*, 56 ME. L. REV. 1, 6 (2004) ("[The GPL] requires no acceptance. It requires no contractual obligation. It says you are permitted to do, just don't try to reduce anybody else's rights."); Pamela Jones, *The GPL Is a License, Not a Contract, Which Is Why the Sky Isn't Falling* (Dec. 14, 2003), *at* http://www.groklaw.net/article.php?story=20031214210634851; Eben Moglen, *Enforcing the GPL* (Sept. 10, 2001) [hereinafter Moglen, *Enforcing the GPL*], *at* http://www.gnu.org/philosophy/enforcing-gpl.html.

65. *See* Daniel Ravicher, *Facilitating Collaborative Software Development: The Enforceability of Mass-Market Public Software Licenses*, 5 VA. J.L. & TECH. 11 (2000).

66. *See* GNU GPL, *supra* note 34, at Preamble.

67. *Id.*

68. *Id.*

vision on licensees. Copyleft achieves a purpose specified in the Preamble, "To protect your rights, we need to make restrictions that forbid anyone to deny you these rights or to ask you to surrender the rights."[69] Licensees are restricted from using GPL-covered code in proprietary derivatives, a restriction motivated by the goal of preserving access to the software for all users.[70] Copyleft licenses, such as the GPL, prevent someone from turning free software into proprietary software. The copyleft condition of the GPL appears formally in Section 2(b).[71]

2. *Fees*

The GPL's Preamble mentions twice that charging a fee for the distribution of GPL-covered software is not only allowed but a guaranteed right.[72] This point is often confused with the fact that the GPL forbids requiring that any third party who receives the software pay a license fee.[73] A license fee would violate Section 6 of the GPL, which reads in relevant part:

> Each time you redistribute the Program (or any work based on the Program), the recipient automatically receives a license from the original licensor to copy, distribute or modify the Program subject to these terms and conditions. You may not impose any further restrictions on the recipients' exercise of the rights granted herein.[74]

To require a royalty or license fee of those third parties would be to impose a further restriction on them. In contrast, nothing in the GPL prevents someone from charging fees for service, warranty protection, or indemnification of software licensed under the GPL.

3. *Source Code*

The ability to access, modify, and distribute source code is at the heart of the GPL. The Preamble explains that the license guarantees "that you

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69. *Id.*

70. *Id.*

71. *Id.* For the full text of Section 2(b), see *supra* note 58.

72. "Our General Public Licenses are designed to make sure that you have the freedom to distribute copies of free software (and charge for this service if you wish)" and "if you distribute copies of such a program, whether gratis or for a fee . . . ." GNU GPL, *supra* note 34, at Preamble. For rebuttals to several misconceptions about free software, see Joseph Scott Miller, *Allchin's Folly: Exploding Some Myths About Open Source Software*, 20 CARDOZO ARTS & ENT. L.J. 491 (2002).

73. *See Frequently Asked Questions about the GNU GPL*, *supra* note at 42, http://www.fsf.org/licensing/licenses/gpl-faq.html#DoesTheGPLAllowRequireFee.

74. GNU GPL, *supra* note 34, at Section 6.

receive source code or can get it if you want it"[75] and that "you can change the software or use pieces of it in new free programs."[76] Those who distribute GPL-covered software must ensure that recipients "receive or can get the source code."[77] Sections 1 and 3 of the GPL contain most of the formal discussion of a licensee's rights and responsibilities regarding source code.

4. Knowing Your Rights

The Preamble to the GPL twice emphasizes the importance of informing licensees of their rights.[78] After listing several software freedoms it provides, the license states that it is designed to make sure "that you know you can do these things."[79] Additionally, those who distribute GPL-covered software are informed of their responsibilities to recipients. The license states, "you must show [the recipients] these terms so they know their rights."[80] This requirement appears formally within Section 1 of the GPL, where those who distribute GPL-covered code are required to "keep intact all the notices that refer to this License and to the absence of any warranty; and give any other recipients of the Program a copy of this License along with the Program."[81] The GPL is in widespread use and many software developers and users are familiar with its terms, perhaps due in part to the requirement that the license text be included. Over time, this has resulted in a savings of transaction costs for software distributors and users. A user familiar with the GPL, upon encountering a new GPL-covered program, can quickly decide whether the license and software suits his purposes. As free software licenses proliferate, however, this time savings is jeopardized. Consequently, both the FSF and the OSI discourage the creation of new licenses where an existing one would suffice.[82]

5. Patents

Finally, the Preamble flags a threat to the free software community: patents. The GPL requires that those who would distribute software under

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75. *Id.* at Preamble.
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.* at Section 1.
82. *See The Approved Licenses*, *supra* note 57; *Licenses*, Free Software Foundation, *at* http://www.fsf.org/licensing/licenses/#LicenseList (last modified Feb. 14, 2005); *OSI Certification Mark and Process*, Open Source Initiative, *at* http://www.opensource.org/docs/certification_mark.php#approval (last visited Mar. 6, 2005).

the GPL not bind themselves to a patent license that would "not permit royalty-free redistribution of the Program by all those who receive copies directly or indirectly through you . . . ."[83] If a developer of GPL-covered software had a patent license that was not available to those who might receive the software, then such recipients would become patent infringers. To avoid this problem the GPL requires such developers either to ensure that the patent holder permits royalty-free redistribution by all or to simply refrain from distributing patented software under the GPL.

B. The GPL and Derivative Works

Determining when a piece of software is a "derivative work" of a GPL-covered work is critical to the licensing regime, particularly considering the fact that the GPL requires that derivative works that are distributed must also be licensed under the GPL. The lack of certainty regarding what counts as a derivative work is only partially the fault of the GPL.[84] In general, what constitutes a derivative work within software is not sufficiently clear from either the statutes or the case law.[85] A case providing clear guidelines for assessing derivative software works, even if it had nothing to do with the GPL, would do much to simplify the counseling that attorneys do for their clients on free software licensing issues.

The nature of software is one of the reasons why defining derivative works for software is difficult. Most software is made up of numerous individual programs and files that work together to produce the results the end-user experiences. Software programs also make use of "libraries." A

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83. GNU GPL, *supra* note 34, at Section 7.

84. It is relevant that the GPL chooses to define derivative works by relying solely on copyright law rather than independently defining what will count as a derivative work. This approach was dictated by the FSF's desire to make the GPL a unilateral grant of a license rather than a contract. *See supra* note 64. If the FSF had independently defined derivative works, which conflicted with copyright law, then it seems more likely that the recipient of a work licensed under the GPL would have to agree to the FSF's definition, forming a contract. Of course, many may argue that the GPL must or will be interpreted as a contract, so until the courts decide that issue favorably to the FSF, it is not clear whether accepting ambiguity about what counts as a derivative work does more harm than good. One argument that the GPL is a contract is that the license itself constitutes an offer, any copying, modifying, or distribution of a GPL-covered work by a would-be licensee constitutes implied acceptance of that offer, and the licensee's consideration is impliedly promising to abide by the GPL's terms, while the licensor's consideration is the software itself. A simpler complaint about derivative works and the GPL is that the license may define the term in more than one way, providing a possibility of inconsistency. *See* Phil Albert, *A Consumer's Review of the General Public License*, LINUXINSIDER, July 20, 2004, *at* http://www.linuxinsider.com/story/35193.html.

85. Daniel Ravicher, *Software Derivative Work: A Circuit Dependent Determination* (2002), *at* http://www.pbwt.com/Attorney/files/ravicher_1.pdf.

library is a collection of subprograms used to develop software.[86] "Libraries are distinguished from executables in that they are not independent programs; rather, they are 'helper' code that provides services to some other independent program."[87] A library may be either statically or dynamically linked to the independent programs that it helps.[88]

Static linking involves embedding the library in the independent program when it is compiled.[89] A dynamically linked library is not incorporated into a program, rather it exists both in its own place on a computer's hard drive and in its own memory space while in use.[90] Multiple programs might even be dynamically linked to the same library and communicate with it while it sits in a single memory space.[91] Consequently, some have argued that a proprietary program could dynamically link to a library licensed under the GPL, or a program licensed under the GPL could dynamically link to a proprietary library, and in neither case would a "derivative work" of the GPL-covered work be created, since the two programs retain distinct existences and only tenuous connections.[92]

This is not the view of the FSF, however.[93] The FSF argues that even dynamic linking creates a derivative work, and has written a different license, the GNU Lesser General Public License (LGPL), for those who wish to permit such proprietary linking.[94] However, the FSF does not recommend the use of the LGPL, as the FSF ultimately sees the LGPL as encouraging an unhealthy reliance on proprietary software, and it would prefer that the needed proprietary software, which would be linked, be rewrit-

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86. *Library (computer science)*, WIKIPEDIA: THE FREE ENCYLOPEDIA, *at* http://en.wikipedia.org/wiki/Library_(computer_science) (last modified Feb. 8, 2005).

87. *Id.*

88. *Id.*

89. *Id.* "Compiling" refers to the act of turning human-readable source code into machine-readable binary code.

90. *Id.*

91. *Id.*

92. Lawrence Rosen, *The Unreasonable Fear of Infection* 2 (2001), *at* http://www.rosenlaw.com/html/GPL.PDF (last visited Feb. 16, 2005), states that:

> Dynamic linking, on the other hand, is a transitory relationship between two programs for which they are each pre-designed. The linking program need not be modified to implement the linkage. For example, a printer driver for a new printer can be installed in a program without modifying the source code of the original program. Such linkage does not constitute the creation of a derivative work.

93. *See* Richard Stallman, *Why You Shouldn't Use the Library GPL for Your Next Library*, Feb. 1997, *at* http://www.gnu.org/philosophy/why-not-lgpl.html.

94. *The GNU Lesser General Public License*, *supra* note 28.

ten, and licensed under a free software license.[95] Ultimately, the issue of what constitutes a derivative software work must be addressed by statute or the courts. There was some hope that the issue would be decided in a case from 2002, but the court did not reach this issue.[96]

C. Software Patents and Free Software

Many within the free software community now believe that software patents are the greatest threat to open source and free software.[97] A report by Open Source Risk Management found that 283 granted patents could potentially be used against the Linux kernel.[98] However, none of these patents have been tested in court, and there is no indication that the Linux kernel is any more susceptible to such claims than other large software projects.[99] Rather, it is likely that most any software project that reaches the size of the Linux kernel would be subject to similar threats from patents.[100] Most proprietary software gains some protection from this problem through obscurity. Since proprietary code is seldom released to users, it is more difficult to identify potentially infringing processes.

The free software community is well aware of the threat of software patents. IBM, now a major contributor to free software projects, has pledged not to assert its massive patent portfolio against the Linux kernel.[101] GNU/Linux provider Red Hat prominently displays a "patent promise" on its website that states "software patents generally impede innovation" and pledges Red Hat's patents will not be used offensively against an open source or free software project.[102] MySQL AB, which provides its

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95. Stallman, *supra* note 93.

96. Progress Software Corp. v. MySQL AB, 195 F. Supp. 2d 328 (D. Mass. 2002) (holding that the defendant demonstrated a substantial likelihood of success on breach of contract claim concerning its trademark); *see* Laura Majerus, *Court Evaluates Meaning of "Derivative Work" in an Open Source License* (Fall 2002), *available at* http://www.fenwick.com/docstore/publications/IP/IP_bulletins/IP_Bulletin_Fall_2002.pdf.

97. Richard Stallman, *Fighting Software Patents—Singly and Together*, *at* http://www.gnu.org/philosophy/fighting-software-patents.html (last modified Feb. 11, 2005).

98. Press Release, Open Source Risk Management, Results of First-Ever Linux Patent Review Announced, Patent Insurance Offered (Aug. 2, 2004), *available at* http://www.osriskmanagement.com/press_releases/press_release_080204.pdf.

99. Steven J. Vaughan-Nichols, *Author of Linux Patent Study Says Ballmer Got It Wrong*, eWEEK, Nov. 19, 2004, *at* http://www.eweek.com/print_article2/0,2533,a=139669,00.asp.

100. *Id.*

101. Stephen Shankland, *IBM Pledges No Patent Attacks Against Linux*, CNET NEWS.COM, Aug. 4, 2004, *at* http://news.zdnet.com/2100-3513_22-5296787.html.

102. Red Hat, Inc., *Statement of Position and Our Promise on Software Patents*, *at* http://www.redhat.com/legal/patent_policy.html (last visited Feb. 16, 2005).

MySQL database software under a dual-licensing scheme, providing the software under either the GPL or an alternative license, prominently links to www.nosoftwarepatents.com from every page on its site.[103] MySQL AB's patent policy declares,

> We do not think that software patents are a useful way to protect software IP. Instead, we believe that copyright protection is sufficient. We have concluded that software patents are harmful to the software industry at large. This is why we support those who work for an abolishment of software patents. We also work with other companies and groups to build a joint defense against software patents.[104]

The FSF also opposes software patents, and Richard Stallman regularly discusses how he believes they stifle innovation.[105] There is also a highly organized effort to prevent laws that would allow the patenting of software in Europe.[106]

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103. Stacey Quandt, *Taking Open Source to the Bank: Open Source and Profit Are Not Oxymorons*, LINUX MAG., Sept. 2004, *at* http://www.linux-mag.com/2004-09/bank_01.html. Quandt also discusses the dual-licensing strategies of Sleepycat Software and Trolltech. The MySQL database software is often tightly integrated with other software applications. Developers of those applications have a choice: They can download and use MySQL at no cost under the terms of the GPL; however, they will likely be required to provide the source code of the applications they distribute if their application is integrated with MySQL in the relevant ways. *See MySQL Commercial License*, MySQL, *at* http://www.mysql.com/company/legal/licensing/commercial-license.html (last visited Mar. 6, 2005) (listing situations where MySQL AB believes that you would either need to release your source or get their "commercial" license). Alternatively, developers can pay for a "commercial" license that allows licensees to keep private the source to their distributed applications, which are integrated with MySQL. MySQL AB can implement this dual-licensing scheme because it holds the copyrights to all of its software and asks the developers that submit modifications to assign their copyrights to MySQL AB. *See MySQL Lists: mysql: Re: Index Create Speed*, MySQL, *at* http://lists.mysql.com/mysql/84008 (posting from Michael Widenius, CTO, MySQL AB, to MySQL General Discussion (Aug. 30, 2001)). The use of the term "commercial" in MySQL AB's commercial license, which serves as an alternative to the GPL, is misleading because the GPL guarantees the right to distribute copies of a GPL-covered program for a fee—that is, commercially. *See supra* Part III.A.2.

104. *MySQL Public Patent Policy*, MySQL, *at* http://www.mysql.com/company/legal/patents.html (last modified Sept. 1, 2004). For the view that computer software in machine readable form should not be afforded copyright, and favoring a sui generis approach instead, see Pamela Samuelson, *CONTU Revisited: The Case Against Copyright Protection For Computer Programs In Machine-Readable Form*, 1984 DUKE L.J. 663; Pamela Samuelson et al., *A Manifesto Concerning the Legal Protection of Computer Programs*, 94 COLUM. L. REV. 2308 (1994).

105. Stallman, *supra* note 97.

106. *Software Patents vs Parliamentary Democracy*, *at* http://swpat.ffii.org (last visited Mar. 6, 2005).

The free software community is particularly concerned about software patents because many free software projects lack the financial and institutional resources necessary to defend themselves in patent litigation. Patent litigation is notoriously expensive.[107] Additionally, the nature of software itself, in which each individual program can make use of so many ideas, is cited as making software patents particularly problematic, because literally hundreds of patents sometimes cover the ideas implemented in a single software program.[108] There are numerous other reasons for being dissatisfied with the current way patents are granted for software in the United States, many of which are shared even by those outside the free software community.[109]

IBM and Sun Microsystems have recently illustrated one approach to mitigating the harmful side effects of software patents on free software

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107. Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 NW. U. L. REV. 1495, 1502 (2001) ("When patent litigation does occur, it is expensive. The American Intellectual Property Law Association reports, based on a survey of its members, that the median cost of patent litigation to each side is $799,000 through the end of discovery, and $1,503,000 through trial and appeal.").

108. Stallman, *supra* note 97.

109. *See, e.g.*, Viva R. Moffat, *Mutant Copyrights and Backdoor Patents: The Problem of Overlapping Intellectual Property Protection*, 19 BERKELEY TECH. L.J. 1473, 1512 (2004) ("[O]verlapping protection disrupts the federal intellectual property system, frustrates the patent and copyright bargains, and meddles with the incentive structures. Moreover, overlapping protection imposes a host of unnecessary costs on intellectual property owners, litigants, third parties, and the public."). Julie E. Cohen & Mark A. Lemley state:

> The extent to which the patent system is actually necessary to induce innovation that would not otherwise occur is an unanswered, and perhaps unanswerable, empirical question . . . . The bewildering variety of software innovations generated in the years before software was considered patentable suggests that for software, at least, patent protection may not be as necessary as the reward theory assumes. The question is complicated, however, by the availability of copyright protection for software during that period, and by uncertainty over both the scope of copyright protection and the degree of overlap between the copyright and patent models of protection.

Julie E. Cohen & Mark A. Lemley, *Patent Scope and Innovation in the Software Industry*, 89 CALIF. L. REV. 1, 5 n.5 (2001); *see also* Robert P. Merges, *One Hundred Years of Solicitude: Intellectual Property Law, 1900-2000*, 88 CALIF. L. REV. 2187, 2230 (2000) ("Concerning the interim period when software patents were in doubt, however, at least this much can be said: The industry learned to work around the absence of patent protection quite nicely. There was no shortage of technical innovation and new commercial products. Perhaps something about software provided profits ample enough to induce entry and innovation even in the absence of patents."); Samuelson et al., *supra* note 104, at 2343-47.

and open source development. IBM went beyond its earlier pledge not to use its patents against the Linux kernel and dedicated 500 of its existing software patents to a "patent commons" for use by any developer working on software licensed under an OSI-approved license.[110] Sun Microsystems followed and announced that it would provide licenses at no cost to more than 1,600 of its software patents related to its Solaris operating system, which it also intends to release under an OSI-approved license, the Common Development and Distribution License ("CDDL").[111] Sun's announcement was immediately questioned to gain clarification of what exactly Sun had pledged, particularly whether Sun's patents would be licensed to all developers working under an OSI-approved license or merely to those contributing to the new open source version of Solaris.[112] Sun acknowledged the confusion and said, "Clearly we have no intention of suing open-source developers."[113] However, Sun ultimately conceded that its patent grant restricts the use of the pledged patents to projects licensed under Sun's CDDL.[114]

While the free software community would likely appreciate even more support from patent holders, ultimately, the community's greatest defense may be its very method of operating. Almost every free software project

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110. *Feast for Open Source As IBM Opens Patent Pantry*, IBM, *at* http://www.ibm.com/news/us/en/2005/01/patents.html (last visited Mar. 6, 2005); Press Release, IBM, IBM Pledges 500 U.S. Patents To Open Source In Support Of Innovation and Open Standards (Jan. 11, 2005), *available at* http://www.ibm.com/press/PressServleForm.wss?TemplateName=ShowPressReleaseTemplate&SelectString=t1.docunid=7473; Jim Wagner, *IBM Pledges Patents to Open Source*, INTERNETNEWS.COM, Jan. 11, 2005, *at* http://www.internetnews.com/dev-news/article.php/3457381.

111. Press Release, Sun Microsystems, Sun Grants Global Open Source Community Access to More than 1,600 Patents (Jan. 25, 2005), *available at* http://www.sun.com/smi/Press/sunflash/2005-01/sunflash.20050125.2.html.

112. Bruce Perens, *The Open-source Patent Conundrum*, CNET NEWS.COM, Jan. 31, 2005, *at* http://news.com.com/The+open+source+patent+condundrum/2010-1071_3-5557340.html; Michael Singer, *Sun Solaris Patent Release Questioned*, INTERNETNEWS.COM, Jan. 28, 2005, *at* http://www.internetnews.com/bus-news/print.php/3465901; Richard Stallman, *Sun's No-op Announcement*, NEWSFORGE, Jan. 31, 2005, *at* http://trends.newsforge.com/print.pl?sid=05/01/31/1310231; Letter from Daniel Ravicher, Executive Director, Public Patent Foundation, to Scott McNealy, Chairman and CEO, Sun Microsystems, Inc. (Jan. 8. 2005), *available at* http://www.pubpat.org/PUBPAT_Ltr_re_Sun_Patent_Grant.pdf.

113. Stephen Shankland, *Sun: Patent Use OK Beyond Solaris Project*, CNET NEWS.COM, Jan. 31, 2005, *at* http://news.zdnet.com/2102-9593_22-5557658.html *see also* Philip H. Albert, *OpenSolaris: Beyond the Rhetoric*, LINUXINSIDER, Feb. 1, 2005, *at* http://www.linuxinsider.com/story/OpenSolaris-Beyond-the-Rhetoric-40176.html.

114. Peter Galli, *Sun Criticized for Limitations on Patent Release*, eWeek, Feb. 7, 2005, *at* http://www.eweek.com/article2/0,1759,1761720,00.asp.

posts its code on the Internet for all to browse or download. Patents are only available if one can satisfy, *inter alia*, the statutory novelty and nonobviousness requirements.[115] Those who seek to challenge or invalidate a patent can reference prior art in order to show that something was not novel or that it was obvious given the prior art.[116] As free software projects post more and more code to the Internet, they are in the process of building the largest repository of software prior art in existence. Since most proprietary source code is never publicly disclosed, it can be difficult for a patent examiner to say whether a process in a software patent application is truly novel or nonobvious.

IV. ENFORCEMENT OF THE GPL

Historically, the GPL has been primarily enforced through private negotiation and settlement agreements. This process has been successful thus far because most alleged violators have apparently been eager to correct any defects in their compliance. These extra-judicial resolutions have generally satisfied the goals of the copyright holders enforcing the GPL, but left the question of the GPL's enforceability in court largely unanswered. In 2004, however, two cases began to illuminate how courts will enforce the GPL.

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115. *See* 35 U.S.C. § 102 (2000). Section 102 states that:

> A person shall be entitled to a patent unless—
>
> (a) the invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention thereof by the applicant for patent, or
>
> (b) the invention was patented or described in a printed publication in this or a foreign country or in public use or on sale in this country, more than one year prior to the date of the application for patent in the United States . . . .

Id.

116. *See id.* § 103. Section 103 states that:

> A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title [35 U.S.C. § 102], if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains . . . .

Id.

A. Private GPL Enforcement by the Free Software Foundation

The only party who can license a work under the GPL is the copyright holder. Consequently, the only party who can seek a remedy for violation of the GPL as applied to that work is the copyright holder. There is a misconception that because the FSF wrote the GPL that it is therefore the enforcement police for all software licensed under the GPL.[117] While the FSF is often willing to help, and asks to be informed of GPL violations,[118] ultimately the copyright holder is responsible for enforcement. The FSF does hold the copyrights to many widely-used free software programs, particularly those within its GNU project.[119] For those programs, the FSF *does* handle enforcement, primarily through its pro bono general counsel.[120]

The FSF engaged in an interesting public example of private enforcement of the GPL in 2003. Linksys was distributing its popular WRT54G wireless router with GPL-covered software, but was not providing source code.[121] Initial discussions with Linksys were not moving fast enough to

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117. Robert McMillan, *SCO: IBM Can't Enforce GPL Software License*, COMPUTERWORLD, Oct. 28, 2003, *at* http://www.computerworld.com/printthis/2003/0,4814,86587,00.html.

118. *Violations of the GPL, LGPL, and GFDL*, Free Software Foundation, *at* http://www.fsf.org/licensing/licenses/gpl-violation.html (last modified Feb. 12, 2005).

119. *FSF/UNESCO, Free Software Directory*, Free Software Foundation, *at* http://directory.fsf.org/GNU (last visited Mar. 6, 2005).

120. Moglen, *Enforcing the GPL*, *supra* note 64. Moglen reports encountering little difficulty in these private enforcement actions. He investigates GPL violations "dozens of times a year." *Id.* FSF's Executive Director, Bradley Kuhn, said there were thirty such actions ongoing in October 2003 and that fifty hand been handled during 2002. Daniel Lyons, *Linux's Hit Men*, FORBES.COM, Oct. 14, 2003, *at* http://www.forbes.com/2003/10/14/cz_dl_1014linksys_print.html. Moglen reports that a "quiet initial contact is usually sufficient to resolve the problem. Parties thought they were complying with GPL, and are pleased to follow advice on the correction of an error." Moglen, *Enforcing the GPL*, *supra* note 64. He also explains that the enforceability of the GPL is not in doubt in these discussions. Well-advised companies down to individual developers all decide it is better to comply than fight. Moglen demonstrates his powers of persuasion when he shares some details of these conversations: "[P]eople all over the world are pressuring me to enforce the GPL in court, just to prove I can. I really need to make an example of someone. Would you like to volunteer?" *Id.* So far, no one has. Moglen insists that the FSF's goals are not litigation, but "compliance with the license, and security for future good behavior . . . ." *Id.*

121. Zack Brown, *More On Possible GPL Violations By Wireless Vendors*, Kernel Traffic (June 24, 2003), *at* http://www.kerneltraffic.org/kernel-traffic/kt20030708_221.html#8; Zack Brown, *Possible GPL Violations By Many Wireless Vendors*, Kernel Traffic (June 7, 2003), *at* http://www.kerneltraffic.org/kernel-traffic/kt20030616_219.html#16. A router is a computer networking device that forwards data packets toward their destinations through a process of discovering paths along which information can be sent.

satisfy some developers of the Linux kernel.[122] The FSF stepped in to negotiate with Linksys' new owner, Cisco Systems, who eventually complied with the license and now provides the GPL-covered source code from the Linksys website for not only the WRT54G, but also for dozens of Linksys devices using GPL-covered software.[123] Consequently, this router has become particularly popular among hackers,[124] who have even developed projects to install more full-featured GNU/Linux installations on the router.[125]

B. Private GPL Enforcement by Other Copyright Holders

The FSF is not the only copyright holder who licenses software under the GPL and who has had significant success enforcing the GPL privately. One of the more prominent examples of such private enforcement is provided by Harald Welte, who would later be the plaintiff in this year's Munich court decision enforcing the GPL. Welte is the head member of the Netfilter/iptables core software development team.[126] The netfilter/iptables software acts as a firewall for GNU/Linux systems[127] and is in widespread

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Router, WIKIPEDIA: THE FREE ENCYCLOPEDIA, *at* http://en.wikipedia.org/wiki/Router (last modified Feb. 16, 2005); *Routing*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, *at* http://en.wikipedia.org/wiki/Routing (last modified Jan. 26, 2005).

122. *Linksys GPL Issues Raise Embedded Concerns*, LINUXDEVICES.COM, Oct. 14, 2003, *at* http://www.linuxdevices.com/cgi-bin/printerfriendly.cgi?id=NS7719522768; Lyons, *supra* note 120; Zack Brown, *Possible Linksys GPL Violations: The Saga Continues*, Kernel Traffic, Oct. 24, 2003, *at* http://www.kerneltraffic.org/kernel-traffic/kt20031024_235.html#8.

123. *Linksys GPL Code Center*, Cisco Systems, Inc., *at* http://www.linksys.com/support/gpl.asp (last visited Mar. 6, 2005).

124. This Note uses the term 'hacker' in its original sense of "a person who enjoys exploring the details of programmable systems and how to stretch their capabilities . . . ." *See* Eric S. Raymond, *The New Hacker Dictionary*, *available at* http://www.catb.org/~esr/jargon/html/H/hacker.html (last visited Mar. 6, 2005). This is opposed to the popular media sense of "[o]ne who breaks security on a system." *The New Hacker Dictionary*, *available at* http://www.catb.org/~esr/jargon/html/C/cracker.html (last visited Mar. 6, 2005).

125. Jim Buzbee, *Linux on the WRT54G* (Jan. 15. 2005), *at* http://www.batbox.org/wrt54g-linux.html.

126. Other active members include Jozsef Kadlecsik, Martin Josefsson, and Patrick McHardy. The core team previously included James Morris, Marc Boucher, and Rusty Russell, who were critical to the project's early success. *About the Netfilter/iptables Project: The Netfilter Core Team*, Netfilter, *at* http://www.netfilter.org/about.html#coreteam (last visited Mar. 6, 2005).

127. *Netfilter/iptables Project Homepage*, Netfilter, *at* http://www.netfilter.org (last visited Mar. 4, 2005). "A firewall is a piece of hardware or software which functions in a networked environment to prevent some communications forbidden by the security policy, analogous to the function of firewalls in building construction." *Firewall (network-*

use, especially in hardware routers.[128] The netfilter software is itself a part of the Linux kernel and since its source code is freely available on the web, it becomes a natural choice for inclusion by many device manufacturers. Problems arise when these device manufacturers do not understand or ignore the licensing terms under which the software is provided. Manufacturers that distribute modified versions of the software are required by the GPL to provide both the full text of the GPL license itself, as well as the source code to the modified software they are distributing.[129] Several manufacturers have failed to do this, and Harald Welte has sought to enforce the terms of the GPL against them.[130]

Welte's first success came in February 2004, when he announced an out-of-court settlement with Allnet GmbH.[131] Allnet was offering two routers, both including software developed by the netfilter/iptables project.[132] However, Allnet did not fulfill the obligations of the GPL regarding the netfilter/iptables software because it did not make any source code offering or include the terms of the GPL with its products.[133] In the settlement, Allnet agreed to adhere to all clauses of the license and to inform its customers about their respective rights and obligations under the GPL.[134] Allnet also agreed to refrain from offering any new netfilter/iptables based products without adhering to the GPL.[135] Finally, Allnet made "a significant donation" to the FSF Europe[136] and to the Foundation of a Free Information Infrastructure.[137]

Buoyed by this success, Welte pursued similar successful GPL-enforcement actions against Fujitsu-Siemens, ASUS, and Securepoint be-

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ing), WIKIPEDIA: THE FREE ENCYCLOPEDIA, *in* http://en.wikipedia.org/wiki/Firewall_(networking) (last modified Feb. 16, 2005).

128. Harald Welte, *Harald Welte's Blog*, *at* http://gnumonks.org/~laforge/weblog/linux/gpl-violations (last visited Mar. 6, 2005).

129. GNU GPL, *supra* note 34, at Section 1.

130. Welte, *supra* note 128. Welte also operates the gpl-violations.org project which "tries to raise public awareness about past and present infringing use(r)s of GPL licensed software." *See The GPL-Violations Project?*, gpl-violations.org, http://www.gplviolations.org (last visited Mar. 6, 2005).

131. *Allnet GmbH Resolves Iptables GPL Violation*, LWN.NET, Feb. 17, 2004, *at* http://lwn.net/Articles/71418.

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

136. *See Freesoftware Foundation Europe*, *supra* note 25.

137. *Foundation for a Free Information Infrastructure*, *at* http://www.ffii.org (last visited Mar. 6, 2005).

fore coming across a violator of the GPL that was reluctant to comply with the license's terms: Sitecom Germany GmbH.

C. Judicial Enforcement of the GPL: The Munich District Court Decisions

The first clear resolution of the GPL's enforceability came this year from a German district court in Munich hearing Welte's case against Sitecom. The court held that the GPL was a valid and enforceable copyright license.

1. Background

Sitecom Germany, a subsidiary of Netherlands-based Sitecom Europe B.V., sold a wireless router, the WL-122, which contained the netfilter project's firewalling software, iptables, in binary form.[138] Sitecom was not providing source code to those to whom it distributed the WL-122 routers, nor was it providing a copy of the GPL license as required.[139] On March 18, 2004, Welte notified Sitecom of these violations of the GPL.[140] By April 1, after discussions had stalled, Welte filed an application for a preliminary injunction with the Munich District Court.[141] The court issued injunction the following day and enjoined Sitecom from distributing, copying, or making available to the public the software netfilter/iptables without at the same time "making reference to the licensing under the GPL and attaching the license text of the GPL as well as making available the source code of the software netfilter/iptables free of any license fee."[142] Sitecom filed an objection to the preliminary injunction on April 20, 2004.[143]

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138. Welte v. Sitecom Deutschland GmbH, LG (Munich) (2004), *available at* http://www.jbb.de/urteil_lg_muenchen_gpl.pdf (May 19, 2004) (official publication in German). Jaschinski Biere Brexl (JBB), Welte's attorneys, provided an unofficial English translation on their firm website. JBB, Welte v. Sitecom Deutschland GmbH, No. 21 O 6123/04 (Dist. Ct. of Munich 2004) [hereinafter *Welte* translation], *at* http://www.jbb.de/judgment_dc_munich_gpl.pdf. *See also* Thomas Hören & Christian Ahlert, *District Court of Munich I, Judgement of 19/05/2004—file reference: 21 0 6123/04 (Open Source—effectiveness of GPL), at* http://www.oii.ox.ac.uk/resources/feedback/OIIFB_GPL2_20040903.pdf (last visited Mar. 6, 2005) (English translation provided by the Oxford Internet Institute).

139. *Welte* translation, *supra* note 138, at 4.

140. *Id.*

141. *Id.* at 4-5.

142. *Id.* at 5.

143. *Id.*

2. *The Munich Court's Holding*

On May 19, 2004, the court upheld the preliminary injunction.[144] Welte argued that only the copyright holder can give someone permission to copy, modify, or distribute its copyrighted software.[145] If a copyright holder chooses to license its software under the GPL and nothing else, then anyone who copies, modifies, or distributes that software must either be in compliance with the terms of the license, or be deemed an infringer of the copyright.[146] Welte argued that, since netfilter/iptables is only offered under the GPL, Sitecom must either comply or be held an infringer.[147]

The court focused its analysis on the termination clause in Section 4 of the GPL.[148] It held that this clause was valid under German law, and further stated that regardless of the validity of the second and third sentences in the section, the first sentence—"You may not copy, modify, sublicense, or distribute the Program except as expressly provided under this License."—would remain valid.[149]

This was an important victory for the GPL, because the court agreed that a copyright holder could adopt the GPL as the sole licensing mechanism and could refuse to allow copying, modification, or distribution under any other terms.[150] The court clearly differentiated between licensing software under the GPL and placing software in the public domain.[151] The court noted that,

> [T]he Panel shares the view that one cannot regard the conditions of the GPL (General Public License) as containing a waiver of copyright and related legal rights. On the contrary, the users

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144. *Id.* at 8, 13.
145. *Id.* at 5-7.
146. *Id.*
147. *Id.*
148. *Id.* at 8-12. The clause states in full:

> You may not copy, modify, sublicense, or distribute the Program except as expressly provided under this License. Any attempt otherwise to copy, modify, sublicense or distribute the Program is void, and will automatically terminate your rights under this License. However, parties who have received copies, or rights, from you under this License will not have their licenses terminated so long as such parties remain in full compliance.

GNU GPL, *supra* note 34, at Section 4.

149. *Welte* translation, *supra* note 138, at 12.
150. *See id.* at 8 (stating that the conditions of the GPL are not a waiver of copyright).
151. This is not to say that there is any legal impediment to donating software to the public domain, rather it is to say that those who choose to license their software under the GPL have not done so and retain their copyrights.

> avail themselves of the conditions of copyright, in order to guarantee and carry out their conceptions of the further development and dissemination of software.[152]

The court further held that Sections 2 and 3 of the GPL, which are the heart of the GPL and implement both its copyleft nature and its requirement of providing source code, were valid.[153] The court added that even if the GPL were invalid as a whole, then the result would be that any use of the software would be illegal, because all uses would be unlicensed infringements without the GPL acting as a license.[154] In effect, the court adopted Welte's argument that Sitecom Germany must either comply with the terms of the license or be considered an infringer.

Harald Welte has reported that the significant media attention brought by this first successful court test of the GPL has only brought more viola-

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152. *Welte* translation, *supra* note 138, at 8 (with minor modifications of the translation for style).

153. *Id.* at 12. GNU GPL, *supra* note 34, at Section 2, reads in part:

> You may modify your copy or copies of the Program or any portion of it, thus forming a work based on the Program, and copy and distribute such modifications or work under the terms of Section 1 above, provided that you also meet all of these conditions: [¶] a) You must cause the modified files to carry prominent notices stating that you changed the files and the date of any change. [¶] b) You must cause any work that you distribute or publish, that in whole or in part contains or is derived from the Program or any part thereof, to be licensed as a whole at no charge to all third parties under the terms of this License.

GNU GPL, *supra* note 34, at Section 3, reads in part:

> You may copy and distribute the Program (or a work based on it, under Section 2) in object code or executable form under the terms of Sections 1 and 2 above provided that you also do one of the following: [¶] a) Accompany it with the complete corresponding machine-readable source code, which must be distributed under the terms of Sections 1 and 2 above on a medium customarily used for software interchange; or, [¶] b) Accompany it with a written offer, valid for at least three years, to give any third party, for a charge no more than your cost of physically performing source distribution, a complete machine-readable copy of the corresponding source code, to be distributed under the terms of Sections 1 and 2 above on a medium customarily used for software interchange; or, [¶] c) Accompany it with the information you received as to the offer to distribute corresponding source code. (This alternative is allowed only for noncommercial distribution and only if you received the program in object code or executable form with such an offer, in accord with Subsection b above.)

154. *Welte* translation, *supra* note 138, at 12.

tions to light.[155] Within a week of Sitecom's May 19th appeal, Welte learned of and commenced enforcement against three more potential infringers.[156]

This raises the question: Why enforce the license? The netfilter/iptables project provides its software at no cost. Welte did not win damages, but rather an injunction and GPL compliance. If he had lost, under German law, he would have had to pay attorneys fees, and these enforcement actions take up valuable time.[157] What motivates those, like Welte, that seek to enforce the GPL? The answer can be found in the philosophy driving the GPL itself. The netfilter team members are among those free software developers who have given some thought to their choice of license, and chose the GPL for the work that it does as a license. The license keeps one's copyrighted work available in the manner one chooses. Software developers spend a great deal of time creating such software, and when they are not being paid directly for that work, there is even more reason to think they may seek other forms of compensation for the long hours, such as the assurance that others will always be able to study, modify, improve, and share the work that they have begun.[158] Welte is one of many free software developers who has made a conscious choice

155. Welte, *supra* note 128.

156. *Id.*

157. Since Welte won twice, Sitecom had to pay his attorneys' fees. Additionally, unlike in the United States, attorney fees are regulated in Germany and Welte can more accurately assess his monetary risk in advance of each enforcement action.

158. *See* Pamela Samuelson, *Mapping the Digital Public Domain: Threats and Opportunities*, 66 LAW & CONTEMP. PROBS. 147, 167-68 (2003). Professor Samuelson has stated:

> From the standpoint of many open source developers, dedicating a program to the public domain is a suboptimal strategy for achieving open source objectives because proprietary derivatives can be made of public domain programs. Those who breach the terms of an open source license by making a proprietary derivative program will be deemed infringers of the underlying intellectual property rights in the program and may be enjoined from this form of free-riding on open source development. Thus, open source licenses use property rights to preserve and maintain a commons in an existing intellectual resource.

Id.; *see also* Robert P. Merges, *A New Dynamism in the Public Domain*, 71 U. CHI. L. REV. 183, 192 (2004) ("[B]y eschewing property rights, a large number of independent contributors can create and integrate components into a single, useable asset with minimal transaction costs.").

to use the GPL because it prevents others from making proprietary derivatives of his work.[159]

D. Court Discussion of the GPL in the United States: *SCO v. IBM*

Though version 2 of the GPL was released in 1991, no U.S. court has ruled on its enforceability in the ensuing fourteen years. Indeed, the GPL has only been mentioned in passing in U.S. courts.[160] However, in March of 2003, Caldera Systems, Inc., doing business as The SCO Group, filed a complaint against IBM in Utah state court,[161] alleging misappropriation of trade secrets, unfair competition, interference with contract, and breach of

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159. When asked why he pursued this legal action, Welte said, "Because I write code under the GPL and not the BSD license." E-mail from Harald Welte, Head Member, Netfilter Care Team, to Brian W. Carver, Law Student, University of California at Berkeley, School of Law (Boalt Hall) (Jan. 3, 2005) (on file with author). The BSD license is not a copyleft license and allows proprietary derivatives. *See Various Licenses and Comments About Them*, *supra* note 57. Welte's response is indicative of those who purposefully choose to license their works under the GPL as a means of guaranteeing that derivatives of their efforts remain free software. Linus Torvalds, the lead developer of the Linux kernel, has expressed similar motivations. Torvalds said:

> I really want a license to do just two things: make the code available to others, and make sure that improvements stay that way. That's really it. Nothing more, nothing less. Everything else is fluff. It may sound like a very simple concept, but even most open-source licenses fail my criteria very fundamentally. They tend to fail in allowing somebody to limit the availability of improvements some way.

Stephen Shankland, *Torvalds: A Solaris Skeptic*, CNET NEWS.COM, Dec. 21, 2004, *at* http://news.com.com/2102-1082_3-5498799.html?tag=st.util.print.

160. In *Computer Associates International v. Quest Software, Inc.*, the district court relied on the terms of the GPL, in particular an exception added to it, to reach the decision that the GPL was not being violated. 333 F. Supp. 2d 688, 698 (N.D. Ill. 2004). The court wrote, "Any user of that [GPL-covered] code is, however, bound by the terms of the GNU General Public License (GPL). The GPL puts restrictions on the modification and subsequent distribution of freeware [sic] programs." *Id.* While the court mistakenly used the term "freeware" to describe "free software," it appears that the court accepted the legitimacy of the copyleft concept within the GPL. Software that is commonly referred to as "freeware" is usually provided at no cost under a proprietary license and typically does not include access to source code. *See* Richard M. Stallman, *Words to Avoid*, *in* FREE SOFTWARE, FREE SOCIETY: SELECTED ESSAYS OF RICHARD M. STALLMAN (Joshua Gay ed., 2002), *available at* http://www.fsf.org/licensing/essays/words-to-avoid.html.

161. SCO mistakenly alleged that IBM was a Delaware corporation in its complaint, but IBM is incorporated in New York. The case was removed to the Federal District Court of Utah soon after the complaint was filed.

contract.[162] SCO claimed that while it was working with IBM on "Project Monterey," a project to develop enterprise-class UNIX systems on Intel processor-based platforms,[163] IBM allegedly misappropriated SCO's proprietary knowledge.[164] IBM's misappropriation was allegedly in the form of contributions of SCO's property to GNU/Linux systems in order to destroy the value of UNIX systems, and thereby, of SCO's business.[165]

The case immediately generated significant media coverage, partly because (1) SCO alleged damages of not less than one billion dollars;[166] (2) SCO hired prominent attorney David Boies of Boies, Schiller and Flexner;[167] (3) the claims SCO made in its complaint depicted GNU/Linux in

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162. Complaint ¶¶ 104-36, Caldera Sys. Inc. v. Int'l Bus. Machs. Corp. (Utah 2003) [hereinafter Complaint], *available at* http://www.sco.com/ibmlawsuit/complaint3.06.03.html. It is notable that this initial complaint contained no claim of copyright infringement.

163. *Id.* ¶¶ 50-55. UNIX® is a registered trademark of The Open Group. *See* The Open Group, *About The Open Group: Boundaryless Information Flow Through Interoperability*, *at* http://www.opengroup.org/tm-guidelines.htm (last visited Feb. 16, 2005).

164. SCO Complaint, *supra* note 162, ¶¶ 50-55, 92-98.

165. It is impossible to appreciate how incongruous some of SCO's claims are without understanding its corporate history. The Santa Cruz Operation (SCO) was a UNIX company, started in 1979, that was acquired by Caldera in 2001, which was a GNU/Linux company founded in 1994. The name "The SCO Group" was adopted under a new CEO in 2002. As just one example of how these changes reduced institutional memory, SCO's complaint alleged that the Linux kernel could never have developed into an enterprise-class product without IBM providing hardware and the accompanying know-how. However, the first shared multiprocessor (SMP) version of the Linux kernel was written by Alan Cox with hardware donated by Caldera. *See Linux SMP*, *at* http://web.archive.org/web/20040202090712/http://www.linux.org.uk/SMP/title.html (last visited Mar. 6, 2005) ("The initial port was made possible thanks to [Caldera logo image with alternate text 'Caldera']."). Additionally, at least one Caldera employee apparently made significant contributions to a now-disputed portion of the Linux kernel, the Journaling File System (JFS). Pamela Jones, *Caldera Employee Was Key Linux Kernel Contributor*, GROKLAW, July 18, 2003, *at* http://www.groklaw.net/article.php?story=128. While a full investigation of numerous similar points is not possible here, the story can be partially unraveled at Eric Raymond, *OSI Position Paper on the SCO-vs.-IBM Complaint* (May 25, 2004), *at* http://www.opensource.org/sco-vs-ibm.html, and The SCO Group, *Company History of SCO*, *at* http://www.caldera.com/company/history.html (last visited Mar. 6, 2005).

166. SCO Complaint, *supra* note 162, ¶ 120. SCO later raised this amount to fifty billion dollars. Hiawatha Bray, *SCO Revokes IBM's Rights to UNIX Code Threatens the Future of Linux as Firm Seeks $50B in Damages*, BOSTON GLOBE, June 17, 2003, at D1.

167. SCO announced Boies' retention in January, *see* Stephen Shankland, *SCO Casts Wider Net for Infringers*, CNET NEWS.COM, Jan. 22, 2003, *at* http://news.com.com/2102 1001_3-981569.html?tag=st.util.print, but may have hired him even earlier, *see* Steven J. Vaughan-Nichols, *SCO Linux/Unix Licensing Nonsense*, Practical Technology (Jan. 16, 2003), *at* http://www.practical-tech.com/business/b01162003.htm ("[U]nnamed sources

an unfavorable light, such as "Prior to IBM's involvement, Linux was the software equivalent of a bicycle. UNIX was the software equivalent of a luxury car.";[168] and (4) SCO's CEO, Darl McBride, offered numerous interviews and held a teleconference for the press the day after the suit was filed.[169]

SCO asserted that it was "the present owner of both UNIX and SCO/UNIX software" and that it had the right to revoke IBM's license to use or sublicense its UNIX systems, both claims that Novell, Inc. would soon contest.[170] SCO initially assured its own GNU/Linux customers that the suit was purely a contractual dispute with IBM, and CEO Darl McBride stated that, "This case is not about the Linux community or us going after them."[171] However, within a few months, SCO, analogized its situation to that of the music industry and sent letters to 1,500 corporate GNU/Linux users explaining its belief that "Linux infringes on our UNIX intellectual property and other rights"[172] and explaining its intent "to aggressively protect and enforce these rights."[173] While many were skeptical of SCO's claims from the beginning,[174] conspiracy theorists felt vindicated

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. . . said that David Boies, of DOJ vs. Microsoft fame, had been hired by SCO to represent the company.").

168. SCO Complaint, *supra* note 162, ¶ 84.

169. *SCO Files Lawsuit Against IBM*, PR Newswire, Mar. 7, 2003.

170. SCO Complaint, *supra* note 162, ¶¶ 2, 18, 44, 60, 105, 117. For Novell's claims to own UNIX copyrights and the right to veto SCO's revocations of IBM's rights, see Novell, *Novell's Unique Legal Rights*, *at* http://www.novell.com/licensing/indemnity/-legal.html (last visited Mar. 6, 2005); Letters between Joseph A. LaSala, Jr., Senior Vice President of Novell, Inc. and Ryan E. Tibbitts, General Counsel of SCO, can be obtained at http://www.novell.com/licensing/indemnity/zip/correspondence.zip. Of particular interest are the letters dated June 9, 2003; June 12, 2003; August 4, 2003; December 23, 2003; and February 11, 2004. These letters assert Novell's ultimate authority over SCO's UNIX licenses and assert ownership of UNIX copyrights.

171. Peter Galli, *SCO: IBM Suit Not About Linux*, EWEEK, Mar. 7, 2003, *at* http://www.eweek.com/print_article2/0,2533,a=38189,00.asp.

172. Peter Galli, *SCO Warns Linux Users of Legal Liability*, EWEEK, May 14, 2003, *at* http://www.eweek.com/print_article2/0,2533,a=41623,00.asp; *see* Letter from Darl McBride, President and CEO, The SCO Group, to Lucio A. Noto, Audit Committee Chair, IBM 2 (May 12, 2003) [hereinafter McBride Letter], *available at* http://www.groklaw.net/pdf/Doc-41-I.pdf. This letter was sent to 1500 corporate GNU/Linux users. *See* Galli, *supra* note 171, at 2.

173. McBride Letter, *supra* note 172, at 2.

174. Members of the free software community, organized by Groklaw.net, collaboratively wrote an open letter to SCO CEO, Darl McBride. While the letter appeared after the announcement of Microsoft's purchase of a UNIX license, it summarized the reactions to the SCO suit by many in the community both before and after that announcement. Letter from members of The Open Source/Free Software Community at Groklaw to Darl McBride, CEO, The SCO Group (Sept. 18, 2003), *available at* http://www.

when it was revealed that, just over two months after SCO filed suit against IBM, Microsoft bought a UNIX license from SCO for between $10-20 million.[175] Some speculated that this UNIX license was merely a means for Microsoft to pay for someone else to blunt the competition it was increasingly seeing from GNU/Linux.[176]

SCO's original complaint has been amended several times, and IBM's counterclaims stretch into the double digits.[177] The case is still fought in the press as much as in court.[178] However, this complex legal fight may yet yield a long-awaited U.S. ruling on the enforceability of the GPL.

1. *Will the GPL Be Tested in a U.S. Court?*

The possibility for a test of the GPL in the United States arose in August 2004 when IBM filed a motion for partial summary judgment as to one of its many counterclaims against SCO.[179] The counterclaim asserted that SCO had violated the terms of the GPL in two ways. First, IBM alleged SCO violated the GPL by implementing its SCOsource Licensing program in an attempt to extract licensing fees from GNU/Linux users. IBM alleged that this was a violation of the GPL because it imposed an additional restriction on the rights of downstream users of software licensed under the GPL, which is forbidden by Section 6.[180] Second, IBM

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groklaw.net/staticpages/index.php?page=20030923112622826. For related research used in the preparation of that letter, see Pamela Jones and the Groklaw Team, *Digging for Truth*, INQUIRERE, Sept. 19, 2003, *at* http://www.theinquirer.net/?article=11649.

175. Dan Richman, *Microsoft, SCO Reach Deal on UNIX*, SEATTLE POST-INTELLIGENCER, May 20, 2003, at C2.

176. Timothy Prickett Morgan, *Microsoft Licenses Unix from SCO Group*, IT JUNGLE, May 21, 2003, *at* http://www.itjungle.com/mid/mid052103-story03.html; *see* Peter Galli, *Microsoft Covers Back With SCO Unix License*, EWEEK, May 26, 2003 ("A Unix/Linux programmer in Boston also questioned whether Microsoft really needed another Unix license given that it held one of the original ATT Unix licenses, the same one Sun Microsystems Inc. has. [A Microsoft spokeswoman] declined to comment."), *at* http://www.eweek.com/print_article2/0,2533,a=42354,00.asp.

177. *SCO v. IBM Legal Documents With Exhibits*, Groklaw, *available at* http://www.groklaw.net/staticpages/index.php?page=20041008201501977#scovibm (last visited Feb. 16, 2005).

178. A LexisNexis news search for "SCO and IBM" produced 1,082 results for 2004.

179. Redacted Memorandum in Support of IBM's Motion For Partial Summary Judgment on its Counterclaim for Copyright Infringement (Eighth Counterclaim), The SCO Group, Inc. v. Int'l Bus. Machs. Corp. (D. Utah 2004) (No. 2:03CV-0294 DAK), [hereinafter IBM Summary Judgment Motion], *available at* http://www.utd.uscourts.gov/reports/ibm/00000231.pdf.

180. The SCOsource program, if it purports to require licensing fees for already-distributed GPL-covered code, is a violation of the GPL's Sections 4 and 6, because an attempt to impose a different license with an accompanying licensing fee on third parties

argued that SCO was distributing sixteen of IBM's own contributions to the Linux kernel, while simultaneously rejecting the GPL license that covers them. This is analogous to the successful argument Harald Welte and the netfilter/iptables project made in Munich.[181] IBM essentially argued, that if SCO distributes IBM's code, then SCO has to accept IBM's license.[182] If SCO has repudiated the GPL, then Sections 4 and 5 indicate that SCO has no right to distribute the GPL-covered code.

IBM was able to bring this enforcement action because it holds copyrights in over 783,000 lines of code in the Linux kernel and licenses them under the GPL.[183] Sixteen such contributions are specified in IBM's motion.[184] SCO appeared to repudiate the GPL license, in several of SCO's answers to IBM's counterclaims,[185] and SCO's CEO even publicly claimed, in an open letter on the SCO website, that the GPL was an unconstitutional violation of U.S. copyright and patent laws,[186] despite the fact that SCO continued to distribute code licensed under the GPL.

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who have already received GPL-covered code would be an impermissible further restriction on those recipients' exercise of the rights granted to them by the GPL. Thus, SCO must be careful to insist that it is only charging for its own software, not covered by the GPL, which would be permissible.

181. *See supra* Part IV.B.

182. Notably, IBM could lose this motion and it would not necessarily mean that the GPL is not enforceable. If SCO could show that there remain material facts in dispute, partial summary judgment would be premature.

183. IBM Summary Judgment Motion, *supra* note 179, at 6.

184. *Id.* at 3-5.

185. SCO's Answer to IBM's Amended Counterclaims ¶¶ 23, 25, 27, 71, 73, 108, 120, 122, The SCO Group, Inc. v. Int'l Bus. Machs. Corp. (D. Utah 2004) (No. 03-CV-0294) [hereinafter SCO's Answer] (essentially repeating the phrase "denies the enforceability of the GPL"), *available at* http://www.groklaw.net/pdf/AnswerAmendCC.10-24-03.pdf; *see id.* at 16 (Sixth Affirmative Defense: "The General Public License ('GPL') is unenforceable, void and/or voidable, and IBM's claims based thereon, or related thereto are barred"); *id.* (Eighth Affirmative Defense: 'The GPL violates the U.S. Constitution, together with copyright antitrust and export control laws, and IBM's claims based thereon, or related thereto, are barred"). *See also Side-by-Side Comparison of IBM Counterclaims and SCO Answer*, Groklaw, Nov. 1, 2003, *at* http://www.groklaw.net/article.php?story=20031101060614944. SCO again alleged each of the above in its SCO's Amended Answer to IBM's Amended Counterclaims, The SCO Group, Inc. v. Int'l Bus. Machs. Corp. (D. Utah 2004) (No. 03-CV-0294), *available at* http://www.utd.uscourts.gov/reports/ibm/00000112.tif (last visited Feb. 16, 2005), and each of them yet again in SCO's Answer to IBM's Second Amended Counterclaims, The SCO Group, Inc. v. Int'l Bus. Machs. Corp., (D. Utah 2004) (No. 03-CV-0294), *available at* http://www.utd.uscourts.gov/reports/ibm/00000141.tif.

186. *Open Letter from Darl McBride, CEO, The SCO Group* (Dec. 4, 2003) [hereinafter *McBride Open Letter*], *at* http://www.caldera.com/copyright. The letter states:

2. *SCO's Reply*

In response to IBM's motion for partial summary judgment, SCO's reply claimed that it had neither repudiated nor violated the GPL.[187] SCO stated that it was not charging licensing fees for GPL-covered code.[188] Rather, SCO asserted that it was charging licensing fees for its UNIX code, which was allegedly inserted into GNU/Linux systems by IBM.[189] SCO acknowledged that the *bulk* of the code in a GNU/Linux distribution is legitimately covered by the GPL, and SCO claimed it was not charging for that code.[190] Instead, SCO asserted that it owned the copyright on *some* code in the Linux kernel, which Novell also claims as its own,[191] and it is this code that SCO claimed to be entitled to charge fees under the SCOsource licenses.

SCO further asserted that, while it may have stated that the GPL was void and unenforceable in documents it filed with the court, those statements should not be held against it, because it is allowed to plead in the alternative.[192] However, SCO's reply fails to address the statements closest to a repudiation of the GPL, the assertions made by its CEO, who pub-

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> SCO asserts that the GPL, under which Linux is distributed, violates the United States Constitution and the U.S. copyright and patent laws. . . . .
>
> . . . .
>
> [W]e believe that responsible corporations throughout the IT industry have advocated use of the GPL without full analysis of its long-term detriment to our economy. We are confident that these corporations will ultimately reverse support for the GPL, and will pursue a more responsible direction.

Id. It is hard to imagine what more one could do to repudiate the GPL than to deny its enforceability and applicability dozens of times on three separate occasions, and then again in an open letter from one's CEO to claim it was an unconstitutional mistake. If SCO's actions did not amount to a repudiation of the GPL, then it may not be possible to repudiate the GPL, and it apparently acts as a license for even those who would refuse it.

187. Opposition to IBM's Motion for Partial Summary Judgment on its Counterclaim for Copyright Infringement (Eighth Counterclaim), at 1, 13, The SCO Group, Inc. v. Int'l Bus. Machs. Corp. (D. Utah 2004) (No. 2:03CV0294DAK) [hereinafter SCO Reply to Summary Judgment], *available at* http://www.utd.uscourts.gov/reports/ibm/00000342.pdf. Instead of "violate," SCO stated "breach the GPL" which assumes that the GPL is a contract. *See supra* note 27. *But see* sources cited *supra* note 64.

188. SCO's Reply to Summary Judgment, *supra* note 187, at 16.

189. Recall that Novell asserts that it owns the copyrights to the UNIX code that SCO claims to be licensing. *See* Novell, *supra* note 170.

190. SCO's Reply to Summary Judgment, *supra* note 187, at 15-17.

191. Although Novell does not assert that the code has been inappropriately placed into the Linux kernel.

192. *Id.* at 14-15; *see* FED. R. CIV. P. 8(e)(2).

licly claimed that the GPL "violates the United States Constitution and the U.S. copyright and patent laws."[193]

3. *Analysis of SCO's Reply*

Until further discovery is completed, at least two material facts in dispute appear to preclude IBM's success on the first prong of its argument related to licensing fees. However, IBM may prevail on its counterclaim of repudiation. SCO's claim that it is only charging for its own code is the only potential response to IBM's motion. Otherwise, if SCO acknowledged that it was charging royalties for GPL-covered code, it would be in violation of the GPL and would likely lose its license. In any case, SCO faces additional problems.

SCO's first problem is that the court may stop it from changing its story. First, SCO has been stating publicly that it is charging $699 for "Linux," not "part of Linux," under a license it calls the "SCO Intellectual Property License for Linux."[194] The court might prevent SCO from claiming that it is merely charging buyers for a fraction of the kernel that it claims as its own. SCO's license fee appears to be a flat fee for an entire kernel or an entire Operating System. So the court could find that this is what it is.[195] Secondly, Novell asserts that it owns the code in question.[196] Therefore, SCO must prove (1) that it owns the code in question and (2) that the code it owns is improperly licensed under the GPL. Given the nature of a motion for summary judgment, it seems premature for the court to resolve this motion based upon the first prong of IBM's argument.[197]

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193. *See* McBride Open Letter, *supra* note 186.

194. The SCO Group, *SCO IP Licenses*, *at* http://shop.sco.com/caldera/summary.jsp ?collection=Scosource (last visited Mar. 6, 2005) [hereinafter The SCO Group, *SCO IP Licenses*] ("SCO IP Paid Up License - 1-CPU - $699.00."); The SCO Group, *SCOsource*, *at* http://www.sco.com/scosource/linuxlicense.html (last visited Mar. 6, 2005).

195. For comparison, Red Hat's Enterprise Linux ES Basic, which includes a year of support, costs half ($349) of what SCO is charging, and RHEL ES Standard costs $799, which includes Installation and Documentation Media (CDs), Printed Installation Guide, and faster phone service response time. *See* Red Hat, Inc., *Red Hat Enterprise Linux ES*, *at* http://www.redhat.com/apps/commerce/rhel/es/? (last visited Feb. 16, 2005). SCO's price of $699 for its "SCO Intellectual Property License for Linux" is comparable then to what other GNU/Linux distributors charge for an entire operating system with a year of support. *See* The SCO Group, *SCO IP Licenses*, *supra* note 194.

196. *See* Novell, *supra* note 170.

197. The public and the author are operating without the benefit of redacted portions of these memoranda that could conceivably resolve some of these facts. However, the dispute with Novell over code ownership is unlikely to have been resolved by any redacted information in these proceedings, leaving at least one material fact in dispute.

IBM's claim of repudiation is more problematic for SCO. SCO failed to even address or explain the public comments made by SCO's CEO that could appear to repudiate the license agreement. Because if a licensee has claimed publicly that the license offered "violates the United States Constitution and the U.S. copyright and patent laws,"[198] then it would be reasonable for the licensor to believe that someone who holds such a view does not intend to be bound by, agree to, accept, or benefit from such a license. Such public statements also are not pleadings and should not fall under Federal Rules of Civil Procedure 8(e)(2). If SCO repudiated, then under contract law, according to Corbin, the injured party no longer has to perform under the contract and has a legal right to damages, a right which arises instantaneously with the repudiation.[199] Moreover, Sections 4 and 5 of the GPL indicate that such repudiation "automatically" terminates the license. SCO nonetheless argued that the GPL does not indicate "when" the license would terminate and claimed that the only notice it received of such termination was from IBM's motion for partial summary judgment itself.[200] However, if the court gives the word "automatically" its plain meaning, this would seem to indicate that SCO's license terminated at the moment SCO's CEO publicly repudiated the GPL. Therefore, the vital question for the court to address is: what constitutes a repudiation of the GPL?[201]

4. *An Early Ruling*

On February 9, 2005, recognizing the benefit that further discovery could have on the outcome of these and other claims by the parties, the court denied without prejudice IBM's motion for partial summary judgment on its counterclaim to enforce the GPL. The court explicitly provided that IBM could renew or refile its motion once discovery is complete.[202] he decision did not reach the merits because there had been no hearing on IBM's motion and the decision was issued more than two weeks before IBM's reply brief was due.

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198. McBride, *supra* note 186.

199. 12 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 1105 (2002).

200. SCO's Reply to Summary Judgment, *supra* note 187, at 24-26.

201. Answering this question may require an initial resolution of whether the GPL is a contract or a pure license. This would be necessary in order to find the appropriate guidance on the respective standards of contract and pure license repudiation. However, the very notion of a repudiation of a pure license seems irrational in most cases. Why repudiate a unilateral grant of permission for which one provided no consideration?

202. Memorandum Decision and Order at 16, The SCO Group, Inc. v. Int'l Bus. Machs. Corp. (D. Utah 2005) (No. 2:03CV0294 DAK), *available at* http://www.utd.uscourts.gov/reports/ibm/00000398.pdf (last visited Feb. 16, 2005).

However, in ruling on another motion, the court gave some indication of its estimation of the parties' positions. The court noted that SCO's reason for seeking dismissal or a stay of IBM's claim for declaratory judgment on the non-infringement and non-inducement counterclaim "transformed during the course of briefing its motion."[203] The court felt SCO contradicted itself: "Notwithstanding SCO's puzzling denial in its briefing that it has not alleged a claim against IBM for copyright infringement arising out of its use, reproduction, or improvement of Linux, it clearly has alleged such a claim."[204] The court also expressed displeasure at SCO's use of the press: "Indeed, in light of SCO's lawsuit against [another corporate GNU/Linux user] and SCO's public statements during the last two years, which have essentially invited this claim, it is incomprehensible that SCO seeks to postpone resolution of this claim."[205] Finally, the court provided the best indication yet that this litigation will end favorably for IBM:

> Viewed against the backdrop of SCO's plethora of public statements concerning IBM's and others' infringement of SCO's purported copyrights to the UNIX software, it is astonishing that SCO has not offered any competent evidence to create a disputed fact regarding whether IBM has infringed SCO's alleged copyrights through IBM's Linux activities. Further, SCO, in its briefing, chose to cavalierly ignore IBM's claims that SCO could not create a disputed fact regarding whether it even owned the relevant copyrights.
>
> Nevertheless, despite the vast disparity between SCO's public accusations and its actual evidence—or complete lack thereof—and the resulting temptation to grant IBM's motion, the court has determined that it would be premature to grant summary judgment . . . .[206]

Even though the court determined that it was necessary to complete discovery before ruling on any dispositive motions, the court sent a strong signal to SCO that the time for hard evidence has arrived, and that, without it, IBM can renew or refile its motions and expect success.[207] If IBM chooses to renew or refile its motion to enforce the GPL, one thing seems certain: simply by looking to the facts and to the terms of the GPL to determine the outcome, the district court can do much to indicate that the GPL is a valid and enforceable license. No one seriously suspects that the court will find the GPL unconstitutional and violative of the copyright and

203. *Id.* at 3.
204. *Id.* at 4.
205. *Id.*
206. *Id.* at 10.
207. *Id.* at 16.

patent laws, despite SCO CEO Darl McBride's claims. Indeed, IBM appears to be well on its way to making the same argument that succeeded for Harald Welte in Munich: "You refuse the only license terms offered, yet you distribute the code. This makes you an infringer."

V. CONCLUSION

The GPL grew out of Richard Stallman's fervent desire to provide freedom to software users and developers. It has been widely adopted by both those who share his vision for a more free society and by those who simply appreciate the practical benefits that software freedoms provide. Some challenges still face the free software community that grew up around the GPL: the proliferation of software patents could derail the progress made thus far, what constitutes a derivative work within software remains contested and somewhat unclear, and a firm court decision on the GPL's enforceability continues to be elusive. The past year saw greater recognition of the problems software patents pose to the free software community and some moves were made to address them. Additionally, the Munich court decision enforcing the GPL and the continuing success of private GPL enforcement has bolstered the legal certainty surrounding the GPL. Furthermore, SCO's dispute with IBM may yet provide a U.S. ruling on the GPL. Finally, a Version 3 of the GPL is in the works,[208] and it also will likely address these issues while continuing to encourage software users and developers to share and share alike.

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208. *See* Peter Galli, *GPL 3 to Take on IP, Patents*, EWEEK, Nov. 22, 2004, *at* http://www.eweek.com/article2/0,1759,1730102,00.asp; Peter Galli, *Rewriting GPL No Easy Task*, EWEEK, Feb. 2, 2005, *at* http://www.eweek.com/article2/0,1759,1758752,00.asp; Stephen Shankland, *Sprucing up Open Source's GPL Foundation*, CNET NEWS.COM, Dec. 23, 2004, *at* http://news.zdnet.com/2102-3513_22-5501561.html?tag=printthis.

BERKELEY TECHNOLOGY LAW JOURNAL
ANNUAL REVIEW OF LAW AND TECHNOLOGY

COPYRIGHT IN ENTERTAINMENT LAW AND NEW MEDIA

MGM STUDIOS, INC. V. GROKSTER, LTD. & IN RE AIMSTER LITIGATION: A STUDY OF SECONDARY COPYRIGHT LIABILITY IN THE PEER-TO-PEER CONTEXT

By Andrew J. Lee

Twenty years ago, copyright owners challenged the legality of the Sony Betamax video tape recorder ("VTR") in the landmark Supreme Court case *Sony Corp. of America v. Universal City Studios, Inc.*[1] The fundamental question posed to the Court was whether Sony, as the manufacturer of a copying device, could be held secondarily liable for the copyright infringements of its end users.[2] In a 5-4 decision the Court declined to find Sony liable,[3] and articulated a broad standard that shields a technology provider from secondary liability if its product is capable of "substantial noninfringing uses."[4]

This past year, in *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.* ("*Grokster II*"),[5] the Ninth Circuit affirmed the applicability of the *Sony* doctrine to peer-to-peer (P2P) file sharing computer software.[6] Specifically, the court determined that P2P software distributors Grokster and StreamCast Networks could not be held liable as contributory copyright infringers because, like Sony in part, their products were capable of substantial noninfringing uses.[7]

Grokster II is a significant legal victory for technology advocates because it marks the first time a P2P provider has been able to successfully invoke *Sony* as a defense. However, the future reach of secondary copyright liability in the digital age remains fluid for several reasons. First, the Ninth Circuit opinion now arguably conflicts with the Seventh Circuit's *In re Aimster Copyright Litigation* decision in its interpretation of the scope

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1. *See* 464 U.S. 417 (1984).
2. *Id.* at 420.
3. *Id.* at 418, 456.
4. *See id.* at 442.
5. 380 F.3d 1154 (9th Cir. 2004) [hereinafter *Grokster II*].
6. *See id.* at 1162.
7. *See id.* at 1162-64. The Ninth Circuit applied the *Sony* rule in the course of analyzing the defendants' liability under the common law test for contributory liability. The court also determined that the defendants could not be held liable as vicarious infringers. *Id.* at 1164-66. The distinction between contributory and vicarious copyright infringement is discussed further in Part I.

of the *Sony* shield,[8] setting the stage for a re-examination of the *Sony* doctrine by the Supreme Court.[9] Second, in the absence of clear Supreme Court adjudication, it is uncertain whether other circuits will choose to adopt the Ninth Circuit, Seventh Circuit, or some alternative analysis. Finally, copyright owners from the entertainment industries have made, and continue to make, concerted attempts to overturn *Sony* through legislative action.[10]

Part I of this Note gives context to the *Grokster II* opinion by reviewing the common law doctrines of secondary copyright liability, the *Sony* decision, and the basics of P2P technology. Part II examines the two P2P cases that preceded *Grokster II*—*Napster* and *Aimster*—and discusses how the respective courts assessed the secondary copyright liability of those providers. Part III reviews the Ninth Circuit's decision in *Grokster II*. Finally, Part IV explores the doctrinal differences between the Ninth and Seventh Circuits' interpretation of *Sony*, and proposes that the *Grokster II* decision creates a circuit split requiring clarification by the Supreme Court. Part IV also considers the legal and policy issues that are implicated by *Grokster II* and *Aimster*.

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8. *See* 334 F.3d 643, 649 (7th Cir. 2003) (suggesting, *inter alia*, that courts should take into account the ratio of infringing to noninfringing uses of a product in determining secondary liability). The Seventh Circuit's interpretation of *Sony* is discussed further in Part II.

9. The plaintiff copyright owners in *Grokster II* filed a petition for a writ of certiorari on October 8, 2004, which can be found at http://www.eff.org/IP/P2P/MGM_v_Grokster. The Supreme Court granted certiorari on December 10, 2004, and scheduled oral arguments for March 29, 2005; it will likely make a final ruling by the summer of 2005. MGM Studios, Inc. v. Grokster, Ltd., 125 S. Ct. 686 (2004); *see* Elec. Frontier Found., *Supreme Court to Hear MGM v. Grokster*, http://eff.org/news/archives/2004_12.php#002139 (last visited Jan. 20, 2005).

10. The Inducing Infringement of Copyrights (INDUCE) Act, the latest proposed bill targeting peer-to-peer file sharing networks, would hold secondarily liable anyone who "induces" the direct copyright infringement of another. *See* U.S. COPYRIGHT OFFICE, 09/02/04 DISCUSSION DRAFT (2004) (U.S. Copyright Office discussion draft of the INDUCE Act), *available at* http://www.corante.com/importance/archives/Copyright_Office_Discussion_Draft_Alternative_INDUCE_Act.pdf. Negotiations over the draft form of the bill appear to have ended without resolution in the last congressional term, but may be revived this term. *See* Reuters, *Controversial Copyright Bill Dies in Senate*, MSNBC NEWS, Oct. 8, 2004, http://msnbc.msn.com/id/6208947.

I. BACKGROUND

A. Theories of Secondary Copyright Liability

The purpose of copyright law is to promote the public welfare by encouraging the creation and dissemination of expressive works.[11] To that end, the Copyright Act grants authors the exclusive right to reproduce, distribute, perform, display, or license their works.[12]

While the Copyright Act imposes liability only for direct infringement of authors' exclusive rights, courts have also protected copyright monopoly privileges through the imposition of secondary infringement liability. Direct liability is codified at § 501(a) of the Copyright Act: "Anyone who violates any of the exclusive rights of the copyright owner as provided by sections 106 through 122 . . . is an infringer."[13] In contrast, the two recognized theories of secondary copyright liability, contributory and vicarious infringement, are common law doctrines.[14]

Contributory liability evolved from the tort concept of enterprise liability, and exists when: (1) the alleged secondary infringer has knowledge of direct infringement by another and (2) said infringer causes, induces, or materially contributes to the infringement.[15] Vicarious copyright infringement grew out of the agency doctrine of *respondeat superior*, although a finding of vicarious infringement does not require a formal agency relationship between the vicarious and direct infringer.[16] Rather, liability under this theory arises from: (1) direct financial interest in the

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11. The Constitution grants to Congress 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." U.S. CONST. art. I, § 8, cl. 8; *see also* Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 432 (1984) ("The immediate effect of our copyright law is to secure a fair return for an 'author's' creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good.").

12. *See* 17 U.S.C. § 106 (2000). There are certain exceptions to these exclusive rights, such as fair use. *See id.* § 107.

13. *Id.* § 501(a).

14. *See* 3 MELVIN B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 12.04 (2004).

15. *Id.*; *see also* Gershwin Publ'g Corp. v. Columbia Artists Mgmt., Inc., 443 F.2d 1159, 1162 (2d Cir. 1971) (defining a contributory copyright infringer as "one who, with knowledge of the infringing activity, induces, causes, or materially contributes to the infringing conduct of another").

16. 3 NIMMER & NIMMER, *supra* note 14, § 12.04.

infringement of another and (2) the right and ability to supervise the infringing conduct.[17]

B. *Sony Corp. of Am. v. Universal Studios, Inc.*

In 1984, the *Sony* Court faced the question of how to assess the secondary liability of a technology provider that markets or distributes a product that may be used for infringing purposes.[18] Plaintiffs Disney and Universal Studios sought to establish Sony's liability based upon the allegations that Sony: (1) supplied the "means" to accomplish infringement of their copyrighted television programs and movies through the "record" function of the Betamax VTR and (2) encouraged infringing activity by advertising its product.[19] The *Sony* majority specifically rejected this argument, stating that there existed no judicial precedent or statutory mandate to support such a theory of liability.[20] Instead, the Court turned to the "staple article of commerce" doctrine from patent law for guidance.[21] This exception to secondary liability, codified at § 271 of the Patent Act, states that a patentee cannot enjoin others from making, using, or selling an article, even if the article capable of being used to infringe a patent, if the article is also "a staple article or commodity of commerce suitable for substantial noninfringing use."[22] The Court recognized two important concepts underlying this doctrine: (1) "the critical importance of not allowing the patentee to extend his monopoly beyond the limits of his specified grant"[23] and (2) the need to "strike a balance between . . . effective—not merely symbolic—protection of the statutory monopoly, and the rights of others freely to engage in substantially unrelated areas of commerce."[24] Finding these issues

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17. *Id.* In a series of early decisions known as the "Dance Hall cases," federal courts first defined the contours of vicarious copyright liability. *See, e.g.*, Dreamland Ball Room, Inc. v. Shapiro, Bernstein & Co., 36 F.2d 354 (7th Cir. 1929) (holding that the proprietor of a dance hall is liable for unauthorized performances of copyrighted musical compositions in the hall if the performances are for the profit of the proprietor).

18. *See* Sony Corp. of America v. Universal City Studios, Inc., 464 U.S. 417, 420 (1984).

19. *Id.* at 436.

20. *Id.* at 437-38. The plaintiffs asserted that the Court's previous ruling in *Kalem Co. v. Harper Bros.*, 222 U.S. 55 (1911), substantiated their theory. However, the *Sony* majority rejected this argument, stating that "*Kalem* did not merely provide the 'means' to accomplish an infringing activity; the producer supplied the work itself, albeit in a new medium of expression"—namely, an unauthorized film version of the book *Ben Hur*. *Id.* at 436.

21. *See id.* at 440-41.

22. *Id.* at 440.

23. *Id.* at 441.

24. *Id.* at 442.

equally relevant to the question of secondary copyright liability,[25] the majority declared "the sale of copying equipment, like the sale of other articles of commerce, does not constitute contributory [copyright] infringement if the product is . . . capable of substantial noninfringing uses."[26]

Under this newly created standard, the majority concluded that Sony could not be held liable as a contributory infringer because the Betamax VTR was capable of at least one substantial noninfringing use: the private, noncommercial time-shifting of television programs.[27]

C. Understanding Peer-To-Peer File Sharing Systems

"Peer-to-peer" is one species of a general class of computer networking paradigms. These paradigms prescribe the way in which nodes of a network are connected to each other (sometimes referred to as the logical network topology) and the direction in which data flows from node to node.[28]

Perhaps the most familiar type of networking paradigm is the "client/server" model utilized by many popular Internet applications, such as the World Wide Web (WWW) and File Transfer Protocol (FTP).[29] In the client/server model, there are two types of network nodes: the data provider (server) and data consumer (client).[30] Data consumers connect to data providers in a "hub and spoke" fashion, and data on the network

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25. *Id.* ("[I]n both areas [copyright and patent law] the contributory infringement doctrine is grounded on the recognition that adequate protection of a monopoly may require the courts to look beyond actual duplication of a device or publication to the products or activities that make such duplication possible.")

26. *Id.*

27. *Id.*

28. *See generally* DAVID BARKAI, PEER-TO-PEER COMPUTING: TECHNOLOGIES FOR SHARING AND COLLABORATING ON THE NET 4-19 (2002); Jim McKeeth, *A Guide to Peer-2-Peer*, *at* http://www.bsdg.org/Jim/Peer2Peer/Paper/3214.html (last visited Jan. 14, 2005).

29. *See* Jesse M. Feder, *Is Betamax Obsolete?:* Sony Corp. of America v. Universal City Studios, Inc. *in the Age of* Napster, 37 CREIGHTON L. REV. 859, 863 (2004) (noting that the client/server paradigm is the "predominant model for most interactions between Internet users and Internet resources"); *see also* Tim Wu, *When Code Isn't Law*, 89 VA. L. REV. 679, 719-20 (2003) (identifying the World Wide Web as the "archetypal client-server model").

30. Client/server systems are occasionally referred to as "two tier" architectures to reflect the hierarchical relationship between provider and consumer. Note, however, that there also exist multi-tier architectures that fall under the rubric of "client/server." These multi-tier approaches incorporate intermediate processing layers between the logical client and server for various purposes, such as queuing and application execution. *See Client/Server Software Architectures—An Overview*, *at* http://www.sei.cmu.edu/str/descriptions/clientserver_body.html (last updated Jan. 9, 2004).

flows from provider to consumer.[31] By way of illustration, consider the typical, two-step WWW transaction. A client user first requests a resource (such as a webpage or file) by typing in a Uniform Resource Locator (URL) address or clicking a hypertext link in her browser window. The web server identified by the URL receives this request and then responds by transmitting, or "serving," the specified resource. Note that the WWW client does not in turn "serve" information to the server or other clients. Thus, the information flow is unidirectional and all of the data available on the network is centralized on server nodes.[32]

In the peer-to-peer paradigm, the dichotomy between client and server is lost.[33] Each network node is considered an equal "peer" that has the ability to serve data to, and consume data from, each other.[34] Thus, the total information pool accessible on this type of network is decentralized among all of the nodes, rather than centralized on servers.[35]

P2P file sharing applications such as Grokster and Napster are built upon the P2P model and allow users to perform two functions: (1) "share" files with other online users by designating local files as available for download (usually by placing them in a "shared" folder recognized by the program) and (2) search for and download other users' shared files.[36] Computer users can participate in a P2P file sharing network by first downloading application software, usually from the P2P provider's website, and then installing and executing the software.[37] This will log in the user's computer as a node on the P2P network and allow the user to begin sending data to, or receiving data from, other users.[38] The "P2P network" itself is simply the aggregate of all of the users of a P2P application online at a particular point in time.[39]

There are several types of P2P file sharing systems, and they represent different approaches to managing the data decentralization inherent in the P2P paradigm.[40] Recall that the information pool in P2P networks, unlike client/server networks, is spread out among all of the nodes. Therefore, a

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31. *See* McKeeth, *supra* note 28 (describing the client/server model as exhibiting a "star" or "hub and spoke" topology at the logical level).

32. *See* Feder, *supra* note 29.

33. *See* BARKAI, *supra* note 28, at 5 ("The client-server duality exhibited by a peer is a central feature of P2P.").

34. *See id.* at 4-5.

35. *See* Feder, *supra* note 29.

36. *See* Wu, *supra* note 29, at 717-18.

37. *Id.* at 721.

38. *See id.* at 717-18.

39. *Id.*

40. *See id.* at 727-40.

P2P platform must provide some mechanism for searching the data that is available. At present, there are three methods that have been implemented to tackle this problem: centralized indexing, supernode indexing, and local indexing.[41]

In the case of centralized indexing, the P2P provider operates and maintains one or more servers that handle the job of indexing the files available on the network and processing user queries.[42] This arrangement places the P2P provider in the position of an arbiter between those users requesting and offering a given file. This also requires the provider to maintain and store a physical list of users' files (the index) on its own machine(s).[43] Despite the administrative requirements involved, this indexing model has certain technical benefits. For example, the use of dedicated computers as indexing servers means that search performance will likely be better than other, more decentralized schemes.[44] In addition, the extra measure of control provided by centralized search processing may allow the P2P provider to better regulate security of the system.[45] The Napster platform, discussed below, employed a centralized indexing model.[46] Napster also used its central servers for non-search related functions such as user registration and authentication.[47]

Supernode indexing is a hybrid scheme that attempts to capture the performance advantages of centralized indexing, but without the burden on the provider to maintain any central servers.[48] The indexing servers in this model, known as supernodes, are actually user computers on the network selected by the software's protocols based on detected bandwidth.[49] These select user nodes handle the duties of the above described centralized indexing servers. The clear advantage to this method is that the P2P provider is taken "out of the loop" of its users' file sharing activities to the extent that (1) the provider does not need to store any information pertaining to shared files and (2) the provider's equipment is not physically involved in the chain of events from user request to file download.[50]

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41. *See* Feder, *supra* note 29, at 864-67.
42. *Id.* at 864.
43. *See id.*
44. *See id.* at 865-66.
45. *See generally* BARKAI, *supra* note 28, at 192-203 (discussing the security issues implicated in P2P networks).
46. *See* Feder, *supra* note 29, at 864-65.
47. *See* A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1011-12 (9th Cir. 2001).
48. *See* Feder, *supra* note 29, at 865.
49. Wu, *supra* note 29, at 734.
50. *See* Feder, *supra* note 29, at 865-66.

Finally, the local indexing model is a completely decentralized approach to user searching. In this case there is no aggregated index, whether on user or corporate servers. Instead, each node on the network simply maintains an index of the local files being shared on that node.[51] User queries are propagated from node to node until the file is found (or, more likely, an arbitrary propagation cap is reached).[52] Like the supernode model, this approach is attractive to P2P providers because it does not require the administration of central indexing resources. However, local indexing is not as bandwidth efficient as the previously described solutions because of the large amount of network traffic generated by node-to-node searching.[53]

II. THE PRIOR PEER-TO-PEER CASES

P2P file sharing systems enable the trading of any type of digital file, including digitized forms of copyrighted media such as music, books, and even motion pictures. Not surprisingly then, the proliferation of unregulated P2P file sharing on the Internet has been accompanied by an explosion in online copyright infringement.[54] In response, copyright owners and stakeholders from the music recording industry have filed a series of lawsuits against P2P software providers.[55]

It is worthwhile to note here that all of the P2P cases decided thus far have agreed on a few basic points. First, as a threshold matter, the reproduction and distribution of copyrighted works by users of P2P networks constitute direct infringement.[56] Second, *Sony* is the controlling authority

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51. *Id.* at 865.

52. *See id.* P2P platforms based on the local indexing model often use propagation caps to limit user search requests to a manageable subset of the network. *Id.*

53. *Id.* at 866.

54. *See generally* Peter S. Menell, *Can Our Current Conception of Copyright Law Survive the Internet Age?: Envisioning Copyright Law's Digital Future*, 46 N.Y.L. SCH. L. REV. 62 (2002-2003) (discussing the impact of digital technologies such as P2P networks, and the widespread copyright infringement they have engendered, on the entertainment industries).

55. While copyright owners continue their legal battles against P2P providers, they have also begun to target individual P2P users for infringement lawsuits. *See* Elizabeth Miles, Note, *In re* Aimster & MGM Studios, Inc. v. Grokster, Ltd.*: Peer-to-Peer and the* Sony *Doctrine*, 19 BERKELEY TECH. L.J. 21, 56-57 (2004).

56. The Ninth Circuit engaged in a fair use analysis to determine whether users of the Napster system were direct infringers. The court concluded that trading copyrighted MP3 files over the Napster network did not constitute fair use and thus directly infringed the copyrights on the traded works. *See* A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1013-18 (9th Cir. 2001).

on the issue of secondary copyright liability. Where the courts have differed is in interpreting the extent to which the *Sony* "substantial noninfringing uses" standard shields P2P providers.

A. *A&M Records, Inc. v. Napster*

Napster was the first mainstream P2P platform to appear, and it quickly grew in size and notoriety; within a year of its debut, tens of millions of users were actively trading MP3 files on its network daily.[57] However, Napster also quickly attracted the attention of the music industry and the Recording Industry Association of America (RIAA). Hoping to shut down online infringement at its apparent source, copyright owners and the RIAA brought suit against Napster in December of 1999.[58] The Ninth Circuit found Napster liable for both contributory and vicarious copyright infringement, and the company went bankrupt shortly thereafter.[59]

The Napster system employed a central indexing P2P model whereby Napster maintained central servers for file indexing and user registration.[60] These servers played a key role in shaping the Ninth Circuit's legal analysis. Napster claimed that, as a technology provider of a product capable of substantial noninfringing uses, it was shielded from secondary liability under *Sony*.[61] The court acknowledged the relevance of the *Sony* standard to the case, but also asserted that Napster's maintenance and operation of central servers created a separate basis of liability regarding its conduct under the common law test for contributory copyright infringement.[62] Therefore, the court held that (1) under *Sony*, it could not impute constructive knowledge of infringement if the Napster software was capable of substantial noninfringing uses, but (2) *Sony* aside, Napster could still be liable as a contributory infringer if it had actual knowledge of specific acts of infringement and materially contributed to those acts.[63] In a separate part of its decision, the court also considered Napster's vicarious liability under the common law vicarious infringement test.[64]

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57. *See* Wu, *supra* note 29, at 728.

58. *See id.*

59. *Id.* at 729.

60. *Napster*, 239 F.3d at 1011.

61. *Id.* at 1020.

62. *See id.* ("We are compelled to make a clear distinction between the architecture of the Napster system and Napster's conduct in relation to the operational capacity of the system.").

63. *Id.* at 1020-21.

64. *Id.* at 1022. The Ninth Circuit declined to apply *Sony* to the doctrine of vicarious liability, although some commentators have suggested that the *Sony* majority did, in fact, intend for its rule to extend to both theories of secondary liability. *See, e.g.*, Mark A.

In retrospect, the court's combination of the *Sony* substantial noninfringing use inquiry with the knowledge prong of the common law test is awkward because there is no clear doctrinal connection between the *Sony* standard and constructive knowledge.[65] Even in *Sony* itself, the Supreme Court acknowledged that Sony knew its VTRs were being used to commit acts of infringement.[66] Nevertheless, Sony was shielded from liability due to the noninfringing capabilities of its product.

The issue of conduct became the lynchpin in the copyright owners' case against Napster. The court made no finding as to whether the Napster software satisfied the substantial noninfringing uses standard,[67] but held Napster liable for contributory infringement because (1) it had actual knowledge of infringing content on its network from notices provided by the RIAA and (2) it materially contributed to infringement by providing its centralized services.[68] Similarly, the court found Napster liable for vicarious infringement because it stood to financially benefit from increasing levels of infringing activity on its network, and it had the right and ability to supervise its users by way of its user registration and authentication system.[69]

The Ninth Circuit's application of *Sony* can best be understood as a two-stage analysis of Napster as a provider of both (1) a *service* (Napster's maintenance and operation of its network) and (2) a *product* (the Napster P2P software). In the former case, a measure of control over infringing activity is implicated and, thus, the common law contributory infringement test applies. In the latter, *Sony* applies. The court can be understood to have held Napster liable as a service provider because Napster was in a position to materially contribute to known acts of infringement and it did

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Lemley & R. Anthony Reese, *Reducing Digital Copyright Infringement Without Restricting Innovation*, 56 STAN. L. REV. 1345, 1358-59 (2004).

65. *See* 2 PAUL GOLDSTEIN, COPYRIGHT § 6.1.2 (Supp. 2005).

66. Sony Corp. of America v. Universal City Studios, Inc., 464 U.S. 417, 426 (1984) ("The District Court assumed that Sony had constructive knowledge of the probability that the Betamax machine would be used to record copyrighted programs.").

67. *Napster*, 239 F.3d at 1021 (noting that "the district court improperly confined the use analysis to current uses, ignoring the system's capabilities," but "whether we might arrive at a different result is not the issue here").

68. *Id.* at 1022.

69. *Id.* at 1023 (noting that Napster had the ability to block individual infringers' access to the system and failed to exercise that right to prevent known acts of infringement).

so.[70] As a result, the court did not have to resolve the question of Napster's contributory liability as a product provider.

The injunction the court imposed upon Napster reflected this distinction between service and product. The injunction's terms did not require Napster to stop distributing its software; rather, the order required Napster to modify its conduct in administrating its network in order to comply with the applicable common law.[71] As a practical matter, however, Napster was unable to fully comply with the court's injunction and ultimately shut down.[72]

B. *In re Aimster Copyright Litigation*

In the *Aimster* case, music copyright owners brought suit for secondary copyright infringement against Aimster, a P2P service that piggybacked on America Online's Instant Messenger technology.[73] The Seventh Circuit addressed the question of whether the district court was correct in granting a preliminary injunction against Aimster,[74] and concluded that the injunction was appropriate because Aimster failed to show any actual substantial noninfringing uses of its service and thus the plaintiffs were likely to prevail at trial.[75]

In reaching its decision, the Seventh Circuit outlined a number of considerations that it believed to be relevant in applying the *Sony* doctrine to P2P technology cases. These considerations, although mainly dicta, significantly limited the protection offered by the "substantial noninfringing uses" shield. First, the court recognized that, unlike Sony, P2P service providers may have an ongoing relationship with their customers, and such a relationship (to the extent to which the provider has control over its users' activities) should be a factor in determining the liability of the provider as a contributory infringer.[76]

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70. *See* Lee B. Burgunder, Comment, *Reflections on* Napster*: The Ninth Circuit Takes a Walk on the Wild Side*, 39 AM. BUS. L.J. 683, 687-88 (2002) (identifying control as the distinguishing factor between providers Sony and Napster).

71. *Napster*, 239 F.3d at 1027.

72. *See* Wu, *supra* note 29, at 730.

73. The Aimster service was only available to users of AOL; furthermore, Aimster users could only trade files by connecting to a chat room enabled by the AOL service. *In re* Aimster Litigation, 334 F.3d 643, 646 (7th Cir. 2003).

74. *Id.*

75. *Id.* at 652.

76. However, the Seventh Circuit also noted that a court must take into account the provider's ability to stop known infringing conduct without practically affecting the availability of substantial noninfringing uses of the service. Thus, as an example, the court theorized that a provider of instant messenger software should not be held contribu-

Second, the Seventh Circuit interpreted *Sony* to suggest that courts must estimate and balance the proportion of infringing and noninfringing uses of a product or service in order to assess contributory liability.[77] To support its contention, the court asserted that the *Sony* majority implicitly engaged in a balancing of the infringing and noninfringing uses of the Betamax VTR.[78] According to the *Aimster* court, the *Sony* majority's "action in striking the cost-benefit trade-off in favor of Sony came to seem prescient" once the potential of the prerecorded videocassette market became evident.[79]

Third, the Seventh Circuit addressed the concept of "willful blindness" and stated that purposely preventing oneself from acquiring actual knowledge of infringing activity could not serve as a defense against contributory liability.[80] Aimster employed encryption technology in its network to purposely shield itself from any actual knowledge of the material its users shared.[81] The court rejected the defendant's argument that it could escape contributory liability through such a tactic.[82]

Fourth, the *Aimster* court suggested that even when there are substantial noninfringing uses of an "Internet file-sharing service, . . . to avoid liability as a contributory infringer the provider of the service must show that it would have been disproportionately costly for him to eliminate or at least to reduce substantially the infringing uses."[83] It is not clear whether the court meant to apply this rule to all products and services, or specifically to Internet file-sharing services.

Finally, the court held that the mere physical capability of a product or service for noninfringing use is insufficient to invoke the *Sony* shield.[84] Rather, in the context of possible future noninfringing uses, the important inquiry is how probable those potential uses are.[85] To hold otherwise, claimed the court, would "be an extreme result, and one not envisaged by

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torily liable for the infringing conduct of its users, even though it could prevent those infringements by policing its service, because such liability would be overly burdensome to the provider and would threaten the continued availability of legitimate uses for its instant messenger software. *Id.* at 648.

77. *See id.* at 649.
78. *Id.*
79. *Id.* at 649-50.
80. *Id.* at 650-51.
81. *Id.*
82. *Id.*
83. *Id.* at 653.
84. *Id.* at 651.
85. *Id.*

the *Sony* majority."[86] Applying this last rule, the court found that Aimster failed to show either actual or probable future noninfringing uses of its service, and thus the *Sony* shield did not apply.[87]

III. *MGM STUDIOS, INC. V. GROKSTER, LTD.*

A. Facts and Procedural Posture

In the district court case *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.* ("*Grokster I*"), plaintiff copyright owners, a consolidated group of organizations from the music recording and motion picture industries, sued defendants Grokster and StreamCast Networks for contributory and vicarious copyright infringement.[88] Grokster and StreamCast distributed P2P file sharing software that was conceptually similar to, but technically distinguishable from, previous generations such as Napster.[89] Grokster's software was a self-branded version of "FastTrack" networking technology that it licensed from Kazaa BV.[90] StreamCast also originally used FastTrack, but by the time of this lawsuit had migrated its product, known as Morpheus, to an open source P2P protocol called Gnutella.[91]

The Grokster platform employed the supernode P2P model whereby select user computers on the network acted as indexing servers.[92] The Morpheus platform employed a fully decentralized local indexing P2P model.[93] Thus, neither defendant stored any file information on its own machines to facilitate user searching. This was in contrast to Napster, which owned and operated central indexing servers.[94] Additionally, Grokster and StreamCast did not collect any user registration information and therefore possessed no ability to authenticate or track users on its networks.[95] In short, "[n]o infringing files or lists of infringing files [were] hosted by defendants, and the defendants [did] not regulate or provide access."[96]

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86. *Id.*
87. *Id.* at 653.
88. 259 F. Supp. 2d 1029, 1031 (C.D. Cal. 2003) [hereinafter *Grokster I*].
89. *Id.* at 1032.
90. *Id.* Kazaa BV was also a defendant in the district court case, but failed to defend against the action (Kazaa had, by that time, passed its P2P software platform to Sharman Networks). Consequently, the court entered a default judgment against Kazaa. *Id.*
91. *Id.*
92. *Grokster II*, 380 F.3d 1154, 1159 (9th Cir. 2004).
93. *See id.*
94. *Id.*
95. *Id.* at 1164.
96. *Id.*

It was undisputed that users of the Grokster and Morpheus software engaged in direct copyright infringement by reproducing and distributing digital versions of copyrighted media.[97] However, defendants asserted that they merely provided a product to the public over which they had no control and therefore were free from any secondary liability for how end users chose to use their networks.[98]

The plaintiffs and defendants filed cross-motions for summary judgment on the issues of contributory and vicarious liability.[99] The district court granted partial summary judgment in favor of Grokster and StreamCast,[100] which the copyright owners then appealed to the Ninth Circuit. In August 2004, the Ninth Circuit affirmed the district court's decision.[101]

B. The Ninth Circuit's Analysis

With respect to the question of contributory liability, the Ninth Circuit closely followed the precedents set in *Sony* and *Napster*. As in *Napster*, the court first determined that it could not impute constructive knowledge of infringement to the defendants if their software was capable of substantial noninfringing uses.[102] Absent constructive knowledge, the court held that defendants could only be liable as contributory infringers if they (1) had actual knowledge of specific acts of infringement at the time they contributed to the infringement and (2) materially contributed to the infringement by failing to act upon that knowledge.[103]

Looking to the facts of the case, the court found that there were several substantial noninfringing uses of the Grokster and Morpheus software.[104] As one "striking example," the court pointed to the music band Wilco, which released its music onto the file sharing networks after it failed to negotiate a recording contract.[105] As a result of the widespread interest generated by this release, the band was able to secure a new contract.[106]

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97. *Grokster I*, 259 F. Supp. 2d 1029, 1034 (C.D. Cal. 2003). The plaintiffs alleged that approximately 90% of the files available on the defendants' networks constituted copyrighted material, of which the plaintiffs owned 70%. *Grokster II*, 380 F.3d at 1158.

98. *Grokster I*, 259 F. Supp. 2d at 1031.

99. *Id.*

100. *Id.* The grant of summary judgment applied only to the defendants' liability arising from the versions of their software in distribution at the start of the district court trial. *Grokster II*, 380 F.3d at 1166.

101. *Grokster II*, 380 F.3d at 1157.

102. *Id.* at 1160.

103. *Id.* at 1161.

104. *Id.*

105. *Id.*

106. *Id.*

The court also noted that both the Grokster and Morpheus systems were used to facilitate the distribution of public domain and government materials.[107] In the court's view, these uses were sufficient to satisfy the *Sony* standard.

Having found that the defendants did not have constructive knowledge of infringement under *Sony* and *Napster*, the court also concluded that defendants did not have actual knowledge *at a time when they contributed* to infringement.[108] Although the record indicated that the defendants did have actual knowledge of infringing activity through various means,[109] the decentralized architecture of the Grokster and Morpheus platforms necessarily precluded the defendants from contributing to infringement at *any* time. Specifically, the defendants did not store any file indexes on their own machines and, therefore, did not provide the "site" or "facilities" for infringement.[110] Thus, Grokster and Morpheus did not have the requisite control over users' infringing conduct to constitute contribution. This analysis also meant that the defendants did not materially contribute to infringement under the second prong of the common law test.

With respect to the question of vicarious liability, the Ninth Circuit again followed *Napster* and applied the common law vicarious infringement test (rather than *Sony*).[111] The court first found that defendants clearly derived a financial benefit through their advertising revenue.[112] Nevertheless, the court held that Grokster and StreamCast did not have the right and ability to supervise its users, as is required by the common law test, because they did not have the technical ability to regulate their users' access to their networks.[113] The copyright owners argued that the defendants could have modified their client software, such as by installing "filters" to block infringing content and thus had the ability to "police" their

107. *Id.*

108. *See id.* at 1162.

109. *Grokster I*, 259 F. Supp. 2d 1029, 1036-37 (C.D. Cal. 2003) (noting that there was a "massive volume" of evidence pointing to the defendants' actual knowledge, including "documents suggesting that both Defendants marketed themselves as 'the next Napster,' that various searches were performed by Defendants' executives for copyrighted song titles or artists, that various internal documents reveal Defendants were aware that their users were infringing copyrights, and that Plaintiffs sent Defendants thousands of notices regarding alleged infringement").

110. *Id.* at 1038 (borrowing the "site and facilities" test for material contribution from *Napster*).

111. *See Grokster II*, 380 F.3d at 1164.

112. *Id.*

113. *See id.* at 1164-65 (noting that the Grokster and Morpheus systems did not have a user registration or log-in capability and therefore could not restrict individual user access to the networks).

users' conduct.[114] The court rejected this argument by drawing a distinction between (1) the obligation to police when there is an ongoing measure of control and (2) the obligation to design one's product to be less susceptible to infringement.[115] The court noted that there is, in fact, no obligation of the latter kind under the copyright law and that the defendants' software was more akin to a product than an "integrated service."[116] Therefore, the court held that the defendants were not liable as vicarious infringers.[117]

The Ninth Circuit concluded its opinion with a caution to other circuits. In its view, P2P software is simply the latest in a long series of technologies that have threatened, but now peacefully coexist with, our copyright regime.[118] Thus, the courts should be wary of expanding the copyright monopoly in the face of emergent technologies:

> [A]s we have observed, we live in a quicksilver technological environment with courts ill-suited to fix the flow of internet innovation. The introduction of new technology is always disruptive to old markets, and particularly to those copyright owners whose works are sold through well-established distribution mechanisms. Yet, history has shown that time and market forces often provide equilibrium in balancing interests, whether the new technology be a player piano, a copier, a tape recorder, a video recorder, a personal computer, a karaoke machine, or an MP3 player. Thus, it is prudent for courts to exercise caution before restructuring liability theories for the purposes of addressing specific market abuses, despite their apparent present magnitude.[119]

IV. DISCUSSION

In *Grokster II*, the Ninth Circuit took a large step towards protecting future innovation in digital technologies by declining to hold P2P providers Grokster and StreamCast liable as secondary infringers. At the same time, the Ninth Circuit's decision has created a conflict with the Seventh Circuit on the proper application of the *Sony* doctrine, thus requiring final adjudication by the Supreme Court. The following discussion will proceed in five parts. Section A demonstrates the existence of a bona fide circuit

114. *Id.* at 1165-66.
115. *See id.*
116. *Id.*
117. *Id.* at 1166.
118. *See id.* at 1166-67.
119. *Id.* at 1167 (citations omitted).

split between the Ninth and Seventh Circuits. Section B highlights doctrinal differences that do not necessarily constitute a circuit split, but nevertheless should be clarified by the Supreme Court. The discussion in Section C argues that the language of the *Sony* decision is inconsistent in parts and thus engenders confusion. Section D demonstrates that the *Grokster II* and *Aimster* opinions reflect fundamental differences of opinion on the proper balance of technology and copyright in the P2P context. The final section, Section E, concludes by elucidating some of the legal and policy issues implicated by the Ninth and Seventh Circuit outcomes.

A. *Grokster II* Creates a Circuit Split with the Seventh Circuit on the Issue of Potential Noninfringing Uses

While the *Grokster II* and *Aimster* opinions reached sharply divergent conclusions on the applicability of the *Sony* defense, some commentators have questioned whether a circuit split actually exists.[120] Viewed narrowly, the Seventh Circuit's holding can be seen as merely invalidating the *Sony* shield in the absence of *any* showing of a potential or actual, substantial noninfringing use.[121] This reasoning is arguably implicit in *Sony* itself and not disputed in *Grokster II*. However, the Seventh Circuit's decision can also be read as turning specifically on the *improbability* of a potential noninfringing use.[122] This consideration is inconsistent with the Ninth Circuit's understanding of *Sony* as explained in *Grokster II*, and provides the basis for a legitimate circuit split.[123]

In determining whether the Aimster service fell within the scope of *Sony* doctrine, the Seventh Circuit enumerated five potential noninfringing uses of the software.[124] These included the distribution of musical works by startup artists who have waived their copyrights and the formation of user "buddy" groups through which users would be able to share ideas and opinions on topics such as popular music[125]—two uses which Aimster had specifically cited as possible legitimate applications of its software at the district court level.[126] The Seventh Circuit acknowledged that all five of the uses were "possibilities," but stated that the mere capability of nonin-

120. *See, e.g.*, Derek Slater, *A Copyfighter's Musings*, Grokster, *Intent, and Cert*, http://blogs.law.harvard.edu/cmusings/2004/08/22#a752 (last updated Aug. 22, 2004) ("Posner's broader interpretation of *Sony* was irrelevant to the *Aimster* case, and thus its conflict with *Grokster* may also be irrelevant.").

121. *See In re* Aimster Litigation, 334 F.3d 643, 652 (7th Cir. 2003).

122. *See id.* at 653.

123. *See Grokster II*, 380 F.3d at 1162.

124. *Aimster*, 334 F.3d at 652-53.

125. *Id.* at 652.

126. *See In re* Aimster Litigation, 252 F. Supp. 2d 634, 653 (N.D. Ill. 2002).

fringing use would not be sufficient to implicate *Sony*: "It is not enough, as we have said, that a product or service be physically capable, as it were, of a noninfringing use."[127] Thus, the court's explicit narrowing of *Sony* to exclude "improbable" uses led directly to its holding against Aimster.

In *Grokster II*, the Ninth Circuit acknowledged that the *Aimster* ruling was based on an inquiry of "how 'probable' the noninfringing uses of a product are," and that this analysis was premised on a "fundamental disagreement" with its own interpretation of *Sony*.[128] Interestingly, the Ninth Circuit attempted to downplay the significance of this disagreement later in the same paragraph by suggesting that the outcome of the *Grokster* litigation would not have been different under *Aimster* principles.[129] The court was correct in the sense that Grokster and StreamCast were able to demonstrate actual noninfringing uses of its software, thus rendering the question of probability moot.[130] However, this does not diminish the existence of a doctrinal split; it merely demonstrates that the Ninth and Seventh Circuit interpretations can reach the same conclusion under certain fact patterns. It is apparent that the two approaches could produce differing results under slightly different facts.

B. *Grokster II* and *Aimster* Also Diverge on Other Important Doctrinal Issues That Require Clarification by the Supreme Court

Beyond the specific question of how to construe the validity of potential uses, the Ninth and Seventh Circuits diverged on three other key issues: (1) the need to estimate the proportion of noninfringing and infringing uses; (2) the role of willful blindness; and (3) the duty of a service provider to implement safeguards against user infringements. Although the Seventh Circuit's thoughts on these issues can be considered dicta, they shed further light on the extent of the current circuit conflict.

First, with respect to the proportion of uses, the *Aimster* court suggested that "when a supplier is offering a product or service that has noninfringing as well as infringing uses, some estimate of the respective magnitudes of theses uses is necessary for a finding of contributory infringement."[131] As a corollary, the Seventh Circuit claimed that Aimster's evidentiary burden included demonstrating the frequency of any actual nonin-

127. *Aimster*, 334 F.3d at 653.

128. *Grokster II*, 380 F.3d at 1162 (stating that the mere capability of substantial noninfringing uses is sufficient to invoke the *Sony* shield).

129. *Id.*

130. *See id.* at 1161.

131. *Aimster*, 334 F.3d at 649.

fringing uses: "Aimster has failed to produce any evidence that its service has ever been used for a noninfringing use, let alone evidence concerning the frequency of such uses."[132] Given the lack of evidence, the court did not have the opportunity to adjudicate on exactly how the "frequency" of a noninfringing use would factor into its analysis.[133] Nevertheless, the court's assertions suggest, particularly when viewed in the P2P context, that technology providers should not be protected from indirect liability if their technology is primarily used for infringement.[134]

The Ninth Circuit specifically rejected any balancing of uses. In response to the copyright owners' argument that the "vast majority" of uses of the defendants' software were illegal, the court reiterated that *Sony* did not contemplate a substantial noninfringing use as a primary use; rather, the product "need only be *capable* of substantial noninfringing uses."[135]

Second, on the issue of willful blindness, the Seventh Circuit noted "[w]illful blindness is knowledge, in copyright law (where indeed it may be enough that the defendant *should* have known of the direct infringement), as it is in the law generally."[136] This is a significant point because, if applied to the facts of *Grokster II*, the defendants could have been held liable. The Ninth Circuit no doubt understood that the Grokster and Morpheus platforms were designed, at least partially, to isolate its providers from the infringing activities of its end users. Thus, the court could have found that the defendants had constructive knowledge from this willful blindness, together with material contribution arising from the "design around" engineering itself. However, the Ninth Circuit did not address this possibility in the opinion. Instead, it stated:

> the peer-to-peer file-sharing technology at issue is not simply a tool engineered to get around the holdings of the *Napster* cases. The technology has numerous other uses, significantly reducing the distribution costs of public domain and permissively shared

132. *Id.* at 653.

133. *Id.*

134. Commentators who disagree with a plain language interpretation of the *Sony* rule in the digital context have proposed a number of alternative legal tests for secondary infringement. *See, e.g.*, Feder, *supra* note 29, at 902-13 (suggesting that courts should find liability when "the commercial significance of the legitimate use of a product is small in relation to its illegitimate use"); *see* Miles, *supra* note 55, at 45-48 (discussing the various legal approaches that have been proposed).

135. *Grokster II*, 380 F.3d at 1162.

136. *Aimster*, 334 F.3d at 650 (citations omitted).

> art and speech, as well as reducing the centralized control of that distribution.[137]

Unfortunately, this statement does not really confront the hard issue of the defendants' willfulness because it says more about P2P technology in general than the defendants' application of it. Furthermore, from a technical standpoint, the court's implication that a for-profit enterprise would purposely decentralize its service to gain some sort of financial or architectural advantage is not particularly plausible. Increasing decentralization in a network service generally decreases the security, performance, and scalability of that service.[138] Thus, it is reasonable to assume that Grokster and StreamCast were driven by considerations separate from technical merits when creating their P2P platforms.

Finally, the Seventh Circuit suggested that, regardless of a service provider's liability under the *Sony* standard, it has a duty to implement economically feasible safeguards that either eliminate or substantially reduce any copyright infringement that might result from use of its service.[139] In other words, in the absence of such safeguards (or evidence that such mechanisms would be disproportionately costly to implement), a service provider could be guilty of secondary copyright infringement despite the existence of substantial noninfringing uses.[140] This is a duty that was not contemplated at all in *Sony or Grokster II*, and places a heavy, and likely unmanageable, burden on service providers.

C. The *Sony* Decision Does Not Provide Clear Guidance for Lower Courts

The doctrinal differences described above can be attributed, in part, to the equivocal manner in which the Supreme Court focused its analysis in the *Sony* decision. The *Sony* majority articulated a broad legal rule, but made a point of highlighting factual details from the district court's findings that implied a much narrower standard. For example, the majority noted that the consumer practice of time-shifting—a use that the majority spent a great deal of time and effort in justifying as a fair use—was the primary use of the Betamax VTR.[141] The Court quoted various surveys

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137. *Grokster II*, 380 F.3d at 1164.

138. *See* Wu, *supra* note 29, at 719; *see also* Feder, *supra* note 29, at 868 ("Peer-to-peer networking is an inferior choice to a central server configuration if the operator's priority is to be able to ensure reliable service, to exercise control over the nature and quality of content or to make the most efficient use of network resources.").

139. *See Aimster*, 334 F.3d at 653.

140. *Id.*

141. Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 423 (1984).

which showed that over 75% of Sony's customers used their VTRs to time-shift programs.[142] Furthermore, the Court observed that the vast majority of Betamax owners still watched as much regularly scheduled television programming as before, suggesting that the commercial impact of time-shifting was minimal.[143] The Court also stressed that the plaintiffs in the case owned, at most, 10% of the copyrighted television programming on the air at the time.[144] While these comments do not preclude the Supreme Court from fashioning a broad rule, they raise the opportunity for courts like the Seventh Circuit to narrowly interpret *Sony* in a way that is still consistent with its factual posture.

D. *Grokster II* and *Aimster* Reflect Fundamental Differences of Opinion on the Proper Balancing of Technology and Copyright in the Digital Age

At a policy level, the Ninth and Seventh Circuits' divergent interpretations seem to be driven by a fundamental disagreement on the relative importance of technological progress and strict copyright protection in the digital era. The Seventh Circuit's secondary liability analysis in *Aimster* was specifically tailored to address the apparent abuses engendered by P2P file sharing technology. For example, P2P networks are primarily, although not solely, used for widespread infringement—thus, the need to consider the proportion of infringing and noninfringing uses. Additionally, P2P providers can structure their code to blind themselves to, but handsomely profit from, user infringement—thus, the need to impute knowledge and impose a duty to stop infringing activities. The *Aimster* court was clearly swayed by the new concerns raised by P2P and sought to stretch *Sony* in order to enforce copyright owners' rights.

In contrast, the legal analysis in *Grokster II* indicates that the Ninth Circuit's primary concern was not for the rights of plaintiff copyright owners, but for the continued development of technology and commerce. Thus, the court declined to consider the willful blindness of P2P providers, or engage in any quantitative comparison of infringing to noninfringing uses. Instead, the court emphasized that the literal "capable of substantial noninfringing uses" standard should apply to P2P providers, regardless of "specific market abuses" or the plaintiffs' "immediate economic aims."[145]

In a sense, the *Aimster* and *Grokster II* decisions are judicial manifestations of the opposing interests in the current P2P debate: strict protection

142. *Id.* at 424.
143. *Id.* at 423-24.
144. *Id.* at 443.
145. *Grokster II*, 380 F.3d 1154, 1166-67 (9th Cir. 2004).

of copyright on the one hand, and technological progress on the other.[146] The Supreme Court needs to provide definitive guidance on if, and how, the balance of these interests should be reweighed in the digital age.

E. Legal and Policy Implications of the Ninth and Seventh Circuit Approaches

Given the uncertain future of secondary copyright liability, it is useful to reflect on the implications of the current circuit decisions. From a legal perspective, *Grokster II* indicates that, at least in the Ninth Circuit, providers of digital technologies will be largely immune from secondary copyright infringement litigation, provided they can demonstrate the capability of substantial noninfringing uses and they do not structure their technology in a way that implicates control over their users' conduct. Considerations such as primary use of the product/service, commercial impact of infringing uses, and the developer's intent in creating the technology are irrelevant. On the other hand, the *Aimster* decision will likely trigger further lawsuits in the Seventh Circuit from the entertainment industry in the face of new technologies because the decision leaves important legal questions about secondary liability—such as how the proportion of infringing to noninfringing uses should be balanced—as yet unanswered.

From a public policy perspective, the relatively stable P2P legal landscape engendered by *Grokster II* will promote investment in and development of further P2P platforms and other digital technologies.[147] At the same time, that development will probably be distinctly influenced by law.[148] In the case of P2P software, the *Grokster II* holding creates the incentive, whether technically desirable or not, to decentralize services as much as possible. This result may have adverse implications on the security, performance, and stability of future P2P platforms that may be substantially used for newly discovered, noninfringing purposes.

Additionally, the Ninth Circuit's decision may be perceived by some as an endorsement of services used to infringe copyrights, thus reinforcing the popular perception that Internet copyright infringement is not an illegal

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146. Commentators on both sides of this debate have weighed in on the relative merits of stronger or weaker protection for technology providers against secondary copyright liability. These different views are expressed in the amicus briefs that have been submitted to the Supreme Court in the *Grokster* case, which are listed at http://www.eff.org/IP/P2P/MGM_v_Grokster (last visited Feb. 27, 2005).

147. *See* Lemley & Reese, *supra* note 64, at 1386-90.

148. *See generally* Ryan Roemer, *The Digital Evolution: Freenet and the Future of Copyright on the Internet*, 2002 UCLA J.L. & TECH. 5 (discussing new P2P technologies such as Freenet that have been developed to withstand the legal challenges encountered by previous systems).

or, at least, a serious, offense.[149] This would, of course, exacerbate the problems of copyright owners trying to protect their intellectual property without the tools of contributory and vicarious copyright infringement litigation.[150]

Aimster's interpretation of *Sony* will no doubt lead to more equitable consequences for copyright owners in certain cases.[151] However, it will also likely put a freeze on the development of technologies that may be used by the public for both infringing and noninfringing purposes.[152] The threat of expensive and risky litigation, the uncertainty in how to develop one's product to avoid secondary liability, and the impossibility of divining how consumers may exploit new technologies are all factors that will likely discourage the creation of new products and services.[153]

V. CONCLUSION

Digital technologies such as P2P file sharing networks have fundamentally changed the way we deal with information. Unfortunately, these technologies have also created what is widely referred to as the "digital

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149. *See* Wu, *supra* note 29, at 724 (highlighting a 1989 Congressional Office of Technology Assessment survey that found sixty-three percent of respondents considered making copies of copyrighted audio material for friends to be "perfectly acceptable"). Professor Wu further argues that P2P networks exploit this social norm by creating a sense of noncommercial "community sharing" among peers. *Id.* at 724-25.

150. Commentators have proposed a number of regulatory, business, and technological schemes as alternatives for copyright owners to pursuing secondary infringement litigation against P2P providers. *See, e.g.*, Lemley & Reese, *supra* note 64, at 1406-25 (discussing, *inter alia*, a levy system for compensating copyright owners and a streamlined dispute resolution system for enforcing copyrights against direct infringers); Jennifer Norman, *Staying Alive: Can the Recording Industry Survive Peer-to-Peer?*, 26 COLUM. J.L. & ARTS 371, 401-09 (2003) (identifying the creation of legitimate online content distribution channels, stronger DRM technologies, and advertising campaigns aimed at changing social norms as alternatives).

151. However, whether such a rule would further promote the output of creative works by artists—a first principle of copyright law—is debatable. Some scholars suggest that artists would not be deterred from producing works in the absence of strong copyright protection, and that our existing copyright regime mainly serves to keep intact current mechanisms of content distribution. *See, e.g.*, Raymond Shih Ray Ku, *The Creative Destruction of Copyright:* Napster *and the New Economics of Digital Technology*, 69 U. CHI. L. REV. 263, 266-69 (2002); Mark S. Nadel, *How Current Copyright Law Discourages Creative Output: The Overlooked Impact of Marketing*, 19 BERKELEY TECH. L.J. 785 (2004).

152. *See* Lemley & Reese, *supra* note 64, at 1374-89; *see also* Heather Green, *Commentary: Are the Copyright Wars Chilling Innovation?*, BUSINESSWEEK, Oct. 11, 2004, http://www.businessweek.com/magazine/content/04_41/b3903473.htm.

153. *See* Lemley & Reese, *supra* note 64, at 1374-89.

copyright dilemma"—namely, the uncontrolled and widespread proliferation of copyright infringement on the Internet.[154] Copyright owners have attempted to protect their rights against P2P software providers on theories of secondary liability, and the courts have responded with inconsistent results. The most recent P2P decision, *Grokster II*, creates a conflict with the Seventh Circuit's *Aimster* decision on the interpretation of the *Sony* doctrine and, thus, raises important doctrinal questions that require clarification by the Supreme Court. The resolutions to those questions will ultimately define the future course of copyright and digital technology.

154. *See* COMMITTEE ON INTELLECTUAL PROPERTY RIGHTS AND THE EMERGING INFORMATION INFRASTRUCTURE, NAT'L RESEARCH COUNCIL, THE DIGITAL DILEMMA: INTELLECTUAL PROPERTY IN THE INFORMATION AGE 23 (2000), *available at* http://www.nap.edu/books/0309064996/html.

PREFACE TO THE TWO *AMICI CURIAE* BRIEFS

Perhaps the most significant copyright case of the year is *MGM, Inc. v. Grokster, Ltd.* In August of 2004, the Ninth Circuit held that peer-to-peer software providers Grokster and StreamCast were not secondarily liable for copyright infringement by individuals who employed the software to share copyrighted files over the Internet. The Supreme Court granted certiorari in December and scheduled oral arguments for the end of March.

The *Grokster* case implicates complex and controversial issues that stand to profoundly affect copyright law. To provide broad perspective on the legal and policy questions raised by the case, this issue features both a Note and two *amicus curiae* briefs filed with the Court by Boalt Hall faculty. The editors hope that this expanded coverage will serve to further the reader's consideration of copyright law's evolution in the digital age.

All the briefs filed in the *Grokster* Supreme Court appeal are available at http://eff.org/IP/P2P/MGM_v_Grokster.

No. 04-480

In The

Supreme Court of the United States

METRO-GOLDWYN-MAYER
STUDIOS INC., et al.,
Petitioners,
v.
GROKSTER, LTD., et al.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF PROFESSORS PETER S. MENELL, DAVID NIMMER, ROBERT P. MERGES, AND JUSTIN HUGHES, AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS*

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January 24, 2005

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INTEREST OF *AMICI CURIAE*

The signatories of this brief are professors of law who have conducted research on copyright and patent law for nearly two decades and have particular expertise on the challenges posed by digital technology. We have received consent to file this *amicus* brief from both parties in this litigation.[1] We submit views on what we perceive to be the crucial issue in this case because we believe that the litigation thus far has skirted fundamental questions regarding the proper interpretation of the Copyright Act and this Court's decision in *Sony Corp. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984).

SUMMARY OF ARGUMENT

This case turns on whether the Supreme Court's 1984 decision in *Sony* conclusively resolves at the summary judgment stage the present dispute—involving strikingly different technology that was unimaginable at the time that the *Sony* case was decided. Although some of the language used in the *Sony* decision—stating that providers of technology that is capable of substantial noninfringing uses cannot be subject to contributory infringement liability—appears to predetermine the outcome of this matter, such a far-reaching, prospective rule goes well beyond the language or intent of the Copyright Act and misconstrues the proper judicial function in copyright adjudication. Over the course of nearly two centuries, courts have evolved, with tacit legislative consent, a rich infringement jurisprudence that balances a range of considerations on a case-by-case basis. This jurisprudence has long recognized indirect as well as direct infringement. In its comprehensive reform and codification of copyright law in the 1976 Copyright Act, Congress purposefully reaffirmed the continued applicability and evolution of this jurisprudence. At the same time, Congress established various express immunities, compulsory licenses, and other categorical limitations on liability. It would be incongruous, therefore, for courts to read additional categorical immunities into the Copyright Act's liability regime. Congress has since added numerous other limitations to copyright liability, none of which bar a finding of infringement in the pre-

1. Acting solely on behalf of ourselves, we offer these views to the Court in the spirit of *pro bono publico*. None of the signatories to this brief have received any financial remuneration for submitting this brief.

sent case. Several amendments prohibit trafficking of particular classes of technology capable of substantial non-infringing uses.

The *Sony* Court derived its "staple article of commerce" standard by analogizing to the Patent Act. Transplanting such a rule from the Patent Act, however, misapprehends critical differences between the two legal regimes. Whereas patent law seeks to promote technological innovation and evolved a staple article of commerce doctrine primarily out of concern for unduly expanding patent scope, copyright law seeks to promote cultural and social progress, manifesting a more cautious stance toward technological dissemination, particularly where a technology threatens widespread piracy of expressive works. Furthermore, amendments to the Copyright Act since the *Sony* decision demonstrate that Congress does not believe that dual-use technology—i.e., technology that is capable of both infringing and substantial non-infringing uses—should be treated as inviolate under copyright law. Rather, Congress has shown that it sees a need to balance the efficacy of the copyright system for promoting creative expression against social interests in technological innovation and consumer autonomy.

Consequently, this Court should clarify that indirect copyright infringement liability requires a balancing of factors based on the protection of copyright owners' rights and other recognized interests and concerns undergirding copyright law. Adverse effects of potential liability on incentives to innovate can and should be considered in such a balance, but no judicially established safe harbors should be recognized or imposed. Any such prospective, categorical safe harbors are properly within the exclusive power of Congress. Until such time as Congress establishes a staple article of commerce immunity to copyright liability, courts should continue to evolve balanced infringement standards that respond to new technologies guided by the text, structure, and purposes of copyright law.

For the present case this means that the Ninth Circuit's decision to affirm summary judgment dismissing the plaintiffs' cause of action should be overturned and the case remanded for a full trial applying an appropriate balancing test. This Court should clarify that copyright liability extends to acts inducing copyright infringement and that contributory and vicarious liability should be judged on the basis of traditional criteria, including considerations of causation, knowledge, and intent. Given the policies animating copyright law, the standard for indirect liability should balance the harm to copyright owners against adverse effects on consumers from the loss of non-infringing uses from dual-use technologies. Such a balance should consider the full range of factors, including the relative magnitudes (present and foreseeable) of infringing and non-infringing use,

the degree of control exercised by manufacturers and distributors of means for reproducing and distributing works of authorship, the intent of such enterprises, the extent to which noninfringing uses can be continued without the technologies at issue, and the extent to which copyright owners can limit unauthorized uses of their works (without undue expense or loss of market). Such an approach would continue the judiciary's vital role as a flexible and responsive institution for addressing evolving challenges to the copyright system. Until such time as Congress expressly enacts a safe harbor in the Copyright Act analogous to patent law's staple article of commerce doctrine, the distributor of technology that is merely *capable* of substantial non-infringing uses (but is in fact used predominantly to facilitate massive infringement) should not be categorically immune from copyright liability.

ARGUMENT

I. FROM ITS INCEPTION, FEDERAL COPYRIGHT LAW HAS ENVISIONED THAT COURTS WILL PLAY A CENTRAL AND ONGOING ROLE IN EVOLVING INFRINGEMENT STANDARDS

A. The Evolution of Copyright Infringement Standards Through the 1976 Act

Copyright infringement standards developed from an austere statutory foundation. The first federal copyright act, passed in 1790, provided simply that "any person or persons who shall print or publish any manuscript, without the consent and approbation of the author or proprietor thereof . . . shall be liable to suffer and pay to the said author or proprietor all damages occasioned by such injury." Act of May 31, 1790, ch. 15, sec. 6. The Act did not provide a formal definition of infringement. General revisions in 1831 and 1870, while expanding the range of works of authorship eligible for statutory protection, did not elaborate the infringement standard. Nor did the 1909 Copyright Act, which stated simply that any person who "shall infringe the copyright in any work protected under the copyright laws of the United States . . . shall be liable" for various remedies. See 17 U.S.C. § 25 (1909 Act), recodified § 101 (1912 Act); see also H. Committee Print, 89th Cong., 1st Sess., Copyright Law Revision Part 6, Supplementary Report of the Register of Copyrights on the General Revision of

the U.S. Copyright Law; 1965 Revision Bill (May 1965), chapter 7 (Copyright Infringement and Remedies) at p. 131 ("It seems strange, though not very serious, that the present law lacks any statement or definition of what constitutes an infringement.").

Against this bare legislative backdrop, courts, since the earliest cases, have given substance to what constitutes infringement through their traditional common law process. The now well-established tools and concepts of copyright infringement analysis—the requirement of substantial similarity, the various tests for substantial similarity, the inverse ratio test (balancing access with probative similarity to determine circumstantial evidence of copying)—as well as limiting doctrines such as de minimis use and fair use all sprouted from judicial crafting of an open-ended statutory provision. See, e.g., *Nichols v. Universal Pictures Corp.*, 45 F.2d 119 (2nd Cir. 1930) (levels of abstraction test); *Folsom v. Marsh*, 9 F. Cas. 342, 344-345 (Cir. Ct. Mass. 1841) (precursor to fair use). As a result, copyright infringement analysis has long reflected an incremental, balanced jurisprudence applied on a case-by-case basis. See generally 4 Melville B. Nimmer & David Nimmer, Nimmer on Copyright § 13.03.

Similarly, courts have long recognized that copyright liability extends to those who contribute to or vicariously profit from the infringing acts of others. The indirect infringement jurisprudence has viewed the concept of copyright liability broadly to encompass more general, tort-like notions of responsibility. Cf. Restatement (Second) Torts §§ 876-77; see *Kalem Co. v. Harper Brothers*, 222 U.S. 55, 62-63 (1911) (observing that contributory liability is a principle "recognized in every part of the law"). The cases have incorporated contributory liability (derived from enterprise liability), vicarious liability (based on *respondeat superior*), and inducement liability. As with more general infringement doctrines, courts have sought to balance competing considerations on a case-by-case basis. See generally 3 Nimmer on Copyright § 12.04 (summarizing and analyzing cases).

Thus, the common law nature of both direct and indirect infringement liability has eschewed bright line rules in favor of open-ended balancing that is sensitive to the changing circumstances—technological and otherwise—that affect the rights of copyright owners and users of copyrighted works.

B. The 1976 Act

By the mid 1950s, the 1909 Act was showing signs of age. The explosion of new technologies for creating, reproducing and, most importantly, broadcasting works of authorship, had fundamentally changed the copy-

right environment during the first half of the 20th century. Congress called upon the Librarian of Congress to undertake a detailed review of the copyright system and to recommend a comprehensive revision of the 1909 Act. The product of two decades of analysis and deliberations, the 1976 Act substantially revised and augmented many of the core provisions. One of the areas to emerge largely unaltered was the standard for and scope of infringement. Intent on retaining the process and principles of infringement analysis developed within the courts, Congress adhered to a terse formulation of the infringement standard: "Anyone who violates any of the exclusive rights of the copyright owner as provided by sections 106 through 118 or who imports copies or phonorecords into the United States in violation of section 602, is an infringer of the copyright or right of the author, as the case may be." 17 U.S.C. § 501 (as initially enacted). One change in the legislative framework relating to infringement law was the decision to codify the fair use doctrine. 17 U.S.C. § 107. But even here, Congress intended that courts would continue to evolve and apply this standard on a case-by-case basis drawing upon the accumulated case law from which the codification was drawn. H.R. Rep. No. 1476, 94th Cong., 2d Sess. 66 (1976) ("[t]he bill endorses the purpose and general scope of the judicial doctrine of fair use. . . . the courts must be free to adapt the doctrine to particular situations on a case-by-case basis."); see Justin Hughes, Fair Use Across Time, 50 UCLA L. Rev. 775, 793,n.59 (2003). Congress did, however, establish several immunities, compulsory licenses, and other categorical exceptions to liability. See, e.g., 17 U.S.C. § 108 (categorical exception for libraries and archives under certain conditions); 17 U.S.C. § 118 (public broadcasting compulsory license); see generally Robert P. Merges, Peter S. Menell, and Mark A. Lemley, Intellectual Property in the New Technological Age 440-42 (3d ed. 2003).

Neither the advisory committees nor Congress devoted much attention to the standards for indirect liability as they were not a contentious issue. None of the many participants in the hearings advocated change in the way such liability was addressed under the 1909 Act. Other matters—including the shift from a dual term structure (with renewal) to a unitary term, codification of fair use, the protection of sound recordings, and the treatment of juke boxes and cable television—attracted the bulk of attention. The specific legislative history of the 1976 Act does, however, make two direct references to indirect liability standards, both of which supported the continuation of then existing doctrines (and evolutionary processes). In explaining the general scope of copyright, the House Report recognizes contributory liability:

> The exclusive rights accorded to a copyright owner under section 106 are 'to do and to authorize' any of the activities specified in the five numbered clauses. Use of the phrase 'to authorize' is intended to avoid any questions as to the liability of *contributory* infringers. For example, a person who lawfully acquires an authorized copy of a motion picture would be an infringer if he or she engages in the business of renting it to others for purposes of unauthorized public performance.

H.R. Rep. No. 94-1476 at 61 (emphasis added). Note that this excerpt treats contributory liability in terms of intent—"for purposes of." In discussing the infringement section, the House Report includes the following explanation:

> Vicarious Liability for Infringing Performances
>
> The committee has considered and rejected an amendment to this section intended to exempt the proprietors of an establishment, such as a ballroom or night club, from liability for copyright infringement committed by an independent contractor, such as an orchestra leader. A well-established principle of copyright law is that a person who violates any of the exclusive rights of the copyright owner is an infringer, including persons who can be considered related or vicarious infringers. To be held a related or vicarious infringer in the case of performing rights, a defendant must either actively operate or supervise the operation of the place wherein the performances occur, or control the content of the infringing program, and expect commercial gain from the operation and either direct or indirect benefit from the infringing performance. The committee has decided that no justification exists for changing existing law, and causing a significant erosion of the public performance right.

Id. at 159-60. That excerpt shows an intent that the principles of vicarious liability that had been developed through the courts would continue to apply under the 1976 Act.

This manner of addressing indirect liability in the copyright law differs markedly from the way in which Congress delineated the boundaries of indirect liability in the Patent Act. In the comprehensive reform of that law in 1952, Congress expressly provided:

> (b) Whoever actively induces infringement of a patent shall be liable as an infringer.
>
> (c) Whoever offers to sell or sells within the United States or imports into the United States a component of a patented machine, manufacture, combination or composition, or a material or apparatus for use in practicing a patented process, constituting a material part of the invention, knowing the same to be especially

> made or especially adapted for use in an infringement of such patent, and not a staple article or commodity of commerce suitable for substantial noninfringing use, shall be liable as a contributory infringer.

35 U.S.C. § 271.

II. THE ANALOGY TO PATENT LAW UPON WHICH THE *SONY* STAPLE ARTICLE OF COMMERCE DOCTRINE WAS BASED DOES NOT HOLD

Given the foregoing history, it is more than a little surprising that this Court in 1984 would appear to have engrafted the Patent Act's express staple article of commerce safe harbor into the then recently enacted comprehensive reform of the Copyright Act, which lack any such express provision. In view of the specific facts and other determinations in the *Sony* case, however, it is not at all clear that such a categorical approach to indirect liability was necessary or fully considered.[2] On the basis of a full trial record, the majority accepted the trial court's conclusion that a significant percentage of home recording was authorized, 464 U.S. at 443 ("the findings of the District Court make it clear that . . . many producers are willing to allow private time-shifting to continue"), and endorsed the trial court's view that any unauthorized time-shifting was fair use, 464 U.S. at 454-55 ("[W]e must conclude that this record amply supports the District Court's conclusion that home time-shifting is fair use."). In combination, these findings come close to a determination that there were no proven infringing uses. The *Sony* plaintiffs also failed to adduce significant evidence of actual or prospective harm from the use of the VCR technology. 464 U.S. at 452-54 (quoting the district court that "[p]laintiffs have admitted that no actual harm to their copyrights has occurred" and that "[h]arm from time-shifting is speculative and, at best, minimal.").

These determinations relieved much of the pressure on delineating the contours of indirect liability. Once these determinations were in place, even under the dissent's "primary use" test, the VCR would not have violated the Copyright Act. Accepting the majority's conclusion that time shifting by users fell within the bounds of the fair use defense, the net balance strongly favored continued marketing of the VCR technology. Thus, the indirect liability standard selected by the majority in *Sony* was not critical to the outcome of the case. The Court's consideration of the issue

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2. Cf. Jonathan Band and Andrew J. McLaughlin, The Marshall Papers: A Peek Behind the Scenes at the Making of Sony v. Universal, 17 Colum.-VLA J.L. & the Arts 427 (1993).

was cursory and the importation of part of patent law's statutory standard for indirect liability lacked any direct legislative support.

Even in 1984, the analogy between patent and copyright for purposes of addressing indirect liability was strained. With 20 years of further statutory development of copyright law, it is now apparent that the patent and copyright regimes differ fundamentally in their treatment of dual-use technology—technology that is capable of both infringing and non-infringing uses. Therefore, the premise on which the importation of the Patent Act's § 271(c) safe harbor was based cannot withstand scrutiny.

A. The Wholesale Judicial Incorporation of a Statutory Patent Law Defense into Copyright Law Was Questionable When Enunciated in 1984

Beyond noting the common constitutional lineage and the "historic kinship" between the patent and copyright systems, the *Sony* decision offers little analysis or justification for transplanting the Patent Act's staple article of commerce doctrine into interpretation of the scope of copyright infringement. A closer examination of the origin, evolution, and role of this patent law doctrine as well as the significant *differences* between the patent and copyright systems as regards the role of technology and enforcement challenges caution against such radical surgery.

While central to both patent and copyright law, technology plays very different roles in the two regimes. In patent law, technological innovation is the end to which the system is directed. Patent claims determine the limits of the patent reward and the law seeks to ensure that patentees do not control more than they invented and rightfully claim. The staple article of commerce doctrine arose as a way of balancing the doctrines of contributory liability (enhancing enforceability and expanding the scope of patents by enabling patentees to limit the sale of complementary products) and patent misuse (antitrust-like limits on the leveraging of patent rights). As recounted in *Dawson Chemical Co. v. Rohm & Haas Co.*, 448 U.S. 176, 205-06 (1980), several overbroad patent misuse decisions had effectively eliminated the doctrine of contributory liability. See Robert P. Merges & John F. Duffy, Patent Law and Policy 1375 (3d ed. 2002). Congress enacted Sections 271(c) and (d) of the 1952 Patent Act in order to restore contributory liability, but subject to anticompetitive limitations on patent scope. The staple article of commerce doctrine embodied in Section 271(c) provided the fulcrum for re-equilibrating the scope of patent law. By immunizing the sale of staple articles of commerce from contributory

liability, Congress precluded patentees from leveraging their patents into the sale of unprotected technologies.

By contrast, in copyright law, technology serves as a means to the end of promoting creation and dissemination of works of authorship—art, music, literature, film, and other expressive works. Technology provides the platforms for instantiation, reproduction, and distribution on which creative expression flourishes and commerce occurs. See Peter S. Menell, Envisioning Copyright Law's Digital Future, 46 N.Y. Law School L. Rev. 63, 98-129 (2002-03). When new technology platforms threaten the economic infrastructure supporting creative expression, copyright law seeks to protect the system that supports the creative arts.

Enforcement differences between the patent and copyright systems reinforce the need for distinctive and tailored approaches to indirect liability. When the sale of a "staple article of commerce" contributes to infringement of patented technology by third parties, the effects are limited to a single patent or perhaps a cluster of no more than a handful of patents. Simply put, a device that contributes to infringement of a particular chemical patent or group of chemical patents is unlikely to infringe a large number of mechanical, electrical, or other chemical patents. Furthermore, the patent owner will have some ability to identify and pursue potential direct infringers by tracing the marketing patterns for the staple article of commerce. There is little reason to believe that a single staple article of commerce could threaten entire industries.

An entirely different dynamic can unfold in the copyright realm. The distribution of at least some dual-use technologies can threaten the very economic foundation of entire content industries (and even multiple industries). The peer-to-peer technology at issue in this case threatens systemic harm cutting across several broad industries—sound recording, film, television, computer software, games, eBooks. The defendants' software products have facilitated unauthorized distribution of millions of copies of protected works. Such software already has exerted a significantly adverse impact on the recording industry. It also represents a growing threat to the software industry. As broadband adoption continues, computers become faster, and computer hard drives become ever larger, such technology will eventually threaten the film industry. And as technology for eBooks becomes more widely accepted, the publishing industry will also face significant enforcement challenges. The social and systemic benefits of being able to protect copyrights at the indirect infringement level, rather than at the end user level, are substantial. Suing thousands of end users wastes both private and public resources and is not nearly as effective as con-

fronting enterprises whose business model is based on distributing software that is used predominantly for infringing uses.

The *Sony* Court conflated the very different attitudes of the patent and copyright regimes with regard to technology by suggesting that a finding of contributory liability in that case would confer "upon all copyright owners collectively . . . the exclusive right to distribute [VCRs] simply because they may be used to infringe copyrights." 464 U.S. at 441, n.21. But if, contrary to the Court's findings, VCRs did pose a serious threat to the "golden goose" of creative expression, then copyright law would have required a very different analytical perspective. Rather than look to patent law—which seeks to delineate the proper scope of exclusive rights in order to promote technological advance and freedom to use that which is not protected—the Court would have been better served by looking to statutory and common law regimes aimed at protecting interests threatened by technologies that can produce harmful side effects—such as tort law (nuisance, product defect) and environmental regulation. Thus, when a court enjoins a factory that spews noxious chemicals under nuisance or statutory environmental law, it would be misleading to characterize such a result as giving pollution victims "exclusive rights" over the factory's technology. A more apt characterization would be that society does not believe that the activity should be permitted in its current form. Such a perspective would not necessarily mean that the factory should be shut down permanently. But it might mean that it would have to install filters to limit the adverse effects on neighbors.

Similarly, copyright law has long constrained technologies and business practices that jeopardize the system that supports creative expression. In *Jerome H. Remick & Co. v. General Electric Co.*, 16 F.2d 829 (S.D.N.Y. 1926), a lawsuit pitting music publishers against the newly emerging radio industry, the court had little difficulty finding that the defendant's broadcast of plaintiff's copyrighted musical composition constituted copyright infringement, despite the fact that such a holding conferred a measure of "control" over the nascent radio broadcasting industry. That case established that radio broadcasters would have to obtain valid copyright licenses if they were going to build the popularity of their medium using copyrighted content.[3] This decision did not "shut down" the radio

3. The dance hall cases can also be characterized in this way. See *Dreamland Ballroom, Inc. v. Shapiro, Bernstein & Co.*, 36 F.2d 354 (7th Cir. 1929) (finding dance hall operators vicariously liable); *Gershwin Publishing Corp. v. Columbia Artists Management, Inc.*, 443 F.2d 1159 (2d Cir. 1971) (finding booking agent vicariously liable). Dance halls, like radio and peer-to-peer technologies, can be used for infringing and non-infringing uses. The dance hall cases established that the proprietors of such facilities

industry. Rather it led to the development of institutions for monitoring of broadcasts and compensation of artists—such as the ASCAP blanket license—which have fostered both commercial broadcasting and the creative arts.

Respondents in the present case claim to be fundamentally different from the defendant in *Jerome H. Remick* because they do not themselves transmit infringing material. But the effective result—and possibly the purpose—of their design choices is to facilitate widespread unauthorized copying. This Court should not allow that distinction, nor the argument that finding for petitioners in this case will confer "control" of respondent's technology on petitioners, to dictate its decision. It is the *uses* of the technology, the purposes for which it was designed and is distributed, that require careful scrutiny under copyright law. Contributory infringement doctrine rightfully grants "control" over these uses to the copyright holder when those uses profoundly undermine the market for the copyrighted works. The plaintiffs in this case have a legitimate interest in preventing *unauthorized reproductions* of their copyrighted work. They should not be viewed as seeking to obtain exclusive rights in staple articles of commerce. If this occasions a redesign of peer-to-peer technology, or licensing of copyrights, that would be no more radical or deleterious than other "foundational" cases in the history of copyright law.

B. Subsequent Changes to the Copyright Act Demonstrate that Congress Does Not Consider Dual-Use Technology Sacrosanct Within the Copyright Realm

Regardless of this Court's supposition in 1984, the manner in which Congress has chosen to amend the Copyright Act since the *Sony* decision demonstrates that Congress does *not* consider the patent and copyright regimes to be analogous in their treatment of indirect liability for dual-use technology. These amendments respond to the threats posed to copyright owners and future authors by the emerging digital distribution platform, which increasingly allows for rapid, nearly costless, unauthorized distribution of perfect reproductions of works of authorship. See Peter S. Menell, Envisioning Copyright Law's Digital Future, 46 N.Y. Law School L. Rev. 63, 129-38 (2002-03). Such technologies offer great opportunities but simultaneously pose serious threats. Whereas the Patent Act continues to provide an express safe harbor for any dual-use technology "capable of

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bore responsibility to ensure that their clubs were not used for infringing uses. In the end, most clubs complied with the law by obtaining blanket licenses through ASCAP and BMI.

substantial non-infringing use," the Copyright Act today directly bans and regulates several business practices and technologies that are undeniably capable of substantial non-infringing uses.

A few months after *Sony* was handed down, Congress amended the Copyright Act's first sale doctrine, 17 U.S.C. § 109, to prohibit the rental of sound recordings. See 16 Record Rental Amendments of 1984, Pub. L. No. 98-450, 98th Cong., 2d Sess., 98 Stat. 1727 (1984) (codified at 17 U.S.C. § 109(b)). Notwithstanding its impact on what would otherwise be legitimate business opportunities, this amendment to the Copyright Act was intended to reduce the threat to the retail market for sound recordings from widely available and improving analog cassette recorders. A half-dozen years later, Congress embroidered on its handiwork to ban software rentals for the benefit of the software industry. See Computer Software Rental Amendments of 1990, Pub. L. No. 101-650, 101st Cong., 2d Sess., 104 Stat. 5089, 5134-37 (1990) (codified at 17 U.S.C. § 109(b)). These copyright law provisions ban business models that are capable of non-infringing uses—the rental of sound recordings and software to people who would not make copies.

With the emergence in the early 1990s of digital home copying technology capable of making flawless copies, Congress directly regulated such devices in order to protect music copyright owners against the threat of unauthorized distribution. Audio Home Recording Act of 1992 (AHRA), Pub. L. No. 102-563, 106 Stat. 4237 (codified at 17 U.S.C. §§ 1001-1010). The AHRA prohibits the importation, manufacture, and distribution of any digital audio recording device that does not incorporate technological controls to block second-generation digital copies. 17 U.S.C. § 1002(a). Thus, this technology regulation allows users to make digital copies from a compact disc, but not from digital copies made using this technology. In so doing, the AHRA limits the viral spread of copies. Consumers are allowed to make "one-off" copies, but prohibited from making copies from copies. In addition, the AHRA imposes levies on the sale of digital audio recording devices and blank media, the proceeds of which are divided among copyright owners. (The statute also exempts digital home copying using media on which the levy has been paid. 17 U.S.C. § 1008.)

Unregulated digital recording devices clearly have non-infringing uses—such as making second generation copies of public domain works or authorized works—yet Congress saw the balancing of copyright, consumer, and technological innovation interests as the appropriate solution. Unlike patent law, Congress did not afford the makers of a technology capable of substantial noninfringing uses unconditional immunity. Rather, the amendment balanced competing interests in order to address what was

perceived to be a serious threat to composers, recording artists, and the businesses that market their creations.

Analogous concerns prompted computer software companies and content owners to seek greater protections against digital piracy in the mid 1990s. As the Internet became a popular platform for the exchange of information, these copyright owners came to see encryption and digital rights management as a critical element in the development of the online marketplace for content. They recognized, however, that such technologies were vulnerable to hacking—unauthorized circumvention of technological protection measures (i.e., digital locks). In 1998, Congress responded by prohibiting circumvention of technological protection measures and banning the trafficking in digital keys. See Digital Millennium Copyright Act of 1998 (DMCA), Pub. L. No. 105-304, 112 Stat. 2860.[4] The legislation makes clear that Congress did not consider staple articles of commerce to be sacrosanct. Digital keys have substantial non-infringing uses, such as enabling consumers to gain access to copyrighted works for purposes of engaging in fair use and public domain works that may be encrypted. Yet based upon the perceived threat posed by such technologies to copyright owners, Congress prohibited the trafficking of technologies capable of non-infringing uses (subject to enumerated exemptions). These provisions establish unequivocally that Congress views dual-use technologies differently within the context of copyright enforcement than it does in the patent realm. Particularly with regard to digital technology, copyright law reflects the concern that dual-use technologies may undermine both the existing off-line marketplace and the formation and vitality of a legal platform for a global digital on-line marketplace for "the movies, music, software, and literary works that are the fruit of American creative genius." S. Rep. No. 105-190, at 8 (1998). The structure and substance of the

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4. As explained in the Senate Report,

> Due to the ease with which digital works can be copied and distributed worldwide virtually instantaneously, copyright owners will hesitate to make their works readily available on the Internet without reasonable assurance that they will be protected against massive piracy. Legislation implementing [the World Intellectual Property Organization] treaties provides this protection and creates the legal platform for launching the global digital on-line marketplace for copyrighted works. It will facilitate making available quickly and conveniently via the Internet the movies, music, software, and literary works that are the fruit of American creative genius. It will also encourage the continued growth of the existing off-line global marketplace for copyrighted works in digital format by setting strong international copyright standards.

S. Rep. No. 190, 105th Cong., 2d Sess. 8 (1998); see also H.R. Rep. No. 551, pt. 2, 105th Cong., 2d Sess. 23 (1998).

sound recording and software rental bans, the AHRA, and the DMCA's antitrafficking bans demonstrate that Congress recognizes that limitations on the design, manufacture, and trafficking of technologies that are capable of non-infringing uses may be necessary and appropriate to effectuate the purposes of the Copyright Act.

In light of these legislative developments, the fundamental premise underlying the *Sony* Court's treatment of indirect liability—that parallels between Title 35 and Title 17 of the U.S. Code require the importation of the staple article of commerce doctrine—does not withstand scrutiny.[5] In addressing indirect copyright liability today, the Court should read the *Sony* case narrowly and fashion indirect liability standards based upon the distinctive policies and concerns animating the Copyright Act.

III. THE COURTS SHOULD CONTINUE TO SERVE AN ONGOING ROLE IN EVOLVING INFRINGEMENT STANDARDS SO AS TO ENSURE THE EFFICACY OF THE COPYRIGHT SYSTEM

A. The Copyright Act Envisions an Active Judicial Role in Evolving Copyright Infringement Standards on a Case-By-Case Basis

The general liability regime of the Copyright Act as well as long-standing jurisprudential traditions underlying the copyright law authorize courts to evolve liability standards to meet emerging needs.[6] This function

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5. As the basis for its reasoning, this Court in *Sony* explained:

> There is no precedent in the law of copyright for the imposition of vicarious liability on such a theory. The closest analogy is provided by the patent law cases to which it is appropriate to refer because of the historic kinship betweenpatent law and copyright law.

464 U.S. at 439. The investigation carried out above explodes the notion that any historic kinship justified transplantation of patent law's staple article of commerce doctrine to copyright law. Indeed, the Court itself was seemingly aware of the make-weight nature of its reasoning, by immediately acknowledging in an accompanying footnote that, "The two areas of the law, naturally, are not identical twins, and we exercise the caution which we have expressed in the past in applying doctrine formulated in one area to the other." *Id.* at 439 n.19. Copyright's indirect infringement doctrines should be calibrated to the specific policies and balances of copyright law to the extent possible, and not other laws that serve different purposes.

6. This Court asserted in *Sony* that the judiciary has been reluctant "to expand the protections afforded by the copyright without explicit legislative guidance." 464 U.S. at 431. Yet, as noted above, it was the judiciary, and not Congress, that brought doctrines of indirect liability into copyright law. The courts properly recognized that failure to extend

is particularly important as the digital age unfolds. Congress faces a steep challenge in responding to the myriad, rapid, and unpredictable changes taking place.[7] Although the challenges posed by new technologies warrant judicial caution and restraint, *Sony*, 464 U.S. at 429-31, failure to evolve infringement standards in response to new technological conditions exposes the copyright system to grave risks. Through the case-by-case evolution and application of infringement standards, the courts serve an essential role in completing the copyright regime and ensuring the continued efficacy of the copyright system.

The emergence of the technology at issue in this case illustrates the importance of judicial vigilance. When Congress passed the DMCA in 1998, peer-to-peer technology was not yet a policy concern. See David Nimmer, Codifying Copyright Comprehensibly, 51 UCLA L. Rev. 1233, 1357-58 (2004). Yet within a matter of months, such technology generated unprecedented levels of unauthorized reproduction and distribution of sound recordings.

At the time Congress passed the DMCA, after several years of deliberation, the Internet functioned principally on a server-client model. End user computers (clients) could access information stored on Internet-accessible servers (web pages). Early skirmishes related principally to the posting of copyrighted works on such servers. Monitoring websites with search engines in conjunction with the DMCA's take-down provisions, 17 U.S.C. § 512, proved a reasonably effective means for removing copyrighted works posted without the authorization of copyright owners.

With the meteoric rise of Napster—the first Internet-based peer-to-peer technology platform—in early 2000, the music industry faced an un-

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liability to those who contribute to, vicariously benefit from, and induce infringement could limit the protections afforded by copyright law.

Superficially, it might seem that affirming the Ninth Circuit's *Grokster* decision would be in keeping with other Supreme Court decisions declining to extend copyright liability to new technologies. *White-Smith Music Pub.Co. v. Apollo Co.*, 209 U.S. 1 (1908) (concluding that a piano roll was not a "copy" of a musical composition under the 1831 definition); *Fortnightly Corp. v. United Artists Television*, 392 U.S. 390 (1968) (concluding that cable retransmission was not public performance under 1909 Act). But on deeper reflection, the analogy does not fit. In both *White-Smith Music* and *Fortnightly Corp.*, the Court was confronted with the simple question whether a statutory definition—created by Congress—applied to a new activity. In the present case, the Court must decide whether a judicial test crafted two decades ago properly frames liability in dramatically different and unforeseeable circumstances.

7. From the time Congress first requisitioned studies to serve as the basis for comprehensive reform of copyright law in 1955, it took more than two decades for comprehensive reform to reach fruition.

precedented threat to the protection of sound recordings and the development of legitimate on-line distribution business models. Napster's technology vastly expanded the effective storage capacity of the Internet by enabling computer users running its freely distributed software to search Napster's central servers for titles of files encoded in the MP3 compression format (commonly used for sound recordings) contained on the computer hard drives of thousands of other Internet clients running Napster's software. Once they found titles of interest, they could use Napster's software to form an Internet connection to the particular computer containing the file, establish a standard Internet transfer protocol link, and quickly and effortlessly transfer the file to the searcher's hard drive. In essence, the Napster technology converted every computer running Napster's software into a "servent"—both server and client. Given the free access Napster technology provided to a vast distributed archive of sound recordings, it is not surprising that this software became the fastest adopted application in the history of computer technology, attaining tens of millions of users within a matter of months. The DMCA's take-down provisions, then just two years old, were not written to reach client-based files; yet in just a few months, Napster's technology contributed to more unauthorized copying than at any time in the history of copyright law. See Joseph Menn, All the Rave 161 (2003) (quoting a venture capitalist's back-of-the-envelope calculation: "You've distributed more music than the whole record industry since it came into existence.").

Record labels, composers, music publishers, and recording artists attacked the problem by suing Napster for indirect copyright infringement. Although Napster did not engage in any direct acts of copying or distributing copyrighted works of others, its software in combination with its centralized indexing function facilitated rampant unauthorized distribution of copyrighted works. The alternative of suing individuals using the software would have been time consuming, expensive, and far less effective in stemming the unauthorized distribution occurring through the Napster network. The district court issued a preliminary injunction and the Ninth Circuit ultimately held, on somewhat different grounds, that Napster was indeed liable. See *A&M Records v. Napster*, 114 F.Supp.2d 896 (N.D. Cal. 1999); 239 F.3d 1004 (9th Cir. 2001).

But this ruling exerted little effect. Any curtailment of unauthorized distribution of copyrighted works through peer-to- peer technology was short-lived as new peer-to-peer software enterprises, built upon less centralized software architectures, entered the market. These peer-to-peer technologies pose even greater exposure for copyright owners than Napster because they are not limited to the distribution of music files. The new

services allow for the distribution of just about any type of file—including movies, software, photographs, and eBooks. Unlike Napster, which operated during its brief existence without any direct revenue model, many of the second generation peer-to-peer system enablers, including the defendants in this case, designed their systems to deliver advertisements (in the form of banners, pop-ups, and other text boxes that appear on users' computer screens). Seeking to avoid copyright liability, they designed their technology in such a way as to limit their control over the peer-to-peer network, yet nonetheless derive substantial advertising revenue from the network's use.

In view of this rapidly changing environment, the appropriate mix of decisionmaking authority can best be achieved through a narrow interpretation of the *Sony* case—i.e., limiting it to the distinctive facts presented—thereby enabling courts to evaluate emerging threats to the copyright system as they arise. The broad reading of the *Sony* decision given by the Ninth Circuit largely eliminates the judicial role by unduly constraining the factual inquiry necessary to evaluate and address new problems and immunizing conduct that poses great actual and potential harm to copyright owners and the copyright system generally so long as the defendants can point to nontrivial potential non-infringing uses. The circumstances surrounding peer-to-peer software at issue in this case could hardly be more different from those confronted in *Sony*. Whereas the VCR merely allowed for the making of single copies of otherwise authorized, freely distributed, over-the-air television broadcasts, the defendants' peer-to-peer software and business models provide the means for widespread unauthorized reproduction *and* distribution of copyrighted works. In contrast to the VCR, the technologies distributed by the defendants are used predominantly for infringing uses that have caused demonstrable harm to copyright owners and inhibited the development of new markets for their works. See Stan J. Liebowitz, File Sharing: Creative Destruction or Just Plain Destruction? (December 2004), available at http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=59984 (concluding that "[d]ata limitations notwithstanding, the evidence seems compelling that file-sharing[8] is responsible for the recent large decline in CD sales for which it has been

8. The term "file sharing," although commonly used to refer to peer-to-peer technology, is a misnomer. A more accurate, if less concise, characterization of what such technology accomplishes is "file search, reproduction, and distribution." Files are not shared in the conventional sense of common use. Following a peer-to-peer transaction, one copy of the file remains on the host computer and another identical copy resides on the recipient's computer.

blamed"). Nonetheless, because of the uncritical application of what they interpreted to be a bright line, categorical rule—whether technology is "merely capable of substantial non-infringing uses"—both courts below disregarded evidence about *relative* harm and benefits in dismissing the plaintiffs' lawsuits at the summary judgment stage. Furthermore, summary adjudication precluded the development of an adequate record for fully considering liability and potential remedies.

B. The Court Should Utilize a Comprehensive Balancing Test for Delineating the Contours of Contributory Liability

To a much greater extent than the Patent Act's indirect liability provisions, copyright law's principles, as reflected in its infringement jurisprudence and the AHRA and DMCA, provide valuable insight and guidance for delineating indirect copyright liability standards. In both the AHRA and the DMCA, Congress balanced the interests in protecting copyrighted works from unauthorized distribution against the social interest in technological innovation and consumer autonomy. In neither case did Congress determine that dual-use technology should be immune from liability. The AHRA regulates the design of products to limit unauthorized reproduction while creating a form of ex ante remedy to compensate creators for likely losses. 17 U.S.C. § 1001 *et seq.* The DMCA, which relates to technological measures controlling access to copyrighted works, prohibits both specific acts to circumvent the technological measure and the manufacture, importation, trafficking in, and marketing of devices that: (1) are primarily designed or produced for the purpose of circumventing a technological measure that effectively "controls access to" a copyrighted work; (2) have only limited commercially significant purpose or use other than to circumvent such technological protection measures; and (3) are marketed for use in circumventing such technological protection measures. 17 U.S.C. § 1201(a)(2).

Extrapolating from and extending the principles underlying these provisions to the more general context of indirect copyright liability, courts can best promote copyright law's essential purpose of providing meaningful legal protection against unauthorized reproduction and distribution of works of authorship without unduly undermining technological advance or consumer autonomy by assessing the *relative* harms and benefits associated with dual-use technologies. If a product or service has substantial non-infringing uses and relatively little infringing use, as with the VCR in

the *Sony* case, then copyright law should not impose liability.[9] By contrast, if a product or service has relatively modest non-infringing uses and causes substantial harm to copyright owners, then courts should delve into the circumstances surrounding the activities in question. Such an inquiry should assess the following considerations:

- the knowledge possessed by the defendants about infringing use;
- the extent to which aspects of the product or service were designed purposefully and without functional advantages to evade liability, see *In re Aimster*, 334 F.3d 643, 650 (7th Cir. 2003) (suggesting that indirect liability doctrine should discourage willful blindness by technology developers and distributors to the adverse effects of their products); Douglas Lichtman, How the Law Responds to Self-Help 49 (2004) (available at http://www .repositories.cdlib.org/bclt/Its/paper1); cf. Restatement (Third) Torts § 2(b) (extending tort liability to defectively designed products based on whether "the foreseeable risks of harm posed by the product could have been reduced or avoided by the adoption of reasonable alternative design by the seller");[10]

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9. Where a particular product feature that is separable from the larger product has modest non-infringing uses but substantial infringing attributes, courts should conduct a more focused analysis along the lines discussed below. It may be possible to order targeted design changes that will preserve the principal non-infringing uses while limiting significant infringing uses.

10. Counsel to one of the defendants in this case illustrates how a broad reading of the *Sony* decision provides a blueprint for designing businesses that can pose a serious threat to the copyright system:

> Can you plausibly deny what your users are up to? . . .
>
> Have you built a level of 'plausible deniability' into your product architecture? If you promote, endorse, or facilitate the use of your product for infringing activity, you're asking for trouble. . . . Software that sends back user reports may lead to more knowledge than you want. Customer support channels can also create bad "knowledge" evidence. Instead, talk up your great legitimate capabilities, sell it (or give it away), and then leave the users alone.
>
> Disaggregate functions . . . In order to be successful, peer-to-peer networks will require products to address numerous functional needs—search, namespace management, security, dynamic file redistribution, to take a few examples. There's no reason why one entity should try to do all of these things . . . .

- whether non-infringing uses can be achieved for most consumers through other means without significant added expense, inconvenience, or loss of functionality;[11]
- the extent to which copyright owners can protect themselves against such infringements without undue cost (e.g., through self-help mechanisms such as encryption);[12]

> This approach may also have legal advantages. If Sony had not only manufactured VCRs, but also sold all the blank video tape, distributed all the TV Guides, and sponsored clubs and swap meets for VCR users, the Betamax case might have turned out differently. . . . A disaggregated model, moreover, may limit what a court can order you to do to stop infringing activity by your users.
>
> . . . Give up the EULA. . . . Although end-user license agreements ("EULAs") are ubiquitous in the software world, copyright owners have attempted to use them in P2P cases to establish "control" for vicarious liability purposes. . . . No direct customer support. Any evidence that you have knowingly assisted an end-user in committing copyright infringement will be used against you. . . .
>
> So let the user community support themselves in whatever forums they like. . . . Your staff can monitor forums and create FAQs that assist users with common problems, but avoid engaging in one-on-one customer support.

Fred von Lohmann, Electronic Frontier Foundation, "IAAL [I am a Lawyer]: What Peer-to-Peer Developers Need to Know about Copyright Law", § V.7 (December 2003) (http://www.eff.org/IP/P2P/p2p_copyright_wp.php).

11. Many if not most of the non-infringing uses alleged in the present case could be accomplished through conventional client-server functionality. For example, bands willing to distribute their creations without compensation can upload their sound recordings to web pages or make them available through a growing number of promotional music services. Many public domain works, such as the Bible, are available directly through Internet sites. With regard to "sampling" of music in advance of purchase, most music copyright owners now authorize online retail services to stream 10 to 30 second segments of protected sound recordings on their websites. Although peer-to-peer technology can offer functional advantages over the conventional clientserver Internet architecture in terms of reducing congestion in downloading large files from a single or limited number of sources, most users do not appear to be gravitating toward the defendants' products for such purposes. Based on usage patterns, they appear to be most strongly motivated by the ability to gain access to works that they would otherwise have to purchase. That does mean that each download using peer-to-peer technology supplants a retail sale. Many consumers are not willing to pay the going price. Furthermore, such technology may well increase sales through a promotion effect. But such technologies adversely affect revenue in some content industries and inhibit the rollout of legitimate business models. See Liebowitz, supra. At a full trial, the parties would be able to provide fuller evidence regarding the use of the technology at issue.

- the extent to which infringement affects only a limited number of works;
- the cost and efficacy of enforcement against direct infringers;[13] the extent to which the plaintiffs seek to expand unduly the scope of their copyrights for purposes of controlling new markets, as opposed to protecting their copyrighted works (copyright misuse);[14] and
- the impacts of potential remedies on both infringing and non-infringing uses.

Other considerations may well be relevant in particular cases, but this list provides a starting point for assessing contributory liability. Cf. *Fogerty v. Fantasy, Inc.*, 510 U.S. 517, 534 n.19 (1994) (outlining non-exclusive list of factors for courts to consider when awarding fees under the Copyright Act).

Such a comprehensive framework provides a systematic basis for balancing the promotion of creative arts with technological innovation and consumer autonomy. Properly applied, such a test would not jeopardize the vast majority of dual-use technologies—such as "a typewriter, a recorder, a camera, a photocopying machine," *Sony*, 464 U.S. at 425 (quoting from the district court)—nor unduly chill technological innovation. It would require courts to undertake a detailed analysis of a broad range of considerations in some cases, such as the present dispute. But as in other aspects of copyright infringement analysis—such as non-literal infringement and fair use—the courts can be expected to develop, refine, and implement sound doctrines for delineating the contours of indirect liability. Such an approach can be expected to promote the development and marketing of technologies that further a broader conception of consumer welfare—technologies that enhance functionality of information distribution platforms without unduly cannibalizing content industries. Furthermore, if

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12. Part of the difficulty with self-help in the present case is that a large legacy of copyrighted works has already been released in unencrypted form. Furthermore, as reflected in the growing availability of decrypted film products on peer-to-peer networks, feasible self-help options might not be sufficiently effective.

13. Where cost-effective means exist to enforce copyright protection against direct infringers, curtailing liability for dual-use technology does not jeopardize copyright protection and promotes diffusion of technology offering non-infringing uses.

14. This consideration does in fact connect to the purposes underlying patent law's staple article of commerce doctrine. But given the other considerations of concern in copyright law—most notably the potential for systemic harm from some dual-use technologies—courts should not elevate this consideration above all others.

the need arises, Congress can step in and provide more specific guidance on the contours of indirect liability. But given the general infringement default regime that has served copyright law well for over two centuries, courts should not bind themselves in advance through adoption of prospective, non-statutory safe harbors. In addition to technology-specific provisions set forth in the Copyright Act, copyright law provides for ongoing judicial evolution of infringement standards to address threats to copyright owners and the copyright system more generally.

CONCLUSION

For the reasons set forth above, it is time to discard overbroad interpretations of the *Sony* case. The Court should articulate a comprehensive, open-ended framework for delineating the scope of contributory infringement and remand this matter for a full trial applying such a balancing standard and more fully assessing liability for inducement and vicarious liability.

Respectfully submitted,
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No. 04-480

In The

Supreme Court of the United States

METRO-GOLDWYN-MAYER STUDIOS, INC., et al.,

Petitioners,

v.

GROKSTER, LTD., et al.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF *AMICI CURIAE* SIXTY INTELLECTUAL PROPERTY AND TECHNOLOGY LAW PROFESSORS AND THE UNITED STATES PUBLIC POLICY COMMITTEE OF THE ASSOCIATION FOR COMPUTING MACHINERY IN SUPPORT OF RESPONDENTS [*Amici* Are Listed On Inside Cover]*

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INTEREST OF *AMICI CURIAE*

Individual *amici* are full-time legal academics who teach and write about intellectual property and technology law, who respect this law and teach students to respect it, who believe that well-balanced intellectual property rules promote the public good, and who strive to assist courts and policymakers in adapting intellectual property law to the challenges of technological advances. *Amicus* U.S. Public Policy Committee of the Association for Computing Machinery ("USACM") is the public policy committee of the world's oldest and largest international scientific and educational organization which comprises 78,000 computing professionals and is dedicated to advancing the arts, sciences, and applications of information technology. USACM educates U.S. government organizations, the computing community, and the American public on matters of U.S. public policy relating to information technology. We submit this brief *amicus curiae*[1] out of a firm conviction that the secondary liability standards for which Petitioners are arguing in this case have no grounding in the copyright statute, and would have profoundly disruptive and destabilizing consequences in the copyright case law and in a wide array of industry sectors —thereby undermining, rather than promoting, the constitutional purposes of intellectual property law: "[t]o promote the Progress of Science and useful Arts." U.S. Const. art. I, § 8, cl. 8. Our only interest in this case is in the sound evolution of intellectual property law and policy.

1. The parties' letters of consent to the filing of this brief have been lodged with the Clerk. Pursuant to Rule 37.6 of the Rules of this Court, *amici curiae* state that no counsel for a party has written this brief in whole or in part and that no person or entity, other than *amici*, their members, or their counsel, has made a monetary contribution to the preparation or submission of this brief. Students of the Samuelson Law, Technology & Public Policy Clinic at the University of California at Berkeley, Boalt Hall (School of Law) (Brian W. Carver, Marci Meingast, Aaron Perzanowski, and Bethelwel Wilson) helped to prepare this brief under the supervision of Jack I. Lerner and Deirdre K. Mulligan.

SUMMARY OF THE ARGUMENT

This case is fundamentally about technology policy, not about file sharing or copyright infringement. Each of the alternative secondary liability standards for which Petitioners and supporting *amici* argue would dramatically change the balance of power between the entertainment industry and the technology industry. It would do so despite the absence of a statutory basis in copyright law for this change and would disrupt settled expectations in the information technology industry.

While the Court in *Sony Corp. v. Universal City Studios*, 464 U.S. 417 (1984), could have rejected Universal's claim because copyright law lacks a statutory provision imposing liability on technology developers for the infringing acts of their users, it decided to seek guidance in the closely analogous provisions codified in patent law. The safe harbor rule in *Sony* for technologies with substantial non-infringing uses means that in order for a developer to avoid secondary liability, the technology at issue must already have, or there exists a reasonable possibility that it will have, non-infringing uses, and as in patent law, such uses should be deemed insubstantial if they are farfetched, illusory, impractical, or merely experimental. This rule strikes a balance between the interests of rights holders in legal enforcement of statutorily granted exclusive rights, the interests of developers of multiple-use technologies, and the interests of the public in access to technologies with non-infringing uses. For more than twenty years, both the technology and entertainment industries have experienced unprecedented technological innovation and economic prosperity under the fundamental framework created by the *Sony* rule. The alternative tests for secondary liability proposed by Petitioners and various *amici* would upset settled expectations and mire the courts in subjective review of new technologies—a recipe for instability and confusion that would severely impair innovation and technological development.

Indeed, the *Sony* rule, which is amenable to summary judgment, has prevented the very confusion and instability in copyright that, in the patent context, led to Congress's enactment of the staple article of commerce rule. Prior to the enactment of 35 U.S.C. § 271, secondary liability in patent law was decided on a case-by-case basis, and various courts imposed differing liability standards, creating instability and uncertainty in patent law. Section 271 was added to the patent statute to clarify and stabilize secondary liability rules, and it has been largely successful in doing so – just as *Sony* has been in the copyright context.

Because any substantial revision of the *Sony* safe harbor for technologies with substantial non-infringing uses will disrupt settled expectations for so many stakeholders besides the parties to this case, we respectfully

suggest that the Court is not the proper forum for such a wholesale change of the law. As the Court has recognized many times, only Congress has the institutional competence to accommodate fully the various competing interests that are inevitably implicated by new technologies. Peer-to-peer technology already has yielded many unique non-infringing uses and is a generic infrastructure enabling many other future uses. When Congress has been concerned about disruptive technologies such as this, it has demonstrated the will to regulate while carefully preserving *Sony* and signaling its support for *Sony*; recent activity in Congress demonstrates that Congress is currently deeply engaged in doing just that with respect to peer-to-peer technology.

For these reasons, *amici* respectfully urge the Court to affirm the judgment of the Court of Appeals.

ARGUMENT

I. THE CURRENT DISPUTE IS ONE PART OF A MUCH LARGER PHENOMENON AS COPYRIGHT ADJUSTS TO DIGITAL TECHNOLOGIES.

Digital technologies have posed numerous challenges for courts, legislatures, policymakers, various industries and institutions, parents, children, and the public at large. The internet, in particular, has made possible myriad new social benefits—from e-government initiatives to new businesses and business models to virtual communities and social networks to enhanced democratic discourse. The internet has, however, been no more immune from malefactors than the physical world, including those who engage in denial of service attacks, online stalking, phishing and identity theft, dissemination of computer viruses and worms, child pornography, and of course, copyright infringement. The internet has greatly lowered the barriers to entry to a global communications network for the creation and dissemination of digital information.

Peer-to-peer file sharing technology ("P2P") is one of these new dissemination tools. Both authorized and unauthorized peer-to-peer file sharing has become easy to do and remarkably common, even after some successful lawsuits against file sharing technology developers and individual file sharers. No matter what the Court rules in this case, unauthorized

peer-to-peer sharing of copyrighted works is likely to continue,[2] much as many of us might wish otherwise.

With this sobering thought in mind, we respectfully suggest that this case is fundamentally about technology policy, not about file sharing or copyright infringement. Leading associations of the information technology industry, the consumer electronics industry, the internet industry, the telecommunications industry, and the venture capital community have submitted briefs *amicus curiae* in this case not because they condone copyright infringement, unauthorized file sharing, or the business practices of Grokster and Streamcast. These industry associations see clearly, as we do, the risk that the Court will be so deeply troubled by the volume of copyrighted works being shared without authorization via peer-to-peer networks that it will abandon the *Sony* safe harbor for technologies with substantial non-infringing uses in favor of a primary use or complex balancing test for judging secondary liability of technology developers.

Virtually all of the alternative tests that Petitioners ("MGM") and various *amici* propose[3] would radically alter the balance of power between the entertainment industry and the technology (and associated) industries in a manner that would have serious negative consequences for investments in innovation, for competition, for the public, and perhaps even for the entertainment industry itself.[4]

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2. *See Metro-Goldwyn-Mayer Studios, Inc. v. Grokster Ltd.*, 380 F.3d 1154, 1163 (9th Cir. 2004); Peter Biddle, et al., *The Darknet and the Future of Content Distribution in Proceedings Of ACM Workshop On Digital Rights Management* (2002).

3. Some *amici* urge the Court to consider Grokster's liability as an active inducer of copyright infringement, even though no claim for active inducement was made below and it is not properly at issue in this appeal. *See, e.g.*, Br. of *Amici Curiae* Digital Media Ass'n et al. Should the Court decide, however, to recognize a new strand of secondary liability in copyright law, *amici* recommend that the Court adopt the stringent requirements that patent law requires to establish active inducement, namely, overt acts of inducement, such as advertising that encourages infringement, and a specific intent to induce others to infringe. We also observe that Senators Hatch and Leahy perceive copyright law not to have an inducement liability rule, an omission they sought to change last term by introducing a controversial bill to create such a new secondary liability rule. *See* Inducing Infringement of Copyrights Act of 2004, S. 2560, 108th Cong. (2004); 150 Cong. Rec. S7190-91 (daily ed. June 22, 2004) (statement of Sen. Hatch).

4. Contrary to the assertions of *amici* International Rights Owners ("IRO"), *see* Br. of *Amici Curiae* Int'l Rights Owners, the *Sony* rule comports fully with the United States's international treaty obligations. Neither the Berne Convention for the Protection of Literary and Artistic Works, the Agreement on Trade-Related Aspects of Intellectual Property Rights, nor the WIPO Copyright Treaty contains any provision requiring signatories to adopt secondary liability rules in their copyright laws. Nor, as the IRO admit, is there any consensus among signatory countries that secondary liability should apply to suppliers of multiple-use goods and technologies used to infringe. Indeed, the

The entertainment industry may need a carefully targeted remedy against certain "bad actors," but that is not what it is seeking from the Court.[5]

II. THE STAPLE ARTICLE OF COMMERCE LIMITATION ON SECONDARY LIABILITY IS AS SOUND FOR COPYRIGHT AS FOR PATENT LAW.

Virtually everyone professes to agree that the *Sony* decision is sound law, even if there is considerable disagreement about how the decision should be interpreted. Yet by arguing for alternative tests, Petitioners and supporting *amici* are implicitly asking the Court to repudiate the Court's decision in *Sony* to borrow the staple article of commerce rule from patent law. Because we regard copyright and patent law as congruent and complementary and because Congress had carefully crafted the staple article of commerce rule for patent law, we regard the Court's borrowing of this concept in *Sony* as sound, indeed as prescient.

That copyright law today is as much about promoting incentives to invest in the creation and dissemination of technological works as in music and films is evident from the Congressional decision to extend copyright protection to computer programs.[6] The computer software industry contributes even more significantly to the U.S. gross domestic product than

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laws of the United Kingdom, Germany, and the Netherlands, among other countries, are consistent with the *Sony* rule: they do not impose secondary liability on suppliers of multiple-use goods absent the supplier's actual knowledge of a specific infringement at the time when the supplier could take action to prevent it. *See* 1 K. Garnett et al., *Copinger & Skone James on Copyright* 469-72, 486 (14th ed. 1999); Paul Goldstein, *International Copyright* 272 (2001); *Kazaa v. Buma/Stemra*, No. 1370/01 (Amsterdam Ct. of Appeal, 28 Mar. 2002); *Techno Design "Internet Programming" BV v. Stichting Bescherming Rechten Entertainment Industrie Nederland, Brein*, No. 85489/HA ZA 02-992.

5. *See UMG Recordings, Inc. v. Bertelsmann AG*, 222 F.R.D. 408, 415 (N.D. Cal. 2004) (denying motion to dismiss contributory and vicarious infringement claim against funder of Napster); *Perfect 10, Inc. v. Visa Int'l Serv. Ass'n*, 2004 U.S. Dist. LEXIS 15895, *12, *15 (N.D. Cal. 2004) (dismissing with leave to amend contributory and vicarious infringement claim against credit card company that processed payments to infringing website).

6. *See* Nat'l Comm'n on New Technological Uses of Copyrighted Works (CONTU), *Final Report* 1 (July 31, 1978); Gen. Revision of Copyright Law, Pub. L. No. 94-553, 90 Stat. 2541 (1976). Indeed, Grokster and Streamcast's software is as copyrightable as MGM's movies. *See* 17 U.S.C. § 102(a) (2000).

the entertainment industry; it is also a major export industry.[7] Computer programs, like digital entertainment products, are highly vulnerable to copyright infringement because digital works can be so cheaply and easily copied and distributed in networked environments. Even though many commercial software programs, along with MGM's movies, are widely available via peer-to-peer networks, the commercial software industry urges the Court, as *amici* do, to preserve the *Sony* safe harbor for technologies with substantial non-infringing uses and affirm the soundness of the Court's decision to borrow the staple article of commerce doctrine from patent law.[8]

A. The Reasons Given By The Court In *Sony* For Borrowing The Staple Article Of Commerce Rule From Patent Law Remain Sound Today.

As the Court in *Sony* observed, "[t]he Copyright Act does not expressly render anyone liable for infringement committed by another."[9] 464 U.S. at 434. More than twenty years later, this is still true. "[I]f [secondary] liability is to be imposed on Sony in this case, it must rest on the fact that it has sold equipment with constructive knowledge of the fact that its customers may use that equipment to make unauthorized copies of copyrighted material." *Id.* at 439. The Court found "no precedent in the law of copyright for the imposition of vicarious liability on such a theory." *Id.*

The Court recognized that "the closest analogy" to the problem then before it was found in patent law. *Id.* Patent law "expressly brands anyone who 'actively induces infringement of a patent' as an infringer, 35 U.S.C. § 271(b), and further imposes liability on certain individuals labeled as

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7. *See* Stephen E. Siwek, International Intellectual Property Alliance, *Copyright Industries in the U.S. Economy* 10 (2004), *at* http:// www.iipa.com/pdf/2004_SIWEK_FULL.pdf.

8. *See, e.g.*, Br. of *Amici Curiae* Digital Media Ass'n et al. at 7; Br. of *Amici Curiae* Bus. Software Alliance et al. at 6.

9. Senators Hatch and Leahy assert that the Copyright Act does contain a statutory basis for secondary liability because § 106 grants exclusive rights not only to do, but "to authorize" certain activities, such as reproducing a work in copies. Br. of *Amici Curiae* United States Sens. Patrick Leahy and Orrin G. Hatch at 7. We agree that this language provides a statutory basis for imposing secondary liability on some actors, such as the producer of an infringing film who wrongfully authorizes its distribution. *See Kalem Co. v. Harper Bros.*, 222 U.S. 55 (1911). This phrase, however, is an exceptionally thin reed on which to premise secondary liability for a technology provider. Neither Sony nor Grokster can meaningfully be said to have "authorize[d]" the infringing acts of others, even if their technologies facilitated infringement. Thus, there is no statutory basis for imposing secondary liability on these actors for providing infringement-enabling technologies.

'contributory' infringers, § 271(c)." *Id.* at 435. Section 271's contributory infringement rule, however, "is confined to the knowing sale of a component especially made for use in connection with a particular patent," *id.* at 440, and "expressly provides that the sale of a 'staple article or commodity of commerce suitable for substantial noninfringing use' is not contributory infringement," *id.* (citing 35 U.S.C. § 271(c)). This is true even if the seller of that article knows that its customers will, in fact, infringe.[10]

"When a charge of contributory infringement is predicated entirely on the sale of an article of commerce that is used by the purchaser to infringe a patent," the Court observed, "the public interest in access to that article of commerce is necessarily implicated." *Id.* at 440. A rule forbidding the sale of staple items would negatively affect those who would purchase the technology for non-infringing purposes as well as developers of similar and complementary technologies or services, and in the copyright context, the interests of rights holders who either do not object to or actively encourage copying of their works by users of a multiple-use technology. *Id.* at 456.

To hold a technology developer liable for contributory infringement is "normally the functional equivalent of holding that the disputed article is within the [statutory] monopoly." *Id.* at 441. The Court in *Sony* found it "extraordinary to suggest that the Copyright Act confers upon all copyright owners, much less the respondents in this case, the exclusive right to distribute VTRs simply because they may be used to infringe copyrights." *Id.* at n.21. To construe copyright law as Universal urged "would enlarge the scope of [Universal's] statutory monopolies to encompass control over an article of commerce that is not the subject of copyright protection." *Id.* at 421.

The Court also invoked the "historic kinship" of patent and copyright law as a reason to borrow the staple article doctrine from patent law.[11] *Id.*

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10. *See*, e.g., 5 Donald S. Chisum, *Chisum on Patents* § 17.04; *Warner-Lambert Co. v. Apotex Corp.*, 316 F.3d 1348, 1365 (Fed. Cir. 2003) (no secondary patent liability "even when the defendant has actual knowledge that some users of its product may be infringing the patent").

11. *Sony* was far from the first case in which the Court borrowed patent concepts in copyright cases. *See, e.g., United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 157-78 (1948) (analogizing copyright to patent with respect to tie-ins); *Fox Film Corp. v. Doyal*, 286 U.S. 123, 131 (1932) (holding that patents and copyrights should receive identical treatment with respect to permissibility of state tax on copyright royalties). *See also Lasercomb Am., Inc. v. Reynolds*, 911 F.2d 970, 978 (4th Cir. 1990) (borrowing patent misuse doctrine in a copyright case); *In re Patient Educ. Media, Inc.*, 210 B.R. 237, 241 n.7 (Bankr. S.D.N.Y. 1997) (bankruptcy court looked to patent law for guidance because of the historic kinship between copyright and patent); *Henry v. A. B. Dick Co.*,

at 439.[11] These two laws not only derive from the same constitutional source, *id.* at 429, but have a similar underlying policy:

> The monopoly privileges that Congress may authorize are neither unlimited nor primarily designed to provide a special private benefit. Rather, the limited monopoly is a means by which an important public purpose may be achieved. It is intended to motivate the creative activity of authors and inventors by the provision of a special reward, and to allow the public access to the products of their genius after the limited period of exclusive control has expired.

Id. See also id. at 491 (Blackmun, J., dissenting) ("[M]any of the concerns underlying 'the staple article of commerce' doctrine are present in copyright law as well.").[12]

The need to balance between the rights of creators to enjoy a monopoly over their works and the social concerns that arise when monopolists go too far continues to motivate these parallel bodies of law. In each body of law, the application of the "staple article of commerce" doctrine fairly and adequately polices the border, limiting the ability of the rights holder to deprive society of the good that comes from the existence of other enterprises that frustrate the exercise of the monopoly but support substantial non-infringing uses.

B. The *Sony* Safe Harbor Is A Manifestly Reasonable And Balanced Rule.

The *Sony* decision has been widely heralded as the "Magna Carta" of the information technology industry because it is a clear "rule of the road" that establishes limits to contributory liability and creates a defined space within which technology developers can innovate and create.[13] Because far from every technology will satisfy *Sony*'s substantial non-infringing

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224 U.S. 1, 48-49 (1912) (citing *Kalem*) (early patent secondary liability case borrowing from copyright law).

12. Courts have also had patent policy in mind when they have limited the scope of protection of functional works unprotected by patent law. *See Baker v. Selden*, 101 U.S. 99 (1880); *Bonito Boats v. Thunder Craft Boats*, 489 U.S. 141 (1989); *Atari Games Corp. v. Nintendo of Am., Inc.*, 975 F.2d 832 (Fed. Cir. 1992); *Lotus v. Borland*, 49 F.3d 807 (1st Cir. 1995); *Computer Assocs. Int'l v. Altai, Inc.*, 982 F.2d 693, 721 (2d Cir. 1992); *Sega Enters. v. Accolade, Inc.*, 997 F.2d 1510 (9th Cir. 1992); *Image Tech. Servs. v. Eastman Kodak Co.*, 123 F.3d 1195 (9th Cir. 1998).

13. *Efforts to Curb Illegal Downloading of Copyrighted Music: Hearing on S. 2560 Before the Sen. Comm. on the Judiciary*, 108th Cong., 2d Sess. 6 (2004) (statement of Kevin McGuinness, Executive Director and General Counsel, Netcoalition).

use standard, we believe that this safe harbor fairly balances the interests of the information technology and other copyright industries.

The *Sony* requirement that a technology have or be capable of substantial non-infringing uses in order for its developer to avoid secondary liability, 464 U.S. at 442, means that a technology must already have, or that there exists a reasonable possibility that it will have, current or future non-infringing uses, and as in patent law, such uses should be deemed insubstantial if they are "far-fetched, illusory, impractical, or merely experimental." 5 Donald S. Chisum, *Chisum on Patents* § 17.03[3] (2004).[14]

The patent case law provides insight into the meaning of the term "substantial." An "occasional aberrant use," for example, falls below the minimum requirement for substantiality. *Dennison Mfg. Co. v. Ben Clements & Sons, Inc.*, 467 F. Supp. 391, 428 (S.D.N.Y. 1979).[15] Courts applying *Sony* in copyright cases have construed the "substantial" requirement in a similar way. *See, e.g.*, *A & M Records, Inc. v. Abdallah*, 948 F. Supp. 1449, 1456 (C.D. Cal. 1996) (determining that while time-loaded cassette tapes were capable of non-infringing uses, those uses were insubstantial). Even Justice Blackmun stated in his dissent in *Sony* that contributory liability against a technology provider ought to lie only "if virtually all of the product's use . . . is to infringe." 464 U.S. at 491.

Properly understood, the "capability" requirement also limits the availability of the *Sony* safe harbor.[16] We agree with the Seventh Circuit

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14. We see no reason why the *Sony* safe harbor for technologies with substantial non-infringing uses should be limited to the doctrine of contributory infringement. Other courts have embraced this Court's treatment of secondary liability under the *Sony* rule and have found it equally applicable to both contributory and vicarious liability. *See Dynacore Holdings Corp. v. U.S. Philips Corp.*, 363 F.3d 1263, 1275 (Fed. Cir. 2004) (describing "*Sony* standard for vicarious infringement liability"); *In re Aimster Copyright Litig.*, 334 F.3d 643, 654 (7th Cir. 2003) (explaining that *Sony* Court "treat[ed] vicarious and contributory infringement interchangeably"). Furthermore, Congress did not distinguish between these forms of secondary liability when creating safe harbors for online service providers. *See* 17 U.S.C. §§ 512(a)-(d) (2000) (creating safe harbors from claims of secondary liability).

15. *See also Univ. of Cal. v. Hansen*, 54 U.S.P.Q.2d 1473, 1479-80 (E.D. Cal. 1999); *Allergan Sales, Inc. v. Pharmacia & UpJohn, Inc.*, 41 U.S.P.Q.2d 1283, 1288 (S.D. Cal. 1996) (substantial non-infringing uses of foldable lenses found because some physicians used the lenses in unpatented procedures); *Vesture Corp. v. Thermal Solutions Inc.*, 284 F. Supp. 2d 290, 317 (M.D.N.C. 2003); *N. Y. Scaffolding Co. v. Whitney*, 224 F. 452, 461 (8th Cir. 1915) (non-infringing uses that are "futile and impractical" are insufficient).

16. We agree with this Court that future potential uses, as well as existing uses, should be taken into account. *Sony*, 464 U.S. at 442; *see also A & M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004, 1021 (9th Cir. 2001).

that implausible or hypothetical potential uses should not satisfy the capability standard. *In re Aimster Copyright Litig.*, 334 F.3d 643, 653 (7th Cir. 2003). Rather, reasonable possibility should be the benchmark for capability. The fabric top for convertibles in *Aro Manufacturing Co. v. Convertible Top Replacement*, 377 U.S. 476 (1964), for example, might have been hypotheti-cally capable of being used by small children as a tent, but it was not suitable for such a use. Hence, it was not "capable" of substantial non-infringing uses within the meaning of the patent statute. The time-loaded cassettes in *A & M Records, Inc. v. Abdallah*, 948 F. Supp. 1449 (C.D. Cal. 1996), may similarly have been hypothetically capable of non-infringing uses, but they were not suitable for such uses, and the court properly rejected the *Sony* safe harbor defense in that case.[17]

Assessing the reasonable capability or suitability of a technology for non-infringing uses is a sound approach in part because uses of technology often change over time, particularly those involving general purpose or multipurpose technologies. Legal challenges may be brought before users have had a chance to experiment with the technologies and decide on optimal uses. Peer-to-peer technologies, for example, promise wide-ranging benefits, including relieving network congestion and increasing security and fault tolerance, many of which are still in early development.[18] In short, the "capable of substantial noninfringing uses" test provides breathing room for the future.

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17. MGM and some supporting *amici* contend that only "commercially significant" non-infringing uses can be considered. Br. for Pet'rs MGM et al. at 30. The commercial significance of non-infringing uses of technology may be one way to qualify for the *Sony* safe harbor, but we do not understand the Court to have intended in its references to this phrase to indicate that no other significance can be considered. In the patent context, there is no such limitation; a technology need only be "suitable for significant non-infringing uses" to qualify for § 271(c) safe harbor. Moreover, the Court certainly regarded "*private, noncommercial* time-shifting" as "commercially significant," *Sony*, 464 U.S. at 442 (emphasis added), on the grounds that a significant number of consumers might wish to obtain the product for its non-infringing uses. Requiring the kind of commercial significance for which MGM and some of its *amici* argue would effectively preclude protection for a growing and important group of non-commercial innovators. *See, e.g.*, Dan Hunter and Gregory Lastowka, *Amateur-to-Amateur*, 46 Wm. & Mary L. Rev. 951 (2004). Such a narrow understanding of "substantial" would undermine the capability analysis by binding it to current commercial viability and inevitably frustrate the policies underlying the *Sony* decision. Limiting substantiality to commercial significance, coupled with a future-directed capability inquiry, would place courts in the untenable position of predicting the commercial import of later arising uses.

18. *See infra* Part III.C.

The *Sony* safe harbor further promotes business certainty and judicial efficiency because of its simplicity, clarity, predictability, and objectivity. It does not require delving into technology developers' states of mind; it does not require extensive evidence or speculation about current and future uses of technologies and in what proportion each use exists or is likely to evolve; and it does not require courts to consider what other kinds of technologies might have been developed instead. *Sony* simply asks courts to determine whether the technology has or is capable of substantial non-infringing uses.

Without such a bright line rule, innovators would be wary of developing transformative new technologies because of uncertainties about potential liability. Under the *Sony* rule, both technology developers and potential funders can readily determine whether such a potentially disruptive technology is capable of substantial non-infringing uses, and invest accordingly. Should a dispute arise, the *Sony* rule lends itself to speedy adjudication by summary judgment, thereby averting the risk and expense of lengthy trials that would drain innovators' resources and deter investment in innovative technologies.

The *Sony* rule also ensures that no one industry can control the evolution or entry into the market of new technologies. Leaving technology development in the hands of technology developers has often benefited copyright owners as well as the public. As the aftermath of *Sony* demonstrates, limiting secondary liability can spur complementary market building. Not only were Sony and its competitors free to compete and innovate, offering improved products at lower costs, but a large installed base of VTR's gave rise to the home video market—greatly enriching the motion picture industry.[19]

C. Standards For Secondary Liability Proposed By MGM And Various *Amici* Were Raised And Rejected In *Sony*. If Adopted Now, They Would Destabilize Secondary Liability In Copyright Law As Patent Law Was Unstable Prior To 1952.

Prior to 1952, the U.S. patent statute contained no statutory secondary liability rule. Courts responded on a case-by-case basis to patent owner pleas for imposing liability on some who contributed to others' infringement. Some courts focused on the alleged contributor's knowledge of infringing acts,[20] some on intent to bring about infringement,[21] some on the

19. *See* James Lardner, *Fast Forward* 297-300 (1987).

20. Prior to the enactment of § 271, judicial inquiry into the defen-dant's knowledge and intent figured heavily in determinations of contributory patent liability. *See Wallace v. Holmes*, 29 F. Cas. 74 (D. Conn. 1871). As the doctrine of contributory patent

relative proportion of infringing and non-infringing uses of a technology,[22] and some on the product's design[23]—among other factors. The rulings from this jurisprudence were confusing in part because courts applied different and sometimes conflicting tests, and in part because courts were sometimes "excessively indulgent" in protecting patent holders against those who might contribute to infringement and sometimes too forgiving towards defendants who supplied their customers with technologies whose only use was for infringement.[24] There was so much uncertainty and instability in the patent case law that witnesses at legislative hearings on patent reform testified that they could not advise their clients adequately on secondary liability claims.[25] After considering the many problems with the

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infringement developed, the precise levels of knowledge necessary to impute liability became increasingly unclear. As one court asked:

> Is it enough, in a case like that at bar, that the defendant should know the material use to which his studs are to be put, and nothing more? [I]f the defendant in a case like this must know something more than the material use to which his studs are to be put, is it sufficient that he should know that the use of his studs by his vendee would be a breach of a contract between that vendee and the complainant, without any knowledge of the complainant's patent? . . . Is the defendant liable as contributory infringer if he is merely notified that some one claims a patent, in the infringement of which his acts may aid or participate? Or, in order to become liable, must a defendant have some special reason, such as an adjudication, to suppose the patent valid? . . . Is [he], on being notified that a patent is claimed, bound, at his peril, to ascertain the validity of the patent and the fact of infringement by his vendee?

Tubular Rivet & Stud Co. v. O'Brien, 93 F. 200, 203-04 (D. Mass. 1898).

21. *See, e.g., Wallace*, 29 F. Cas. at 80. *See also infra* note 35.

22. Prior to the adoption of § 271 some courts imposed liability by determining how a "device . . . is ordinarily used." *Electro Bleaching Gas Co. v. Paradon Eng'g Co.*, 12 F.2d 511, 513 (2d Cir. 1926).

23. *Cf. infra* note 36.

24. Giles S. Rich, *Infringement Under Section 271 of the Patent Act*, 51 Geo. Wash. L. Rev. 521, 522 (1953). Rich was a member of the drafting committee for the 1952 Act who advocated a statute providing coherent secondary liability rules.

25. *See, e.g., A Bill to Revise and Codify the Laws Relating to Patents and the Patent Office, and to Enact into Law Title 35 of the United States Code Entitled "Patents." Hearing on H.R. 3760 before Subcomm. No. 3 of the Comm. on the Judiciary H.R.*, 82d Cong., 1st Sess. 159 (1951) (statement of Giles Rich, patent attorney) ("[T]he opinion of all of us in the patent bar is that this is a situation in which the decisions of the court have left us so much at sea that only Congress can solve the problem."); A Bill to Provide for the Protection of Patent Rights Where Enforcement Against Direct Infringers is Impracticable, to Define "Contributory Infringement," and for other Purposes, Hearing on H.R. 3866 Before Subcomm. No. 4 of the Comm. on the Judiciary H.R., 81st Cong., 1st Sess. 85 (1949) (statement of Leslie Young, attorney, Fish, Richardson & Neave).

patent secondary liability case law, many in Congress concluded that "the 162 year experiment of getting along without a statute covering this matter ha[d] not worked out very well."[26] Section 271 was added to the patent statute to clarify and stabilize secondary liability rules,[27] and it has been substantially successful in doing so.[28]

Petitioners and various *amici* ask this Court to supplant the *Sony* safe harbor with alternative tests that turn upon predictions about the primary uses consumers will make of products, inquiries into developers' intent, complex cost-benefit analyses of alternative designs, and multi-factor balancing tests that are recipes for confusion and instability in the law, opening the floodgates of litigation and chilling investment in innovative technologies. Several of these tests were explicitly considered and rejected in *Sony*, and all would cast secondary copyright liability into the murky depths of uncertain and unpredictable ad hoc analysis from which Congress salvaged the patent law in 1952 and which this court wisely avoided in *Sony*.[29] Under the varied and fact-intensive standards proposed by Petitioners and certain *amici*, copyright holders could effectively approve or deny new technologies that are disruptive to, or merely competitive with, their business models, and perhaps even technologies that have only a few infringing uses. The adoption of any of the proposed standards "would defeat the reliance interest of those corporations that have structured their

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26. Rich, *supra*, at 522.

27. Revision of Title 35, United States Code, H.R. Rep. No. 1923, 82d Cong., 2d Sess. (1952).

28. We do not mean to suggest that § 271 has solved all secondary liability problems in patent law. The Federal Circuit is still issuing some conflicting opinions on the intent requirement in active inducement. *See Fuji Photo Film Co., Ltd. v. Jazz Photo Corp.*, 394 F.3d 1368, 1377 (Fed. Cir. 2005) (recognizing "lack of clarity" in level of intent required for active inducement).

29. Various *amici* also urge this Court to craft new secondary liability standards derived from tort law principles. *See, e.g.*, Br. of *Amici Curiae* State Att'ys Gen. at 11; Br. of *Amici Curiae* Nat'l Acad. of Recording Arts & Sciences et al. at 20. These proposed standards ignore critical differences between the two doctrines. Product liability law requires manufacturers to account for physical harm, not mere economic harm such as is at issue here, *see* 24 Dan B. Dobbs, *The Law of Torts* § 352 at 972, and the harms that tort law protects against are likely to befall consumers and their invitees, not third parties such as Petitioners. Moreover, tort law does not impose liability where general purpose products are not defectively designed, even when such products are manifestly dangerous. *See generally* Restatement (Third) of Torts § 2, Cmt. d Part IV.D. *See also Riordan v. Int'l Armament Corp.*, 132 Ill. App. 3d 642, 649 (Ill. Ct. App. 1985) (no liability for making or selling guns even though they are widely used to cause bodily harm).

activities . . . based upon the well-established rules." *Allied Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 785 (1992). As the Court has explained, "settled expectations should not be lightly disrupted. . . . In a free, dynamic society, creativity in both commercial and artistic endeavors is fostered by a rule of law that gives people confidence about the legal consequences of their actions." *Landgraf v. USI Film Prods.*, 511 U.S. 244, 265-66 (1994). Giving Petitioners and other rights holders control over technology companies that create and sell multiple-use technologies would be unprecedented and highly disruptive.

1. *The Proposed Primary Purpose Standard Would Expose Technology Developers To Unbounded Liability For Acts They Can Neither Predict Nor Control.*

Petitioners propose that technologies be deemed illegal if their "primary use" is to infringe copyrights. Br. for Pet'rs MGM et al. at 30. Petitioners argue that *Sony* itself was a "primary use" case, that is, that the Court ruled for Sony because the primary use of the VTR was to make fair use copies of TV programs for time-shifting purposes. *Id.* at 15. This is neither what the Court said nor what it meant. Indeed, the Court explicitly rejected the suggestion that courts weigh whether "infringing uses outweigh noninfringing uses" or try to predict "the future percentage of legal versus illegal home-use recording." *Sony*, 464 U.S. at 444 (internal citations omitted).

The Court's reasons for rejecting the primary use standard remain sound. First, the primary use of a technology may well shift over time, creating an irresolvable tension between *Sony*'s call for consideration of a device's capabilities and the primary use test's concern with present levels of infringement. The essence of the *Sony* rule is the majority's insight that holding up the development of a technology, and its potential noninfringing uses, based on current usage, would "block the wheels of commerce." *Id.* at 441 (quoting *Henry v. A. B. Dick Co.*, 224 U.S. 1, 48 (1912)). Second, the *Sony* rule protects developers from liability based on consumer uses of the technology. In contrast, the proposed primary use test would unfairly hold a developer liable for indirect infringement not because of any actions taken by the developer, but rather on the basis of end users' decisions to use a device primarily for illegal purposes.[30]

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30. *See* Daren Fonda, *Downloading Hollywood*, Time Magazine, Feb. 14, 2005 at 43 (describing BitTorrent, a P2P file sharing tool that was designed to ease the distribution of open source Linux files but is widely used for unauthorized distribution of copyrighted works).

A primary use standard also raises questions of fact likely to render summary judgment impossible.[31] Primary use tests rely on contentious and difficult-to-obtain factual evidence of infringing versus non-infringing uses, a gauge of liability largely outside the control of the technology developer.[32] Under such a standard, developers would be provided little guidance as to potential liability and have few levers with which to control it.

2. *Proposed Standards That Examine The Intent Of Technology Developers And Compare Benefits Of Alternative Technology Designs, And Proposed Multi-Factor Balancing Tests, Will Inappropriately Vest Technology Design Decisions In The Courts.*

MGM and several *amici* also ask this Court to adopt alternative standards that would inevitably involve judges and juries in the intricacies of technical design. The proposed new theories of liability range from intentional design of the technology to enable infringement, to the availability of alternative designs that might have mitigated infringement, to an *Aimster*-like "disproportionately costly" test for judging whether a technology developer has done enough to avert or minimize infringing uses of its multiple-use, general purpose products. None of these alternative tests finds support in *Sony* and all would create considerable uncertainty that would stifle innovation, especially since courts are not well-suited to second-guess technology design decisions.

Sony intentionally designed the Betamax to allow consumers to make unauthorized copies of broadcast television programming, *Sony*, 464 U.S. at 490, and Universal sought to prevent its distribution precisely because

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31. If a primary purpose test had been adopted in *Sony* and additional fact finding had been conducted, it is not at all clear that Sony would have prevailed. Universal contended that "authorized uses of the VTR constituted no more that 9% of uses." Br. for Resps. Universal City Studios and Walt Disney Prods. at 48, *Sony*, 464 U.S. 417 (1984) (No. 811687). Survey evidence showed that "the average household harbored 31.5 cassettes," well more than needed for time-shifting. Twenty-three percent of people surveyed reported that they used their Betamaxes[more for] librarying than for time-shifting; fifty-four percent answered the opposite; twenty percent said it was an equal proposition"; another survey found that 75 percent of households were making permanent libraries of off-the-air programs. Lardner, *supra*, at 116, 230.

32. Other *amici* point out there is little in the factual record on the nature of the uses of copyrighted works by users of P2P networks. To determine the extent to which current uses are infringing, permitted under the fair use doctrine, or otherwise authorized would require extensive judicial fact finding. *See* Br. of *Amici Curiae* Glynn Lunney et al. at 22-23.

of the technology's design,[33] *see id.* at 420. Despite alternate design features for video players, including removing the tuner, *Sony*, 464 U.S. at 493 n.42, or including a feature disallowing the copying of specified broadcast programming, *id.* at 494, the Court evaluated the technology as presented.[34]

Like the primary purpose standard, an intentional or alternative design standard is incompatible with summary judgment. Determining the subjective states of mind of a technology's developers and investors will be difficult, time-consuming, and ultimately inconclusive. While on occasion direct evidence of a developer's intended use of a device may be available, discerning intent will often prove a matter of inference from other available information.[35] Similarly, evaluating alternative designs will require judges and juries to answer complicated questions about the feasibility of technology design options and related business models, and resolve impenetrable questions of the potential economic consequences of technologies not chosen. It would require that courts consider whether developers could have developed or anticipated development by others of technologies that could be integrated into their own offerings to eliminate or reduce infringing uses. Courts would be required to determine whether such technologies were ready for commercial implementation, were cost-effective to implement, and whether any adverse technical effects they might impose on the product outweighed their benefits. Scholars and other commentators have noted the undesirable effect on technical innovation wrought by entrusting courts to oversee product design.[36] We question

33. Universal argued that the Court should "direct [Sony] to devise a technological means to prevent VTR copying only of programs owned by respondents and others who object to such copying." Br. for Resps. Universal City Studios and Walt Disney Prods. at 53, *Sony, supra*. While such alternative designs may have been feasible, the Court wisely avoided interfering in technology design decisions.

34. This analysis is supported by patent case law as well. *See Universal Elecs. v. Zenith Elecs. Corp.*, 846 F. Supp. 641, 651 (N.D. Ill. 1994) ("[T]he relevant inquiry is whether there are substantial non-infringing uses for a device, not whether a device is designed so as to allow infringement of a patented process.").

35. In patent law before § 271 was enacted, intent to infringe was at times inferred if the defendant's product was "utterly useless" for non-infringing purposes, *Wallace*, 29 F. Cas. at 79, *see also Thomson-Houston Elec. Co. v. Ohio Brass Co.*, 80 F. 712, 723-24 (6th Cir. 1897). In other instances courts considered whether a product was "adapted to the infringing use," *Rupp & Wittgenfeld v. Elliot*, 131 F. 730, 732 (6th Cir. 1904), or if the product's "most conspicuous use" was infringing. *Henry v. A. B. Dick Co.*, 224 U.S. 1, 49 (1912).

36. *See United States v. Microsoft Corp.*, 147 F.3d 935, 948 (D.C. Cir. 1998) ("Antitrust scholars have long recognized the undesirability of having courts oversee product design, and any dampening of technological innovation would be at cross

whether it is prudent to require the federal judiciary to undertake this task on a routine basis.

These design standards invite unprecedented copyright holder control over technology because they allow copyright owners simply to focus on the infringing capabilities of a technology and claim that, if the technology is being used for that purpose, it must have been designed for it – no matter how strong the developer's denial. Copyright holders could also single out specific features as objectionable, claiming that their inclusion is evidence of contributory infringement. Copyright owners will always be able to allege very high losses from infringement and low costs of technology fixes while technology developers will be forced to prove, after exhaustive discovery and a lengthy trial, the infeasibility of or significant performance problems with proposed fixes. Moreover, even in the absence of real damages, courts are required to impose statutory damages on infringers, so that even harmless effects may give rise to substantial liability.

Abandoning the clear, predictable *Sony* standard for the proposed design standard is inconsistent with the copyright statute and with Congress's repeated judgment to limit copyright holders' control over the design of technologies with substantial non-infringing uses.[37] Design-based tests would involve the courts in the minutiae of technology design, the outcome of which would be a moving target of rights holder-driven technology mandates. Neither the federal courts nor copyright owners should be in charge of industrial design policy for the United States.

The difficulties created by the uncertain and unpredictable nature of these proposed standards are compounded when they are formulated as components of unwieldy multi-factor tests that incorporate such factors as the cost of pursuing direct infringers, the availability of self-help mecha-

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purposes with antitrust law."); Richard A. Posner, *Antitrust in the New Economy*, 68 Antitrust L. J. 925, 936-40 (2001) (discussing factors that limit judicial competence in new technology antitrust cases, including "unusually difficult questions of fact," "technical complexity," difficulty finding neutral experts, "daunting challenge to the fact-finding capacity of the judiciary," "imponderable[]" economic questions, and poor fit between judicial process and technological design process); Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law*, ¶ 775c, at 233 (1996) ("Because courts and juries are generally incapable of addressing the technical merits or anticompetitive effects of innovation, they quickly make the relevant question turn on intent. We believe this is the worst way to handle claims that innovation violates the antitrust laws.").

37. *See infra* Part III.B-C.

nisms,[38] the level of knowledge, and the cost of discovering and discouraging infringement.[39] Such tests would erect a labyrinth of indirect liability likely to confound even the most savvy and cautious technology developers and certain to chill investment.

Rather than introducing new secondary liability factors, creating evermore complicated structures of liability, and straying farther from the present statutory scheme, this Court should reaffirm the objective, pragmatic standard it announced in *Sony* and avoid "dis-rupt[ing] settled expectations in an area of the law in which the demands of the national economy require stability." *Allied Signal*, 504 U.S. at 786.

III. ABANDONING THE *SONY* SAFE HARBOR FOR STAPLE ARTICLES OF COMMERCE SHOULD BE DONE, IF AT ALL, BY CONGRESS.

The alternative tests for secondary liability for which Petitioners and various *amici* argue are without statutory foundation and would have far-reaching ramifications for many stakeholders apart from the parties to this case, including many firms that have made significant investments in innovative technologies in reliance on the *Sony* safe harbor. Either of these considerations would argue for deference to Congress; considered together, they demand such deference.

As this Court recognized in *Sony*, Congress has the institutional capability to hear from many interested parties, make findings about the need for regulations and likely impacts of statutory proposals, and accommodate the competing interests that are inevitably implicated by new technologies. 464 U.S. at 456. When Congress has been concerned about disruptive technologies in the past, it has demonstrated the will to regulate and has carefully preserved the *Sony* safe harbor as the default secondary liability rule in copyright law.

A. Without Explicit Legislative Guidance, It Is Premature To Abandon *Sony* Or To Revise Copyright Protections At The Expense Of So Many Unrepresented Stakeholders.

When this Court was last faced with expansive copyright secondary liability claims that, if granted, would affect many other stakeholders, the

38. *See* Br. of *Amici Curiae* Peter S. Menell et al. at 3, 24-29 (proposing thirteen-factor balancing test as "a starting point" for assessing secondary liability for technology developers).

39. *See* Br. of *Amici Curiae* Kenneth J. Arrow et al. at 14.

Court chose to defer to Congress because of its "constitutional authority and institutional ability to accommodate fully the varied permutations of competing interests that are inevitably implicated by [ ] new technology." *Sony*, 464 U.S. at 431. The Court spoke of the "judiciary's reluctance to expand the protections afforded by copyright law without explicit legislative guidance [as] a recurring theme," citing several cases in which courts rejected expansive copyright claims. *Id.* Without express legislative guidance on secondary liability, the Court in *Sony* cautioned that the judiciary should be wary of "construing the scope of rights created by a legislative enactment which never contemplated such a calculus of interests." *Id.* (internal citation omitted). Faced with a different new technology challenge, another court observed: "Obviously there is much to be said on all sides. The choices involve economic, social, and policy factors which are far better sifted by a legislature. The possible intermediate solutions are also of the pragmatic kind legislatures, not courts, can and should fashion." *Williams & Wilkins Co. v. United States*, 487 F.2d 1345, 1360 (Ct. Cl. 1973)[40] When, as here, federal courts are asked to interpret copyright law expansively, communications and innovation policy are necessarily implicated. "[I]t is incumbent upon courts to be aware that their copyright decision[s] are de facto setting a substantial and growing part of the nation's communications policy . . . [B]ehind authorship concerns lies a cycle of incumbent and challenger technologies that will never end . . . The only question is how painful and costly the transitions will be."[41]

B. Congress Has Acted In Response to Disruptive Technologies In The Past And It Supports The *Sony* Safe Harbor As A Default Copyright Secondary Liability Rule.

In *Sony*, the Court recognized that "Congress has . . . often examined other innovations in the past." 464 U.S. at 456. In *White-Smith Music Publishing Co. v. Apollo Co.*, 209 U.S. 1 (1908), for example, the Supreme Court rejected claims that unauthorized sound recordings infringed copyright. Shortly thereafter, Congress amended copyright law to give composers the right to control mechanical reproductions of their works, but

40. The need for deference is greatest when "the relevant policy considerations do not invariably point in one direction, and there is vehement disagreement over the validity of the assumptions underlying many of them. The very difficulty of these policy considerations, and Congress's superior institutional competence to pursue this debate, suggest that legislative not judicial solutions are preferable." *Turner Broad. Sys. v. F.C.C.*, 520 U.S. 180, 191 (1997) (footnote omitted).

41. Tim Wu, *On Copyright's Communications Policy*, 103 Mich. L. Rev. 278, 366 (2004).

limited the scope of the right by imposing a compulsory license. *See* 17 U.S.C. § 115 (2000). More recently, the Court refused to extend copyright liability to cable television providers in the absence of an explicit Congressional mandate. *See Fortnightly Corp. v. United Artists Television, Inc.*, 392 U.S. 390 (1968); *Columbia Broad. Sys., Inc. v. Teleprompter Corp.*, 415 U.S. 394 (1974). Congress saw the need for regulation of the retransmission of copyrighted programming by cable operators and acted, once again, by imposing a compulsory license on copyright owners. *See* 17 U.S.C. § 111 (2000).

The Court in *Sony* also noted that Congress might well "take a fresh look at this new technology." 464 U.S. at 456. Had Congress been dissatisfied with this safe harbor for technologies with substantial noninfringing uses, it would have amended the copyright statute to change *Sony*. Its refusal to do so demonstrates its acceptance of the *Sony* safe harbor rule.[42]

Since *Sony*, when Congress has felt the need to adjust secondary liability it has done so. On two occasions, Congress has been persuaded to regulate technologies more strictly than *Sony* requires, but it did so narrowly, leaving the *Sony* safe harbor intact for all other technologies. In the late 1980's and early 1990's, the recording industry sought legislative relief against the developers of digital audio recording ("DAR") technologies used primarily to make "library" copies of copyrighted sound recordings.[43] The recording industry sought a broad legislative mandate to require technical protection measures to be built in to a wide range of technologies capable of recording digital works.[44] Instead, the 1992 Audio Home Recording Act ("AHRA") imposed a narrow technology mandate on defined DAR devices and left the *Sony* safe harbor intact as to all other

42. *See* 144 Cong. Rec. S11,887-88 (daily ed. Oct. 8, 1998) (statement of Sen. Ashcroft) ("It thus should be about as clear as can be to a judge or jury that, unless otherwise specified, nothing in this legislation should be interpreted to limit manufacturers of legitimate products with substantial noninfringing uses – such as VCRs and personal computers – in making fundamental design decisions or revisions. . . ."); 144 Cong. Rec. E2137 (extension of remarks Oct. 13. 1998) (statement of Rep. Bliley) (noting that Administration's proposed rules would foreclose some fair uses of copyrighted works, "effectively overruling the Supreme Court's landmark decision in [Sony]. In the view of our Committee, there was no need to create such risks. . . .").

43. *See* Christine C. Carlisle, *The Audio Home Recording Act of 1992*, 1 J. Intell. Prop. L. 335, 336 (1994).

44. Copyright Issues Presented by Digital Audio Tape, H.R. 1384, 100th Cong., 1st Sess. (1987); A Bill to Implement a Serial Copy Management System for Digital Audio Tape, H.R. 4096, 101st Cong., 2d Sess. (1990); Audio Home Recording Act of 1991, H.R. 3204, 102d Cong. 1st Sess. (1991).

technologies.[45] AHRA protected the public's interests by ensuring that DAR devices could be used to make personal copies of digital music and by immunizing noncommercial copying of sound recordings,[46] while providing for a compulsory license fee on DAR devices.[47]

A few years later, the Clinton Administration's "White Paper"[48] on the challenges of digital technologies facing copyright law recommended regulation of technologies whose primary purpose or effect was to circumvent technical protection measures that copyright owners were using to protect digital works.[49] In 1998, Congress enacted a regulation of anti-circumvention technologies that was more narrowly drawn than the White Paper's proposal.[50] In response to concerns expressed by computer industry associations and public interest groups, Congress adopted several exceptions to these rules and ordered periodic rule-making to consider other exceptions.[51] It specified that information technology developers were not required to design their products to respond to technical protection measures used by copyright owners to protect their works.[52] The *Sony* safe harbor was once again preserved for all other technologies.[53]

C. Congress Is Now Evaluating Various Ways To Address The Peer-to-Peer File-Sharing Phenomenon.

Congress has held no fewer than eight hearings on the peer-to-peer file-sharing phenomenon since Petitioners brought suit against Grokster. In the process, it has heard from many witnesses about the extent of unauthorized file sharing and the implications of P2P for the entertainment industry, including testimony from critics of that industry as well as technology developers, academics, and others about the many socially beneficial current and predicted uses of P2P technologies.

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45. 17 U.S.C. § 1002 (2000).

46. 17 U.S.C. § 1008 (2000).

47. 17 U.S.C. §§ 1003, 1004 (2000).

48. *See* Report of Working Group on Intellectual Property Rights of Information Infrastructure Task Force, Intellectual Property Rights and the National Information Infrastructure, Appendix (Sept. 1995) at 110-14 [hereinafter "White Paper"].

49. *Id.* at 230-34.

50. 17 U.S.C. § 1201 (2000).

51. 17 U.S.C. §§ 1201(f)-(j), (a)(1)(B)-(C) (2000).

52. 17 U.S.C. § 1201(c)(3) (2000).

53. 17 U.S.C. § 1201(c)(2) (2000) ("Nothing in this section shall enlarge or diminish vicarious or contributory liability for copyright infringement in connection with any technology . . .").

Even in its infancy, P2P technology has spawned many unique, non-infringing innovations beyond sharing of media files that cannot easily be replicated with other technologies. The distributed and redundant network at the heart of P2P systems provides an extremely reliable system for storing and distributing information. It ensures content availability in the face of sabotage (e.g., by a "denial of service" attack), equipment failure, and unanticipated and overwhelming popularity.[54] P2P is now at the center of many legitimate enterprises having nothing to do with copyrighted media, such as businesses offering services like Voice Over Internet Protocol ("VOIP").

More fundamentally, P2P technology—like the internet itself—is a generic platform technology that enables many other uses and applications. Unlike the VCR in *Sony*, P2P is infrastructural in that it generates value by being used as an input into a wide range of productive processes, the outputs of which are often public and non-market goods that generate positive externalities which benefit society.[55] P2P is also "generative" in the sense that it has a great capacity to produce unanticipated change driven by broad, varied audiences based on fundamental characteristics such as its ability to make a wide range of tasks easier, its adaptability to a range of different tasks, its ease of mastery by both tinkerers and consumers, and its accessibility and ease of distribution.[56] Any secondary liability standard that inhibits development or distribution of generic technologies with these characteristics will necessarily inhibit not just that technology, but many of the "downstream" uses that the technology enables.

Congress has seen that no simple "quick fix" will resolve the challenges that the internet in general, and peer-to-peer file-sharing technologies in particular, have posed. Many different proposals for reform have been offered,[57] but Congress has thus far been unable to reach consensus

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54. *See In Praise of P2P*, The Economist, Dec. 2, 2004; Qiming Chen et al., Hewlett Packard, *Peer-to-Peer Collaborative Internet Business Servers*, Technical Report HPL-2001-14 (2001) *available at* http://www. hpl.hp.com/techreports/2001/HPL-2001-14.pdf (last visited Feb. 22, 2005).

55. *See* Brett M. Frischmann, *An Economic Theory of Infrastructure and Commons Management*, forthcoming 89 Minn. L. Rev. (April 2005).

56. *See* Jonathan Zittrain, *The Future of the Internet – And How To Save It at* 8-9, *available at* http://cyber.law.harvard.edu/zittrain/ generative.pdf (last visited Feb. 24, 2005).

57. Scholars have also offered several alternative solutions that would compensate rightsholders for P2P distribution of their works. *See* Jessica D. Litman, *Sharing and Stealing*, 27 Hastings Comm. & Ent. L.J. 1 (2004) (proposing opt-out P2P infrastructure funded by a blanket levy); William W. Fisher III, *Promises to Keep: Technology, Law and the Future of Entertainment* 199-258 (2004) (proposing tax on digital devices and

on the appropriate legislative approach to regulating P2P technologies. It is clear, however, that Congress is educating itself regarding the various non-infringing uses P2P allows and the broad set of interests, issues and parties involved in the P2P debate.

We respectfully suggest that this Court not cut short the Congressional conversation about how best to address the challenges posed by P2P technologies.

CONCLUSION

The judgment of the Court of Appeals should be affirmed. Respectfully submitted,

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internet services that would be used to compensate artists for lesser online copyright protection); Daniel J. Gervais, *Copyright, Money and the Internet* (March 3, 2004), *available at* http://www.commonlaw.uottawa.ca/ faculty/prof/dgervais/CopyrightMoney AndTheInternet.pdf (suggesting a collective licensing solution); Neil W. Netanel, *Impose a Noncommercial Use Levy to Allow Free Peer-to-Peer File Sharing*, 17 Harv. J. Law & Tech. 1 (2003) (proposing a noncommercial use levy).

COSTS AND BENEFITS OF THE RECORDING INDUSTRY'S LITIGATION AGAINST INDIVIDUALS

By Kristina Groennings

For the past few years, academic discussion of the recording industry's efforts in the war on piracy has been focused on issues of contributory and vicarious infringement associated with litigation against peer-to-peer (P2P) networks.[1] There has also been significant debate over whether record company sales have actually been affected by file-sharing.[2] Yet, only the occasional discussion has addressed the costs and benefits of pursuing direct infringement claims.[3] This is somewhat surprising, as the record industry is not the only content industry to go after direct infringers.[4]

In August 2003, the Recording Industry Association of America (RIAA) launched its own litigation campaign against individuals for uploading unauthorized music files via the Internet. As of November 11, 2004, a total of 6,200 file-sharers had been targeted in a litigation strategy that, since its inception, has been marked by unprecedented media cover-

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1. Peer-to-peer technology involves individual computers communicating over the Internet on custom networks that route search requests and conduct direct file transfers among the network's users. Unlike the centralized architecture of a client-server relationship—such as a website, where many users visit a single location to use the resources stored there—a P2P network directly connects many individual computers without any centralized server. To join a P2P network, users download software that, when launched, locates and connects to other users online at the time via an underlying network protocol. This software searches for files the user wants on other network members' computers, makes designated user files available to the network, and transfers files between users upon request.

Elizabeth Miles, Note, *In re* Aimster & MGM, Inc. v. Grokster, Ltd.: *Peer-to-Peer and the* Sony *Doctrine*, 19 BERKELEY TECH. L.J. 21, 26-27 (2004) (footnotes omitted).

2. *See generally* Felix Oberholzer, *The Effect of File Sharing on Record Sales—An Empirical Analysis*, Mar. 2004, *available at* http://www.unc.edu/~cigar/papers/FileShaing_March2004.pdf#search='felix%20oberholzer%20The%20Effect%20of%20File%20Sharing%20on%20Record%20Sales'.

3. *See* Mark A. Lemley & R. Anthony Reese, *Reducing Digital Copyright Infringement Without Restricting Innovation*, 56 STAN. L. REV. 1345, 1395-405 (2004).

4. Microsoft has sued many individuals for piracy of its software. *See generally Piracy News*, Microsoft Canada, *at* http://www.asia.microsoft.com/canada/piracy/news/default.mspx (last visited Mar. 11, 2004). DirectTV has pursued claims against individuals who own unauthorized decoding devices. *The Music Industry Strikes Back*, Dataquest, Oct. 30, 2003, *at* http://dataquest.ciol.com/content/ebiz/103103001.asp.

age and public scrutiny.[5] In addition to the RIAA, recording industry associations worldwide are beginning to sue music fans.[6] In June 2004, the Société Civile des Producteurs Phonographiques filed twenty "John Doe" suits targeting users throughout France.[7] Morever, in a highly publicized announcement in November 2004, the Motion Picture Association of America (MPAA) also initiated suits against alleged infringers.[8]

This Note analyzes the effectiveness of the RIAA's litigation against direct infringers. Part I places the RIAA's claims against individual users in context and discusses obstacles that the recording industry has faced in its litigation efforts thus far. Parts II and III discuss the costs and benefits to the record industry of the lawsuits against users, concluding that the benefits outweigh the costs. Finally, Part IV offers suggestions as to additional means by which the RIAA can increase the efficiency of its enforcement efforts.

I. BACKGROUND

By the fall of 2003, suing direct infringers may have been one of the only recourses left to the recording industry.[9] Record companies faced a

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5. Grant Gross, *MPAA to Sue Movie File Swappers*, PC WORLD, Nov. 4, 2004, *at* http://www.pcworld.com/news/article/0,aid,118485,00.asp.

6. dRD, *European P2P Users to Face American-Style Manhunt*, Dec. 17, 2003, *at* http://www.afterdawn.com/news/archive/4797.cfm.

7. Ketola, *P2P Lawsuits Filed in France*, AfterDawn.com, June 29, 2004, *at* http://www.afterdawn.com/news/archive/5366.cfm.

8. Press Release, PR Newswire, Studios to Begin Suing Illegal Film File Swappers (Nov. 4, 2004), *available at* http://sev.prnewswire.com/entertainment/20041104/LATH0 7704112004-1.html.

9. Stan Liebowitz, Will MP3 Downloads Annihilate the Record Industry? The Evidence so Far 29-30 (June 2003). Stan Liebowitz states:

> It is also understandable that the record companies may not be willing participants in this laboratory for economic analysis. Why should they risk their revenues in an experiment that may end badly for them? How many of us would volunteer to undergo surgery without anesthesia to test a theory that claimed it wasn't really necessary? I think it is important to understand that a decline of 20-25% is a considerable number.

Id. By choosing the words "[w]hy should they risk their revenues in an experiment that may end badly for them," Liebowitz acknowledges the precarious situation that record companies faced in the fall of 2003 and the need to take some kind of immediate action. Liebowitz does not address litigation as an option, but does express a preference for resolution of the problem through digital rights management technology as opposed to non-market alternatives.

long-term trend of a decrease in sales, in part attributable to file-sharing.[10] The decline in album sales following the inception of Napster, from 1999 through 2002, had been the most dramatic in the past 30 years.[11] CD sales were down from $13.2 billion in 2000 to $11.2 billion in 2003.[12] The industry's victory in *Napster* was fleeting as publicity over the issue increased awareness of P2P technology and users flocked to decentralized networks like Grokster and KaZaa, making the tracking of P2P use more difficult.[13] In April 2003, the RIAA lost its case of contributory and vicarious infringement against Groskter in a California federal district court.[14] In a desperate move to address the P2P epidemic, on September 8, 2003, the recording industry filed its first round of 261 lawsuits against its own fans.[15]

A number of obstacles have beset the RIAA since it began its campaign to sue individual file-sharers. In December 2003, the litigation process was made more arduous and costly by the District of Columbia Court of Appeals' decision in *Verizon* that prohibited the RIAA from using the Digital Millenium Copyright Act's (DMCA) subpoena provision to compel Internet service providers (ISPs)[16] to disclose alleged infringers' iden-

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10. *Id.* at 27-28 (concluding that there are no other explainable causes of the decline in album sales from 1999 to 2002 other than MP3 downloads and specifically stating that "MP3 downloads are harming the industry").

11. *Id.* at 27. Liebowitz's study analyzes several alternative explanations for this outcome, specifically economic factors including: the price and quantity of records; income changes; changes in recording formats; changes in quality or taste in music; and media portability. However, the author concludes that those factors are inferior to MP3 downloading as explanations for the decline in album sales from 1999-2002. *Id.* at 28.

12. Cade Metz, *Congress Targets Digital Pirates*, PC MAG., Apr. 6, 2004, *available at* http://www.pcmag.com/article2/0,1759,1562415,00.asp.

13. *See* Fonovisa, Inc. v. Napster, Inc., No. C 01-02669 MHP [Related to No. C 99-05183 MHP], Nos. C 01-01412 MHP [Related to No. C 99-05183 MHP], C 01-02431 MHP [Related to No. C 99-05183 MHP], 2002 U.S. Dist. LEXIS 4270 (N.D. Cal. Jan. 28, 2002).

14. MGM Studios, Inc. v. Grokster, Ltd., 259 F. Supp. 2d 1029 (C.D. Cal. 2003), *aff'd*, 380 F.3d 1154 (9th Cir.), *cert. granted*, 125 S. Ct. 686 (2004)..

15. Press Release, Recording Industry Association of America, Recording Industry to Begin Collecting Evidence and Preparing Lawsuits Against File "Sharers" Who Illegally Offer Music Online (June 25, 2003), *at* http://www.riaa.com/news/newsletter/062503.asp; *RIAA v. the People*, Elec. Frontier Found., *at* http://www.eff.org/IP/P2P/riaa-v-thepeople.php (last visited Feb. 24, 2004).

16. *ISP*, WHATIS.COM, *at* http://searchwebservices.techtarget.com/gDefinition/0,294236,sid26_gci214028,00.html (last updated July 1, 2001) (stating that an ISP is "a company that provides individuals and other companies access to the Internet and other related services").

tities.[17] The court determined that ISPs that route material through their servers fall under the safe harbor provision of the DMCA, § 512(a), and are therefore not subject to § 512(h), the subpoena provision.[18]

Prior to *Verizon*, § 512(h) provided a fast, cheap mechanism for discovering suspected file-sharers' identities. The RIAA needed only to supply $35, a copy of notification, the proposed subpoena, and a sworn declaration that the information sought was for the sole purpose of protecting copyright.[19] Shortly before *Verizon* was decided, the RIAA had begun to bundle requests for subpoenas, paying only $35 total for multiple issuances.[20] Courts presumed that no determination that the alleged offender had in fact violated any copyright laws was necessary to compel ISPs' disclosure of subscriber identification information. Without the benefit of the DMCA's subpoena provision, however, the RIAA must now file its lawsuits using alleged offenders' numerical IP addresses.[21] Only after filing can the RIAA then apply for a subpoena to obtain subscribers' identification information.[22] Thus, the RIAA must pay the full cost of filing a suit and any ensuing subpoenas before discovering the identities of alleged infringers and initiating settlement discussions. If mistaken, it is subject to sanctions for the pursuit of frivolous litigation.[23] Therefore, the recording industry must now spend more time and money to pursue its claims against individuals than was the case when its direct infringement campaign began.

Another roadblock for the RIAA has been motions to quash identity subpoenas by Doe defendants, who raise First Amendment, privacy, personal jurisdiction, and improper joinder claims.[24] Some courts have dismissed defendants' claims and affirmed the RIAA's right to subpoena

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17. Recording Indus. Ass'n of Am., Inc. v. Verizon Internet Servs., 351 F.3d 1229, 1236 (D.C. Cir. 2003).

18. *Id.* at 1237.

19. 17 U.S.C. § 512(h)(2)(A)-(C) (2000).

20. Frank Ahrens, *A Reprise of Lawsuits Over Piracy; Music Industry Lacks Defendants' Names*, WASH. POST, Jan. 22, 2004, at E01, *available at* http://www.washingtonpost.com/ac2/wp-dyn/A36795-2004Jan21?language=printer.

21. *More Song Swappers Sued*, CNNMoney, Jan. 21, 2004, *at* http://money.cnn.com/2004/01/21/technology/riaa_suits/index.htm?cnn=yes.

22. *Id.*

23. Ahrens, *supra* note 20.

24. Sony Music Entm't Inc. v. Does 1-40, 326 F. Supp. 2d 556 (S.D.N.Y. 2004); Lee Rainie & Mary Madden, Pew Internet Project and comScore Media Metrix Data Memo (Jan. 2004) (discussing an individual's opposition to an RIAA subpoena based on the violation of state and federal privacy laws), *available at* http://www.pewinternet.org/pdfs/PIP_File_Swapping_Memo_0104.pdf#search='Pew%.

Does.[25] For instance, a district court upheld the RIAA's right to subpoena and rejected the Doe defendants' first amendment argument.[26] The court held that while the act of file-sharing may qualify as speech because the user is making a statement that music should be free, the First Amendment is not a shield for intellectual property infringers.[27] The right of a copyright owner to use the judicial process to pursue well-substantiated infringement claims trumps the right to anonymous speech.[28] Additionally, the court ruled that issues of joinder and personal jurisdiction have no place in a motion to quash a subpoena.[29] A recent Pennsylvania federal district court decision also confirmed the RIAA's legal right to subpoena ISPs, although it additionally held that ISPs must provide notice to the targets of RIAA subpoenas.[30] However, another Pennsylvania court denied the RIAA the right to join claims, requiring the RIAA to instead file indi-

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25. Elektra Entm't Group, Inc. v. Does 1-9, No. 04 Civ. 2289 (RWS), 2004 U.S. Dist. LEXIS 23560 (S.D.N.Y. Sept. 7, 2004); Motown Record Co., L.P. v. Does 1-252, No. 1:04-CV-439-WBH (N.D. Ga. Aug. 16, 2004), *available at* http://www.eff.org/IP/P2P/RIAA_v_ThePeople/JohnDoe/20040818_Motown_Opinion_re_Quash.pdf; *Sony Music Entm't*, 326 F. Supp. 2d at 558.

26. *Sony Music Entm't*, 326 F. Supp. 2d at 562-67 (dismissing First Amendment argument); *id.* at 566 (stating that the RIAA "lacks other means to obtain the subpoenaed information," and that "[a]scertaining the identities and residences of the Doe defendants is critical to plaintiffs' ability to pursue litigation, for without this information, plaintiffs will be unable to serve process").

27. *In re* Capital Cities/ABC, Inc., 918 F. 2d 140, 143 (11th Cir. 1990)); *Sony Music Entm't*, 326 F. Supp. 2d at 563 (citing Universal City Studios v. Reimerdes, 82 F. Supp. 2d 211, 220 (S.D.N.Y 2000).

28. *Sony Music Entm't*, 326 F. Supp. 2d at 563.

29. *Id.* at 567-68. Retaining the right to join multiple Does in a suit may be vital to the feasibility of the RIAA's litigation strategy. The ability of the RIAA to obtain subscriber identification information from ISPs varies depending on how long an ISP retains log files of subscriber activity. Some ISPs erase information from subscriber logs within weeks or days. Moreover, the financial cost of filing individual suits may ultimately render the RIAA's litigation strategy cost-prohibitive. The issue of joinder may soon become yet another hurdle for the RIAA, however. A California federal district court recently ruled against MPAA joinder of suits against Doe defendants, finding that joinder was improper because the suits were "unrelated." *Court Blocks Movie Studios' Bulldozer Legal Strategy*, Elec. Frontier Found., Nov. 23, 2004 (discussing MPAA Twentieth Century Fox Film Corp. v. Does 1-12, No. C 04-04862 WHA (N.D. Cal. Nov. 16, 2004)), *available at* http://www.eff.org/news/archives/2004_11.php.

30. Elektra Entm't Group, Inc. v. Does 1-6, No. 04-1241, 2004 U.S. Dist. LEXIS 22673 (E.D. Pa. Oct. 12, 2004); Anita Ramasastry, *Privacy, Piracy, and Due Process in Peer-to-Peer File Swapping Suits: A Federal District Court Strikes a Good Balance*, DMusic.com, Nov. 10, 2004 (describing holding of court), *at* http://news.dmusic.com/print/14913.

vidual suits and pay the full filing fee for each defendant—in this case totaling $30,000.[31]

Finally, the most recent setback for the RIAA's litigation strategy was the Ninth Circuit Court of Appeals' affirmation that P2P networks Grokster and Streamcast were not contributorily or vicariously liable for users' direct infringement.[32] This decision made it clear that if the RIAA is going to pursue a litigation strategy to combat file-sharing, it must be focused exclusively against direct infringers.[33]

Despite these multiple setbacks, the RIAA has proceeded, seemingly unphased, in its litigation strategy.[34] Its latest round of suits in December 2004 targeted 754 more Does.[35]

II. THE COSTS AND BENEFITS OF LITIGATION AGAINST INDIVIDUAL FILE-SHARERS

Significant benefits to the music industry provide insight into its persistence. Litigation has caused a decrease in user activity on targeted illegitimate sites like KaZaa and increased public understanding of the illegality of file-sharing. Universities have adopted internal enforcement mechanisms and joint initiatives with legitimate online music providers. Finally, the increasing popularity of legal sites like iTunes and the initiation of litigation by other organizations like the MPAA can also be attributed to the RIAA's efforts. On the other hand, though lawsuits have curbed activity on targeted networks like FastTrack, a recent study suggests that overall file-sharing levels have been unaffected, as users are abandoning targeted networks for lesser-known, more sophisticated and secure P2P networks. Moreover, the RIAA's strategy has garnered resistance from civil rights

31. BMG Music v. Does 1-203, No. 04-650, 2004 U.S. Dist. LEXIS 8457 (E.D. Pa. Apr. 2, 2004); *File Cases Separately, RIAA Told*, P2PNet.net, Mar. 8, 2004, *at* http://p2pnet.net/story/929.

32. MGM Studios, Inc. v. Grokster Ltd., 380 F.3d 1154 (9th Cir. 2004).

33. *Id.* at 1160 (holding that "[t]he element of direct infringement is undisputed in this case"). The Supreme Court recently granted certiorari to review the Ninth Circuit's opinion. MGM Studios, Inc. v. Grokster, Ltd., 125 S. Ct. 686 (2004).

34. Ahrens, *supra* note 20 (quoting RIAA President Cary Sherman, stating that "[t]he message to illegal file sharers should be as clear as ever—we can and will continue to bring lawsuits on a regular basis against those who illegally distribute copyrighted music").

35. Press Release, Recording Industry Association of America, RIAA Files New Copyright Infringement Lawsuits Against 754 Illegal File Sharers (Dec. 16, 2004), *available at* http://www.riaa.com/news/newsletter/121604.asp. For a list of RIAA Doe suits, see RIAA v. The People, Electronic Frontier Foundation, *at* http://www.eff.org/IP/P2P/?f=riaa-v-thepeople.html (last visited Mar. 11, 2004).

organizations and caused the recording industry to fall into disfavor with many Americans.

A. Benefits of Direct Enforcement to the Recording Industry

The threat of an RIAA lawsuit will realistically do little to deter dedicated pirates. However, eliminating piracy altogether was never the RIAA's goal.[36] Studies show that many P2P users do respond to the threat of litigation.[37] Though reports on P2P activity vary in their depictions of litigation's overall effect on file-sharing, all reports confirm that lawsuits caused an initial and possibly lasting decrease in file-sharing on mainstream sites targeted by the RIAA such as KaZaa.[38] Some studies also show that litigation is working to deter those who casually download and those who have not yet engaged in criminal activity.[39] The predominant impact of the RIAA's strategy, however, is evidenced in less direct consequences of litigation that will work to combat piracy in the long term. For instance, universities are taking steps to stop piracy on campuses and are negotiating to provide legal online music options to students. Litigation has also contributed to the rise of legitimate business models for distributing music over the Internet such as iTunes. Finally, the RIAA's lawsuits have paved the way for similar litigation by other copyright owners whose efforts will in turn increase the effectiveness of the RIAA's campaign by helping to combat file-sharing worldwide.

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36. *The RIAA: "The Piracy Rate is Growing"*, BUSINESSWEEK ONLINE, May 13, 2002 ("No record company expects to have a piracy-free world. It is the nature of intellectual property to always have some level of piracy.") (quoting Cary Sherman, President, RIAA), *at* http://www.businessweek.com/magazine/content/02_19/b3782609.htm.

37. *See generally* Jefferson Graham, *Online File Swapping Endures*, USA TODAY, July 11, 2004, at 1A, *available at* http://www.usatoday.com/tech/news/2004-07-11-fileswap_x.htm; Press Release, Netratings, Inc., File-Sharing Application Usage Dips After Warning from the Recording Industry (July 14, 2003), *available at* http://www.nielsen-netratings.com/pr/pr_030714.pdf; Lee Rainie & Mary Madden, Pew Internet Project and comScore Media Metrix Data Memo 6 (Apr. 2004), *available at* http://www.pewinternet.org/pdfs/PIP_Filesharing_April_04.pdf.

38. Graham, *supra* note 37; Press Release, Netratings, Inc., File-Sharing Application Usage Dips After Warning from the Recording Industry (July 14, 2003), *available at* http://www.Nielsen-netratings.com; Rainie & Madden, *supra* note 37, at 7.

39. David McGuire, *Internet Piracy: Recording Industry Lawsuits*, WASH. POST, Jan. 22, 2004, *at* http://www.washingtonpost.com/ac2/wp-dyn/A363562004Jan21?; *Music Downloading Up Since November*, ONLINE REP., May 1, 2004, *at* http://www.online-reporter.com/TORbackissues/TOR394.htm#Music%20Downloading%20Up%20Since%20December.

1. *Direct Benefits of the Lawsuits*

As a result of the litigation, networks targeted by the recording industry have shown a dramatic decrease in user base both in the short and long term. The RIAA initially targeted subpoenas at users who allowed their computers to be supernodes[40] on the FastTrack P2P network used by sites like KaZaa and Morpheus.[41] Nielsen/NetRatings reflected immediate flight from those networks, with a fifteen percent drop in P2P usage of KaZaa and Morpheus just one week after the RIAA announced suits against individual users.[42] Use of KaZaa alone dropped a total of forty-one percent from the end of June 2003 (pre-announcement of suits) through September 2003 (post-filing of initial round of suits).[43] P2P research company Big Champagne's data demonstrates that KaZaa's user base continued to drop after the campaign began, from 5.6 million users in October 2003 to 3.8 million in June 2004.[44]

One explanation for the decrease in P2P activity on sites like KaZaa may not be due to the lawsuits at all, but may instead stem from the fact that spyware and slower downloading have made the mainstream networks less appealing to users than newer, more renegade networks.[45] However, the fact that the numbers of users on those sites dropped immediately following initiation of suits more likely implies that users fled the networks in response to the litigation threat.[46] Moreover, studies by the Pew Internet Project, a nonprofit organization never retained by the RIAA, show that the effect of litigation was not limited to those mainstream sites targeted by the lawsuits. The total number of P2P users from spring to

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40. A supernode is a "hub within a P2P network where neighbor users (within the same ISP) automatically upload to the machine the list of files they are sharing. The file download takes place between the PC on which the file is shared and the PC that requested the file, not via the supernode." Alberto Escarlate, *Supernode Users May Face Legal Trouble*, thep2pweblog (Apr. 20, 2004), *at* http://p2p.weblogsinc.com/entry/3352571835868803. For an explanation of P2P technology, see Miles, *supra* note 1 and accompanying text.

41. *How to Not Get Sued by the RIAA for File-Sharing*, Electronic Frontier Foundation, *at* http://www.eff.org/IP/P2P/howto-notgetsued.php (last visited Feb. 24, 2005).

42. Press Release, Netratings, Inc., File-Sharing Application Usage Dips After Warning from the Recording Industry (July 14, 2003), *available at* www.Nielsen-netratings.com.

43. Rainie & Madden, *supra* note 37, at 7.

44. Graham, *supra* note 37, at 1A.

45. Spyware is "[a]ny software that covertly gathers user information through the user's Internet connection without his or her knowledge, usually for advertising purposes." *spyware*, WEBOPEDIA COMPUTER DICTIONARY, *at* http://www.webopedia.com/TERM/s/spyware.html (last modified Feb. 18, 2005).

46. Graham, *supra* note 37, at 1A.

winter of 2003 decreased by fifty percent.[47] Pew Internet survey results also show that the total number of individuals sharing files online dropped from twenty-eight percent in June 2003 to twenty-three percent in February 2004. And, only eighteen percent of total Internet users downloaded music files according to an April 2004 survey, compared to twenty-nine percent in the spring of 2003.[48] Thirty-eight percent of those in the April survey also claimed that the reason why they were downloading fewer files was because of the RIAA suits, up from twenty-seven percent before the end of 2003.[49] Reports from the NPD Internet Research Group and Nielsen/NetRatings also support these findings.[50]

2. *Indirect Benefits of the Litigation Campaign*

RIAA suits against individual users have also had broader social effects that may serve the industry's goals. The litigation campaign has raised public consciousness about the illegality of downloading, been a catalyst for university deals with legitimate music sites, and helped spur the rise of legal sites like iTunes. In addition, other content owners now pursuing litigation against direct infringers benefit from the RIAA's initiatives.

a) Public Perception of the Legality of File-Sharing

Surveys demonstrate that the RIAA's lawsuits have been successful in stigmatizing downloading.[51] In the fall of 2000, seventy-eight percent of downloaders did not think that it was stealing to save music to their hard drives. As of April 2004, that number had dropped to fifty-eight percent.[52] The number of individuals who stated that they cared about copyright grew by ten percent from May 2003 to February 2004.[53] Between April

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47. Rainie & Madden, *supra* note 37, at 6.

48. *Id.* at 4.

49. *Id.*

50. *Id.* at 6.

51. McGuire, *supra* note 39 (stating belief of Eric Garland, Chief Executive, Big Champagne).

52. AMANDA LENHART & SUSANNAH FOX, PEW INTERNET & AMERICAN LIFE PROJECT, DOWNLOADING FREE MUSIC: INTERNET MUSIC LOVERS DON'T THINK IT'S STEALING 2 (2000), *at* http://www.pewinternet.org/pdfs/PIP_Online_Music_Report2.pdf; Rainie & Madden, *supra* note 37, at 5. It is possible that the increase in public awareness may not be solely attributable to the RIAA's lawsuits against direct infringers. The decision in *Napster* and considerable press surrounding the RIAA's litigation against P2P networks may also have impacted public perception. *See* Fonovisa, Inc. v. Napster, Inc., Nos. C 01-01412 MHP [Related to No. C 99-05183 MHP], C 01-02431 MHP [Related to No. C 99-05183 MHP], 2002 U.S. Dist. LEXIS 4270 (N.D. Cal. Jan. 28, 2002).

53. Rainie & Madden, *supra* note 37, at 5.

and October 2003, the number of teens who stated that downloading is illegal increased from 27.5 percent to 43.1 percent.[54] The number of teens who viewed downloading as morally wrong grew from one-fifth of those surveyed in April 2003 to one-third in October 2003.[55] Among users who had never downloaded, sixty percent stated that the lawsuits will prevent them from doing so in the future.[56]

b) Piracy on University Campuses

In its efforts to address piracy on college campuses, the RIAA has used a combination of educational and judicial tactics, both pressing charges against student infringers and working with universities to implement long term solutions. As a result of this two-prong strategy, universities have begun to administer their own deterrent mechanisms, from creating copyright policies and methods for dealing with copyright infringement to partnering with legitimate music sites.

College campuses have been particularly fertile ground for illegal P2P use, as students with tight budgets in the prime music-consuming age group enjoy access to high speed network connections provided by colleges.[57] Students and more broadly, the college-age population, are more likely to engage in file-sharing activity than others. In July 2003, before initiation of litigation, fifty-two percent of individuals ages eighteen to twenty-nine downloaded music, as opposed to only twenty-seven percent of thirty-to forty-nine-year-olds and twelve percent of individuals over fifty.[58] More than a third of full-time students, and slightly less than a third of part-time students are file-sharers, compared to only eighteen percent of non-students.[59] Before initiation of the lawsuits, four out of five full-time students were "not concerned" with the fact that the files they were downloading were protected by copyright, compared with approximately three out of five non-students.[60]

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54. E-Poll, *Online piracy, Have Lawsuits Had An Impact On Downloads?*, Nov. 4, 2003, *available at* http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/11-04-2003/0002050963&EDATE.

55. *Id.*

56. *Music Downloading Up Since November*, *supra* note 39.

57. Jared Wade, *The Music Industry's War on Piracy*, RISK MGMT., Feb. 1, 2004, LEXIS, Nexis Library.

58. Mary Madden & Amanda Lenhart, Pew Internet Project Data Memo: Music Downloading, File-sharing and Copyright 5 (July 2003), *available at* http://www.pewinternet.org/pdfs/PIP_Copyright_memo.pdf.

59. *Id.* at 6.

60. *Id.*

The RIAA has sought non-judicial solutions to file-sharing on college campuses. In the fall of 2002, the RIAA helped found the Joint Committee of the Higher Education and Entertainment Communities to address piracy on college campuses.[61] The organization brings content owners and universities together to facilitate discussion regarding solutions to file-sharing at universities and collaboration on legislative initiatives, as well as to provide educational and technical support.[62] The RIAA has also made efforts to educate university leaders on file-sharing, and urged them to pass on information to students. In addition, the association held an educational conference on file-sharing for university leaders,[63] and sent letters to college presidents asking them to "inform students of their moral and legal responsibilities to respect the rights of copyright owners."[64]

In combination with non-judicial efforts to address piracy on college campuses, in 2003 the RIAA sued over 150 students at thirty-five universities.[65] In March 2004, it announced another wave of lawsuits against eighty-nine students from twenty-one colleges and universities, and in June, it filed suits against eight students and one staff member at the University of Michigan.[66] All of the suits target students that share a particularly great number of songs, averaging 837 each.[67] While the suits threaten a fine of $750 per violation with a total fine up to $150,000, they have been settling for less, averaging $3,000.[68] After serving students with complaints, the RIAA generally refers students to a group of attorneys at a

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61. Roy Mark, *College File Swapping: Making the Illegal, Legal?*, dc.internet.com, Sept. 2, 2003, *available at* http://dc.internet.com/news/article.php/3071331.

62. *Id.*

63. Aymar Jean, *U. Michigan Expects Subpoenas in Next Round of RIAA Legal Action*, MICH. DAILY, Mar. 25, 2004, LEXIS, Nexis Library, University Wire.

64. Grace J. Bergen, *A Conversation and Colloquia Concerning "Who Owns Your Digital Creations?": Litigation as a Tool Against Digital Piracy*, 35 MCGEORGE L. REV. 181, 201 (2004).

65. Luke Jennett, *Student Settles With RIAA*, IOWA STATE DAILY, Sept. 28, 2004, *available at* http://www.iowastatedaily.com/vnews/display.v/ART/2004/09/28/4158e9d048bc8.

66. Aymar Jean, *U. Releases Student Identities to RIAA*, MICH. DAILY, June 7, 2004, *available at* http://www.michigandaily.com/vnews/display.v/ART/2004/06/07/40c407f7c7b79.

67. *Id.*

68. Kari Bellingham, *New Round of RIAA Suits Does Not Deter All U. Wisconsin Students*, BADGER HERALD (Madison, Wis.), Mar. 25, 2004, LEXIS, Nexis Library, University Wire; Josh Huseby, *The RIAA Targets Colorado Campuses*, ROCKY MOUNTAIN COLLEGIAN, Apr. 1, 2004, *available at* http://www.collegian.com/vnews/display.v/ART/2004/04/01/406ba75e8082d. For instance, the RIAA agreed to a settlement of $4500 with a student who uploaded 901 songs. Jennett, *supra* note 65, at 1.

Settlement Support Center.[69] After the RIAA's initiation of lawsuits, the percentage of Internet users ages eighteen to twenty-nine admitting to downloading music dropped from fifty-two to twenty-eight percent.[70]

Specific university policies exemplary of those spawned by the recent litigation are those of the University of Colorado, Colorado State University, Pennsylvania State University, Iowa State University, and Indiana University.[71] At these schools, repercussions for illegal activity conducted using university networks range from Internet disconnection to expulsion from the school.[72] For example, students at Colorado State University and the University of Colorado at Colorado Springs must sign an agreement that states they will not conduct illegal activity on the university network.[73] The university monitors the network for high volumes of activity, and notifies a potential infringer that she must either stop or be disconnected.[74] Pennsylvania State University limits the amount of data students can download to 1.5 gigabytes. If a student exceeds this limit, the university slows down the Internet connection to dial-up speed.[75] The university sent a warning of the ramifications of file-sharing to 110,000 students in March 2003. In April 2003, it suspended Internet access of 220 students.[76] At Iowa State University, first-time offenders are only required to remove infringing copyrighted material. However, the university is threatening greater repercussions in the future, including disciplinary actions, probation, and even deferred expulsion for illegal file-sharing.[77] Repeat offender cases are turned over to the federal legal system.[78]

Indiana University's program has been reported by the U.S. House Judiciary Committee's Subcommittee on Courts, the Internet, and Intellec-

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69. Elizabeth Thomas, *Judge Orders Villanova U. to Deliver Names in RIAA Case*, DAILY PENNSYLVANIAN (Phila.), June 3, 2004, LEXIS, Nexis Library, University Wire.

70. *Id.*

71. *See generally* Huseby, *supra* note 68; Jennett, *supra* note 65; Nicholas Kershbaumer, *Penn State U. to Limit Downloads*, DAILY COLLEGIAN (University Park, Pa.), Jan. 11, 2002, LEXIS, Nexis library, University Wire; Adam VanOsdol, *IU Leads Pack in Combatting Illegal Downloads, Report Says*, IND. DAILY, Aug. 31, 2003, *available at* http://www.idsnews.com/print.php?id=24253.

72. Huseby, *supra* note 68 (stating that infringers who persist post-notification of illegal activity are disconnected from the university network); Jennett, *supra* note 65 (stating that Iowa state is threatening expulsion for file-sharing offenses).

73. Huseby, *supra* note 68, at 1.

74. *Id.*

75. Kershbaumer, *supra* note 71, at 1.

76. Ryan Naraine, *Penn State Cuts off P2P File-Traders*, Apr. 22, 2003, *available at* http://www.atnewyork.com/news/print.php/2194861.

77. Jennett, *supra* note 65, at 1.

78. *Id.*

tual Property to be particularly effective in preventing illegal file-sharing.[79] The university implemented an online file-sharing tutorial and quiz to educate students about copyright laws.[80] Students who receive an illegal file-sharing notice must pass an online quiz and agree to delete infringing files. If they refuse, network access is terminated. For second-time offenders, termination is immediate and the individual's name is forwarded to the dean of students. The number of illegal file-sharing notices received by the university from the RIAA dropped by over fifty percent between the 2003 and 2004 academic years.[81]

A number of schools are also resorting to limitations on per-student bandwidth, due to the potential of high traffic to overburden school servers, a measure which increases downloading time.[82] In addition, almost forty universities and colleges now use "CopySense Network Appliance," a product created by Audible Magic that prevents the transfer of copyrighted files to students' computers.[83] The University of Florida uses another program, ICARUS, to prevent file-sharing altogether.[84]

Colleges and universities also made major changes in the way students can access digital entertainment content from 2003 to 2004.[85] Negotiations with legitimate music services, coupled with disincentives for illegal P2P use, may work to both immediately reduce file-sharing among university students and ultimately reduce illegal downloading by encouraging legal habits at an early age. Pennsylvania State University was the first to enter negotiations with the newly legitimate Napster. University students are given access to Napster's database of 500,000 songs. Tethered downloading is offered free of charge, and students are able to download each song on up to three personal computers.[86] In addition, students may purchase a

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79. Joint Comm. of Higher Educ. & Entm't. Comtys., A Report to the Subcommittee on Courts, the Internet, and Intellectual Property House Judiciary Committee on Progress During the Past Academic Year Addressing Illegal File Sharing on College Campuses 3 (Aug. 24, 2004), *available at* http://www.educause.edu/ir/library/pdf/EPO0412.pdf

80. VanOsdol, *supra* note 71, at 1.

81. *Id.*

82. Beth A. Thomas, *Internet & Technology: Solutions are on Track: Digital File Sharing Spun in a Positive Light*, 6 VAND. J. ENT. L. & PRAC. 129 (2003).

83. Charlotte Hsu, *UCLA Uses its Own Creation to Fight Illegal File-Sharing*, DAILY BRUIN (Los Angeles), Oct. 5, 2004, LEXIS, Nexis Library, University Wire.

84. VanOsdol, *supra* note 71, at 1.

85. This was reported by the Congressional Subcommittee on Courts, the Internet and Intellectual Property. Jennett, *supra* note 65.

86. "A tethered download is a file that cannot be burned onto a CD or transferred to a portable device. The file will be stored on your computer's hard drive, but it is encoded so that it will no longer play once you stop being an active Napster member." Middlebury

song for 99 cents for permanent use.[87] On the fourth day that the service was provided, over 2,600 students had registered for the service and over 100,000 songs had been downloaded.[88] As of fall 2004, Napster, MusicNet, Rhapsody, and iTunes have all negotiated deals with multiple universities.[89] Duke University distributed over 1,500 iPods to freshmen, along with ten free downloads from iTunes.[90]

c) The Rise of Legitimate Options

While the RIAA believes that "litigation is not a business strategy," the threat of litigation has increased the attractiveness of legitimate online music services.[91] When the illegal Napster was available, the cost of downloading was zero and the cost of legal music considerably greater at $17 per album. Now, due to the lawsuits, an illegal download carries with it a risk of a $3,000 fine, whereas legitimate online sites offer singles for only 99 cents.

Immediately following initiation of lawsuits, BuyMusic.com, the largest online store for PC users, noted a thirty percent increase in traffic on its site from September 6th to the 13th.[92] As of April 2004, seventeen percent

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College, *Napster Frequently Asked Questions*, *at* http://www.middlebury.edu/campuslife/services/napster/faq (last visited Feb. 18, 2005).

87. *Penn State and Napster Team Up to Make Legal Tunes Available to Students; University Becomes First in the Nation to Offer Its Student Body a Legal and Quality Alternative to Pirate File Sharing Services*, PR NEWSWIRE, Nov. 6, 2003, LEXIS, Nexis Library, PR Newswire File.

88. *Id.*

89. Scott Banerjee & Bill Holland, *Biz Sees Campus Progress*, BILLBOARD MAG., Sept. 4, 2004, LEXIS, Nexis Library, Billboard File. University deals include the following: Napster—Cornell University, George Washington University, Middlebury College, University of Miami, University of Southern California, Write State University, and University of Rochester; MusicNet—Marietta College, Ohio University, Rochester Institute of Technology, and University of Denver; Rhapsody—The University of California at Berkeley and University of Minnesota.

90. Michele DeCamp, *Let's Get the Downloading Started*, TECHNICIAN (Raleigh, S.C.), Aug. 30, 2004, LEXIS, Nexis Library, University Wire.

91. Jennifer Norman, *Staying Alive: Can the Recording Industry Survive Peer-to-Peer?*, 26 COLUM. J.L. & ARTS 371, 401 (2003) (quoting Cary Sherman, President, RIAA); Press Release, Recording Industry Association of America, RIAA Files New Copyright Infringement Lawsuits Against 754 Illegal File Sharers, Dec. 16, 2004 ("Enforcement online or on the street is always a means to an end—helping foster business environments where legitimate commerce can take route and flourish, while creators can earn their fair share. In a relatively brief time, a whole new online marketplace has emerged and begun to establish itself,") (quoting Cary Sherman, President, RIAA), *available at* http://www.riaa.com/news/newsletter/121604.asp.

92. *BuyMusic.com's Traffic Climbs 30 Percent in Just One Week*, MUSIC INDUS. NEWS NETWORK, Sept. 18, 2003, *at* http://www.mi2n.com/press.php3?press_nb=57113.

of music downloaders claimed that they were using paid services, and over 11 million unique Internet users had visited legitimate music sites, including Musicmatch.com, Roxio, Inc. (the new Napter), iTunes, Listen.com, Walmart, and Liquid.com.[93] From October 2003 to April 2004, iTunes alone received over 2.3 million new visitors to its site.[94] And as of July 2004, over 100 million songs had been downloaded from iTunes.[95] In addition, the percentage of people who stated they would pay for legal downloads is up from 16 percent in 2003 to 19 percent in 2004.[96]

d) Other Organizations Follow Suit

One of the most beneficial outcomes of the RIAA's bold initiation of lawsuits for the record industry is that it paved the way for other content owners to do the same. If the recording industry's lawsuits against individuals had no deterrent effect, it is unlikely that other content owners would be pursuing the same strategy. Yet in the summer of 2004, the MPAA hired one of the RIAA's top litigators to pursue claims against individuals. Press reports indicate that 200 alleged offenders are being targeted in the MPAA's first round of litigation.[97] The International Federation of Phonographic Industries (IFPI) had already pursued suits against file-sharers in Germany, Italy, and Denmark as of June 2004.[98] The music industries in France, Sweden and the United Kingdom have announced

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93. Rainie & Madden, *supra* note 37, at 4.

94. *Id.*

95. *Online Music Survey*, Berkman Ctr. for Internet & Soc'y at Harvard Law Sch., *at* http://cyber.law.harvard.edu/home/onlinemusicsurvey (last visited Nov. 27, 2004).

96. Darren Waters, *Illegal Music Sites 'Here to Stay' RIAA Admits*, BBC NEWS ONLINE, *at* http://www.freerepublic.com/focus/news/818822/posts (citing Jupiter research group results) (last visited Nov. 26, 2004).

97. Benny Evangelista, *Movie Industry Sues File Sharers*, S.F. CHRON., Nov. 17, 2004, at C3, *available at* 2004 WL 58613494. Moreover, following the *Verizon* decision, the MPAA is filing John Doe suits as opposed to attempting to use the DMCA's subpoena provision. *Id.* For a complete list of Doe suits filed by the MPAA, see http://www.eff.org/IP/P2P/MPAA_v_ThePeople. The MPAA has also retained MediaSentry to search for P2P users who distribute copies of infringing material on the Internet. Decl. of Chad Tilbury at 4, Twentieth Century Fox Film Corp. v. Does 1-12, No. C 04 4862 WHA (N.D. Cal.), *available at* http://www.eff.org/IP/P2P/MPAA_v_ThePeople/20041117_20thtilbury.pdf.

98. Andrew Raff, *Filesharing Lawsuits Popular in Europe*, IPTA blog, *at* http://www.iptablog.org/2004/06/11/filesharing_lawsuits_popular_in_europe.html (last visited Nov. 27, 2004).

similar plans. The broadcast industry appears poised to follow in short order.[99]

Moreover, the international nature of the Internet, combined with the ability of P2P networks to transmit files containing any type of content, suggests that widespread litigation will be required to have a significant deterrent effect on illegal downloading. The same P2P networks that are being used to share music are also being used to transmit movies. The MPAA is also focusing its litigation on KaZaa users who use the network to share copyrighted films.[100] Moreover, the same P2P networks used in the United States are used worldwide. Suing uploaders in the United States alone will not sufficiently address the problem, as domestic uploaders comprise only a small fraction of the overall file-sharing population. Only 45.1 percent of American users download from other American users.[101] One out of every six downloads comes from Germany, and a little less than half that from Canada, Italy, and the United Kingdom.[102] There are more European KaZaa users than American, and Europeans are the primary users of other P2P networks like eDonkey and DirectConnect.[103] Therefore, the prosecution of uploaders by IFPI-affiliated organizations in Germany, for instance, will work to decrease the amount of copyrighted content that individuals in the United States can access on illegal sites. Therefore, by setting an example of a litigation strategy against users that other content owners may learn from or emulate, the RIAA stands to indirectly increase the deterrence of alleged infringers without expending additional resources of its own.

B. Costs of Direct Enforcement to the Recording Industry

While studies of P2P activity all confirm that there was an initial decrease in P2P activity on RIAA-targeted sites like KaZaa and Morpheus post-initation of suits, studies simultaneously show either a subsequent resurgence in filesharing or that filesharing levels overall have not been affected by litigation. In addition, reports indicate that in response to the threat of litigation, users have moved to less visible, more secure P2P networks that are employing technological measures to help users avoid de-

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99. *See* Ben Fritz & Marc Graser, *Pirates Set Sail Toward TV Shores*, VARIETY, July 25, 2004, *available at* http://www.variety.com/story.asp?l=story&a=VR1117908194&c=1009.

100. Evangelista, *supra* note 97.

101. Oberholzer, *supra* note 2, at 37.

102. *Id.* at 17, 37.

103. dRD, *supra* note 6, at 1 (citing Nielsen/NetRatings Internet traffic study).

tection. Yet another cost of the RIAA's litigation strategy has been its toll on the public image of record companies.

1. *Effect on Overall, Long-Term P2P Activity*

Though Pew Internet Project reports that the percentage of individuals who download music is still less than it was in spring of 2003,[104] there has been a small resurgence in file-sharing since the initiation of suits.[105] Another recent report by the University of California at Riverside and the San Diego Supercomputer Center ("UC study") shows that though litigation caused a decrease in use of networks such as FastTrack targeted by the lawsuits, overall file-sharing has remained unchanged, as users of those sites simply migrated to more secure and anonymous file-sharing systems.

The UC study used highly technical means to measure the flow of P2P traffic from pre- through post-initiation of lawsuits. The findings were based on monitoring P2P traffic on eight of the most popular networks: FastTrack (KaZaa), eDonkey (including eMule and Overnet networks), WinMx, BitTorrent, Gnutella, Soulseek, and Direct Connect.[106] The study operated on the assumption that most P2P traffic is of copyrighted material.[107] It confirmed a decrease in FastTrack use (KaZaa) on known ports,[108] which it attributed to RIAA litigation efforts.[109] However, it also asserted that there was never a decrease in overall P2P activity and suggested that other reports have underestimated the rate of P2P traffic due to

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104. The number of Internet users who said they downloaded music dropped from twenty-nine percent in the spring of 2003 to eighteen percent in the spring of 2004. Rainie & Madden, *supra* note 37, at 4.

105. The number of American Internet users who say they download music or share files online has increased slightly, but continues to sag well below peak levels. *Id.* at 1. File-sharing experienced a small resurgence of four percentage points from the end of 2003 through the spring of 2004. *Id.* at 4.

106. Thomas Karagiannis et al., *Is P2P Dying or Just Hiding?* at 2, *available at* http://www.caida.org/outreach/papers/2004/p2p-dying/p2p-dying.pdf.

107. *Id.* at 3.

108. A port is a means by which, when using the Internet's protocol TCP/IP (Transmission Control Protocol/Internet Protocol—the basic communication language, or protocol, of the Internet), "a client program specifies a particular server program on a computer in a network." Some ports, "well-known ports," have pre-assigned numbers, determined by the Internet Assigned Numbers Authority. "port", WHATIS.COM, *at* http://searchnetworking.techtarget.com/gDefinition/0,294236,sid_gci212807,00.html (last updated Jul. 31, 2001).

109. Karagiannis, *supra* note 106, at 6.

a failure to measure usage in P2P networks that are "intentionally camouflaging their traffic."[110]

Current P2P migration mirrors events following the decision in *Napster*, in which P2P users migrated from the easily identifiable Napster network to the more elusive Gnutella protocol. Now, with the threat of being held directly liable, P2P users are going even further underground by abandoning known ports like FastTrack for more arbitrary ones like BitTorrent.[111] Data from one ISP on P2P traffic flow from 2002 through 2003 shows that while total P2P traffic either increased or remained the same, traffic on arbitrary ports increased, suggesting that downloaders are using less detectable routes through the Internet. For instance, traffic on BitTorrent grew more than 100 percent, becoming one of the most heavily used networks.[112] Data from comScore Media Metrix support the UC study's findings, showing a growth between November 2003 and February 2004 on BitTorrent, eMule, and even iMesh despite the initiation of lawsuits against iMesh and its users in September.[113] Unique users on BitTorrent in February 2004 almost doubled the number of users on the protocol in November 2003.[114]

2. *Increased Sophistication of P2P Networks*

The UC study suggests that the rate of total file-sharing on all P2P networks has not been slowed by RIAA efforts, which would mean that the RIAA has pursued litigation against users at great cost to the record industry solely to reap indirect benefits like those discussed in the previous section. But the repercussions of downloader response to the lawsuits may be even more serious. Studies also show that users are turning to more sophisticated P2P networks that are not only harder to detect on the Internet, but are also implementing technological countermeasures to help users evade RIAA litigation.[115]

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110. Any port number can be used for the newest P2P protocols, even the port used for Web traffic, as opposed to older P2P protocols which had "well-defined port numbers" that were easier to identify. *Id.* at 1.

111. *Id.* at 7.

112. *Id.* at 6.

113. Press Release, comScore Networks, One in Seven Internet Users Say They No Longer Download Music Files (Apr. 26, 2004), *available at* http://www.comscore.com/press/release.asp?press=449.

114. Rainie & Madden, *supra* note 37, at 4.

115. Matthew Fordahl, *Internet Evolves Underground in Wake of Music-Swapping Suits*, SFGate.com, Oct. 4, 2003, *at* http://www.sfgate.com/cgi-bin/article.cgi?f=/news/archive/2003/10/04/national1251EDT0553.DTL (last visited Feb. 8, 2005).

As part of its campaign against file-sharing, the RIAA began to use Instant Messenger (IM) to notify FastTrack network users of the illegality of their activities. The network responded by changing IM "default" settings, thereby disabling the RIAA's instant messaging campaign and preventing the RIAA from sending warning messages.[116] While this measure may have served only to stem RIAA threats, other technological adaptations may stymie online enforcement efforts altogether. Morpheus, KaZaa Lite, and Shareaza now help users identify Internet Protocol (IP) addresses of companies looking for pirates.[117] Morpheus also allows users to connect to a site that links them to public proxy servers that mask the users' IP numbers.[118] This makes it more difficult for the RIAA to identify infringers, as individuals' ISPs are identified through the IP numbers assigned to computers.[119] A program called "Waste" encrypts instant messaging and content sharing networks of up to fifty users, and unlike most IM programs, its messages do not pass through a central server.[120] Two Spanish-based P2P programs, Filetopia and Blubster, boast superior ability to mask user identities.[121]

3. *Public Image of the Recording Industry*

Perhaps the greatest casualty in the RIAA's war on piracy has been the public's perception of the music industry. The origins of the RIAA's negative publicity include misguided and unpopular lawsuits, the individualistic and experimental nature of the Internet, and the public outcry of civil rights organizations, many of which have submitted amicus briefs on behalf of Doe defendants and supported opposition to RIAA enforcement strategies.

It is clear that in its desire to boost record sales, the RIAA has alienated many of its fans. The NPD Online Research Group's MusicLab survey conducted shortly after intiation of the suits revealed that most con-

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116. Press Release, Recording Industry Association of America, Privacy & Piracy: The Paradox of Illegal File Sharing on Peer-to-Peer Networks and the Impact of Technology on the Entertainment Industry (Sept. 30, 2003) (citing statement of Mitch Bainwol, Chairman & CEO, Recording Industry Association of America, before the Permanent Subcommittee on Investigations Committee on Governmental Affairs, United States Senate), *at* http://www.riaa.com/news/newsletter/093003_2a.asp.

117. *Brawl Over File-Swapping Spawns 'Secure' Software*, SiliconValley.com, July 24, 2003, *at* http://www.siliconvalley.com/mld/siliconvalley/news/editorial/6374384.htm.

118. *Id.*

119. *Id.*

120. Fordahl, *supra* note 115, at 1.

121. *Brawl Over File-Swapping Spawns 'Secure' Software*, *supra* note 117.

sumers did not approve of the industry's measures.[122] Only twenty-three percent of recent file-sharers agreed that "stopping people from freely sharing copyrighted music files through a file-sharing network is the honest and fair thing to do."[123] Two-thirds of recent file-sharers also stated that their opinion of the recording industry was negatively affected by RIAA lawsuits.[124]

There are many possible explanations for public criticism of the RIAA's litigation strategy. In several highly-publicized cases, the targets of RIAA suits were misidentified. Examples include when the RIAA believed an astrophysics professor with the last name of Usher illegally uploaded files by well known R&B artist Usher,[125] sued a sculptor who had never installed file-sharing software for allegedly uploading 2000 songs,[126] and pressed charges against a grandmother for downloading and sharing rock and hip-hop music.[127] The RIAA also received extensive negative publicity for suing a twelve-year-old who lived in a New York housing project.[128]

The RIAA is also fighting an Internet culture that cherishes the freedom of information the Internet allows and views such enforcement efforts as threats both to the culture and to the technological platform that enables it.[129] Although in its early days, the success of the Internet was largely contingent on financial backing from the government and universities,[130] Internet pioneers have classically been characterized as highly individual-

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122. Press Release, NPD Group, Consumers Delete Large Numbers of Digital Music Files from PC Hard Drives (Nov. 5, 2003), *available at* http://www.npd.com/press/releases/press_031105.htm.

123. *Id.*

124. *Id.*

125. Sonia K. Katyal, *A War on CD Piracy, A War on Our Rights*, L.A. TIMES, June 27, 2003, at Cal. Metro, Part 2, at 17.

126. Chris Gaither, *Recording Industry Withdraws Suit Mistaken Identity Raises Questions on Legal Strategy*, BOSTON GLOBE, Sept. 24, 2003, at C1, *available at* http://www.boston.com/business/articles/2003/09/24/recording_industry_withdraws_suit.

127. Ketola, *RIAA Withdraws Charges Against 65-Year Qld*, Afterdown.com, Sept. 26, 2003, *at* http://www.afterdawn.com/news/archive/4529.cfm.

128. Jefferson Graham, *Recording Industry Sues Parents*, USA TODAY, Sept. 14, 2003, at 4D, *available at* http://www.usatoday.com/life/music/news/2003-09-14-riaa_x.htm.

129. Steve Lohr, *The Price of Music: News Analysis; Fighting the Idea that All the Internet Is Free*, N.Y. TIMES, Sept. 9, 2003, at C1.

130. *Id.*

istic and resistant to government control.[131] The notion that information on the Internet should be free has carried over to P2P users today, and makes it more difficult for the RIAA to justify its enforcement strategy to Internet users.[132]

Another source of negative publicity for the RIAA has been the resistance to its litigation strategy by civil liberties groups and consumer rights advocates. The recording industry has been criticized for abusing civil liberties, due process, and privacy rights, as well as expending judicial resources. Boycott-RIAA.com, a coalition of many websites dedicated to representing "the consumer and independent artists positions on the battlefield that copyright has become," is just one of a multitude of sites opposing RIAA initiatives.[133] The Electronic Frontier Foundation's (EFF) "Let the Music Play Campaign" argues that "suing fans doesn't pay artists. Neither does threatening every Internet user's civil liberties."[134] Moreover, since the initiation of lawsuits, groups like the EFF, the American Civil Liberties Union, and Public Citizen have filed numerous amicus briefs on behalf of Doe defendants.[135] The EFF's website "SubpoenaDefense.org" also provides information for Doe defendants on how to proceed when served with a subpoena.[136]

III. PROPOSALS TO INCREASE THE EFFICIENCY OF ENFORCEMENT

The RIAA continues to pursue its litigation strategy despite allegations that litigation has had potentially little effect on overall file-sharing activity, while driving users toward more sophisticated P2P sites and alienating many of its own fans. Yet without the threat of litigation, it is likely that

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131. *See* Jeffrey D. Sullivan & Michael B. De Leeuw, *Spam After Can-Spam: How Inconsistent Thinking Has Made a Hash Out of Unsolicited Commercial E-Mail Policy*, 20 SANTA CLARA COMPUTER & HIGH TECH. L.J. 887, 906-07 (2004).

132. *See generally* Lohr, *supra* note 129.

133. *Why We Are Here*, Mission Statement of Boycott-RIAA.com, *at* http://www.boycott-riaa.com/mission (last visited Feb. 24, 2005). Other anti-RIAA organizations include: Consumers Against the RIAA, *at* http://www.geocities.com/riaasucks (last visited Mar. 18, 2005), and Downhill Battle, *at* http://downhillbattle.org (last visited Mar. 18, 2005).

134. *File-Sharing: It's Music To Our Ears*, Elec. Frontier Found., *at* http://www.eff.org/share (last visited Feb. 24, 2005).

135. *File Cases Separately, RIAA Told*, P2PNet.net, Mar. 8, 2004, *at* http://p2pnet.net/story/929.

136. *Subpoena Defense, Defending the Constitutional Rights of Internet Users and ISPs*, Elec. Frontier Found., *at* http://www.subpoenadefense.org (last visited Feb. 24, 2005).

P2P activity would be at least at the level that it is today, as litigation has sent the message that file-sharing is wrong and worked to deter users of targeted networks. In addition, the lawsuits are helping to change public attitudes and spur stakeholders to implement long term solutions to file-sharing. But, as there appears to be no sign of a cease-fire, in addition to continuing to sue individuals, it would be advantageous for the industry to consider more efficient means of fighting this war.

The RIAA could increase the efficiency of its enforcement strategy by: putting more resources into anti-piracy technology; supporting federal intellectual property enforcement initiatives; increasing the quality of legitimate options; and making changes to its litigation strategy.

A. Anti-Piracy Technology

The RIAA has attempted several technological solutions to the P2P problem, some more effective than others. Solutions have focused on either making CDs harder to convert to MP3 files via digital rights management,[137] or utilizing technological roadblocks to file-sharing. Thus far, the most successful initiatives have focused on the latter.

Attempts at selling CDs with digital rights management have not met with great success. A Norwegian teenager cracked the code to the recording industry's Content Scrambling System and posted it on the Internet.[138] The industry's Secure Digital Music Initiative, which challenged programmers to hack "digitally watermarked audio content," proved to be an embarrassment when a professor met the challenge within just a few weeks.[139] And in 2002, when the industry marketed CDs as copy proof, the technology was proved to be easily circumvented with the use of a felt-tip marker.[140] Thus, attempts to secure content have not been the most

137. Digital Rights Management (DRM) systems may be described as "secure packaging and delivery software designed to prevent purchasers and third parties from making unauthorized uses of digital works." C.J. Alice Chen & Aaron Burstein, *Foreword*, 18 BERKELEY TECH. L.J. 487, 488 (2003) (quoting Dan L. Burk and Julie E. Cohen). DRM restricts consumer behavior, for instance on DVDs may prevent copying or limit the kinds of devices used for playback. Julie E. Cohen, *DRM and Privacy*, 18 BERKELEY TECH. L.J. 575, 580 (2003).

138. The teenager, Jon Johansen, was acquitted in a Norwegian court in 2003. *See* Norway v. Johansen, Bogarting Appellate Court (Dec. 22, 2003). The original decision in Norwegian is *available at* http://websir.lovdata.no/lex/frame-eu.html, while an English translation is *available at* http://www.ipjustice.org/johansen/DVD-Jon-Borgarting-1-eng.pdf.

139. Lawrence Iser & James Toma, *Battling Digital Piracy: Recording Industry Has Taken a Multipronged Response to Illegally Downloaded Music*, NAT. L.J., Jan. 20, 2003, at C1.

140. *Id.*

effective. However, efforts to make content more difficult to find on the Internet have been more successful.

The most promising tactic to date may be "spoofing," whereby the record industry floods P2P networks with decoy music files. Some files contain messages from the artist, some repeat the chorus *ad naseum*, while others contain annoying screeching sounds. The recording industry is using companies like Covenant and Overpeer to implement this tactic.[141] Overpeer sends more than twenty-five billion spoofed songs per month on the FastTrack network.[142] In one sampling, sixty percent of the Linkin Park song "Somewhere I Belong" files were found to be decoys on the LimeWire networks.[143] If the number of decoys is significant enough, less committed users may think twice about the time it could take them to find a quality copy of their favorite song. In this light, the 99 cents it costs to purchase an error-free song on a legitimate site may seem much more palatable.[144] In addition to flooding P2P networks with spoofed files, the RIAA should collaborate with the MPAA to distribute technology for parents to regulate file-sharing on home computers. The MPAA is currently developing free software for this purpose.[145]

Other tactics rumored to be considered or in development by the music industry include: interdiction, which renders the user's hard drive inaccessible to others and prevents the user from downloading;[146] a "freeze," which locks up a computer system and gives a warning about file-sharing;[147] and a program that automatically directs users to legitimate music sites.[148] However, the first two tactics have privacy implications and may induce liability under the Computer Fraud and Abuse Act.[149] Interdic-

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141. Thomas, *supra* note 82, at 135.

142. Berkman Ctr. for Internet & Soc'y at Harvard Law Sch., *Online Music Survey*, *at* http://cyber.law.harvard.edu/home/onlinemusicsurvey (last visited Feb. 18, 2005).

143. Thomas, *supra* note 82141, at 135.

144. *Id.*

145. The MPAA has not yet provided details regarding this software, but it will enable users to remove infringing movies, music, or P2P applications. The software will be available for download on the MPAA site. Jay Lyman, *MPAA Fights Film Swapping with Suits and Software*, TechNewsWorld, Nov. 17, 2004, *at* http://www.technewsworld.com /story/news/38253.html.

146. Iser & Toma, *supra* note 139, at C1.

147. Hillary M. Kowalski, Comment, *Peer-to-Peer File Sharing & Technological Sabotage Tactics: No Legislation Required*, 8 MARQ. INTELL. PROP. L. REV. 297, 302 (2004).

148. *Id.*

149. *Id.*

tion may be considered hacking[150] and a "freeze" may cause loss of data.[151]

B. Urge Federal Enforcement Using the NET Act

In the spring of 2004, the RIAA announced plans to work with the Department of Justice's newly formed Intellectual Property Task Force in the prosecution of criminal charges against large scale infringers.[152] Working in tandem with the task force to prosecute large-scale providers of illegal content is one of the most efficient means by which the RIAA can attack the piracy problem. However, the RIAA could make federal enforcement even more effective by urging the Justice Department to criminally prosecute individuals—that is, smaller-scale infringers—under the No Electronic Theft (NET) Act.

In the past, the Department of Justice has prosecuted a number of intellectual property claims, including those against counterfeiting of pharmaceuticals and pesticides, as well as trade secret theft and illegal movie distribution.[153] Whether spurred by national security motives or the effect of piracy on the vitality of the nation's economy,[154] the creation of the task force signals the federal government's renewed commitment to its fight against intellectual property infringers. The task force aims to target large-scale, organized perpetrators of intellectual property crimes, both domestic and international.[155] Through "Operation Digital Gridlock" in August 2004, the Justice Department successfully prosecuted its first criminal case against a United States-based P2P network that distributed over forty terabytes of infringing copyrighted material.[156]

The NET Act is an important tool at the federal government's disposal, yet there have been relatively few prosecutions of Web pirates and no reported prosecutions of P2P users under the Act. Passed in 1977, the NET Act makes it a felony to willfully infringe a copyright by reproducing or distributing ten or more copyrighted works with a value of at least $2,500

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150. Iser & Toma, *supra* note 139, at C1.

151. Kowalski, *supra* note 147, at 302.

152. Thomas Mennecke, *RIAA Applauds Creation of Intellectual Property Task Force*, Apr. 13, 2004, *at* http://www.slyck.com/news.php?story=449.

153. U.S. DEP'T OF JUSTICE, REPORT OF THE DEPARTMENT OF JUSTICE'S TASK FORCE ON INTELLECTUAL PROPERTY 23-24 (2004), *available at* http://www.usdoj.gov/ag/speeches/2004/ip_task_force_report.pdf.

154. *See id.* at 16 (stating that in 2002, the United States' copyright industries, for instance, contributed 6% of the nation's GDP and employed 4% of the nation's work force).

155. *Id.* at 32.

156. *Id.* at 16. Forty terabytes is equivalent to 60,000 films. *Id.*

within a 180-day period, regardless of whether the infringer reaped actual financial gain.[157] Reproduction or distribution of copyrighted material, including by electronic means, is sufficient for prosecution under the Act.[158] This is the key provision for the copyright industry, because under the Act, the government can prosecute individuals that receive "anything of value," including other copyrighted works, in exchange for copyrighted materials.[159] In contrast, under existing copyright law, criminal charges may only be pressed for willful infringement cases in which the individual received commercial or private financial gain.[160] Penalties for NET Act violations may be up to three years in prison and $250,000 in fines.[161]

Thus far, the Department of Justice has only used the NET Act to charge two non-P2P users who had uploaded only a single film to the Internet.[162] If used more liberally to impose criminal charges against individual P2P users, the NET Act could be a powerful deterrent of individual copyright infringement above and beyond the civil suits currently being filed by the RIAA.

C. Increase Attractiveness of Legitimate Options

While illegal file-sharing now carries risks of direct liability for copyright infringement and is more time consuming as a result of spoofing and other tactics, legal alternatives still require improvement in several respects in order to compete with illegal file-sharing. By working with technology companies, the recording industry can make legal downloading more attractive by: (1) licensing more of their products to online retailers, thereby increasing the amount of music available on legal sites; (2) increasing public approval of the 99 cent fee by giving a greater portion to the artists; (3) renegotiating university licensing arrangements with legitimate sites to make legal music more affordable for students; and (4) facilitating greater compatibility of portable digital music players with multiple legitimate music sites.

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157. 18 U.S.C. § 2319(b)(1) (2000).

158. 17 U.S.C. § 506(a) (2000).

159. *Id.*; Jonathan Peterson, *No Electronic Theft (NET) Act*, WAY.NU, July 22, 2002, *at* http://www.way.nu/archives/000290.html.

160. 17 U.S.C. §506(a).

161. Peterson, *supra* note 158, at 1.

162. *See* Press Release, U.S. Dep't of Justice, Man Pleads Guilty to Internet Piracy of Star Wars Film (Dec. 15, 2000), *at* http://www.cybercrime.gov/spataforeplea.htm; Gabriel Snyder, *'Hulk' Uploader Avoids Jail*, VARIETY ONLINE, Sept. 28, 2003, *available at* http://www.variety.com/article/VR1117893101?categoryid=22&cs=1 (subscription site).

1. *Increase Licensing Speed and Quantity*

In order to compete with illegal music providers, the record industry must move quickly to improve the quality of legitimate sites. Most importantly, it must license higher quantities of music more quickly. As of August 2004, the iTunes Music Store had over one hundred million songs available for American subscribers.[163] However, KaZaa offers ten times that amount.[164] Some of the most popular artists, such as the Beatles, the Dave Mathews Band, and the Grateful Dead, are still not available on legitimate sites.[165] Major artists such as Madonna and the Red Hot Chili Peppers have also been reluctant to license single songs, instead forcing users to purchase the whole album.[166] Some musicians only offer their songs on one site, or do not offer songs at all but rather books or biographies online.[167]

There are several explanations for the inferior selection and delay. For instance: the artist may own the rights to his songs and not want to license, or have concerns about increasing piracy of its songs by Internet distribution;[168] performers may want to license but songwriters may not;[169] multiple rights holders may delay availability;[170] contracts created without Internet music sale provisions need to be renegotiated before artists can

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163. *Apple's iTunes Music Store Offers 1 Million Songs*, macNN.com, Aug. 10, 2004, *at* http://macnn.com/news/25788.

164. Vern Seward, *Is iTMS the Answer to Music Swapping?*, WIRED NEWS, Oct. 22, 2003 (quoting Eric Garland of Big Champagne, stating that as of 2003, "there were 700 million files traded on KaZaa, and 900 million at its peak"), *at* http://www.macobserver.com/article/2003/10/22.11.shtml.

165. Tom Barger, *Music Fans Find Online Jukebox Half-Empty*, Jan. 19, 2004, *at* http://www.boycottriaa.com/article/9956.

166. *Id.*; Jenny Eliscu, *Chilis, Metallica Go Offline*, July 1, 2003, *at* http://www.rollingstone.com/news/story/_/id/5922530?rnd=1101502772665&hasplayer=true&version=6.08.1024.

167. Barger, *supra* note 165 (stating that Led Zepplin does not offer songs, but a spoken-word biography of the band online).

168. *Id.* (stating that Tom Petty may have avoided licensing some of his songs so as not to diminish the value of a 1995 boxed set that included them).

169. *Id.* (stating that complications arise due to the fact that each song has a performance-rights royalty and a publishing-rights royalty received by the performer and songwriter respectively).

170. EMI distributes the Beatles' songs but the group's performance rights are owned by the band members and spouses. (Michael Jackson owns the publishing rights.) EMI has held numerous meetings with Paul McCartney, Ringo Starr, Yoko Ono and the rest of the tight group that controls perhaps the most-loved songs in the pop canon. So far the group remains unswayed.

Id.

offer music online;[171] and record companies must negotiate the Internet release of each song with the songwriters.[172] Disputes between record companies and artists over licensing delayed the launch of iTunes in Europe by several months.[173]

2. *Give More Digital Music Revenues to Artists*

Record companies could increase the volume of music that artists are willing to sell online, and simultaneously improve its public image by giving artists a higher percentage of the revenues from Internet sales. At present, Apple receives thirty-five percent of the revenues from each song sold on their site, while the record companies receive sixty-five percent and major label artists receive at best eight to fourteen cents per song.[174] Apple therefore receives over a third of the revenues while contributing few resources to make digital music available on its site.[175] The industry could structure licensing agreements to retain more money for artists and give less to companies like Apple. Additionally, the record labels themselves could take a smaller cut due to the money they save in marketing and manufacturing over the Internet.[176] In the alternative, legitimate music providers may bypass the record labels completely.[177] For instance, Apple currently permits independent artists not affiliated with record labels to offer music on iTunes, which means the artists receive approximately fifty-five cents per sale.[178]

3. *Improve Upon University Deals with Legitimate Sites*

Deals between universities and legitimate sites are not optimal for two reasons. First, most universities make deals with one online music service.[179] This is problematic because no single legitimate site yet offers the

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171. *Id.*

172. While most are represented by the Harry Fox Agency (65-70%), the RIAA must individually contact those who are not. *Id.*

173. *Licensing Problems Hamper Euro iTunes Store*, macNN.com, June 24, 2003, *at* http://www.macnn.com/news/19897.

174. *iTunes iSbogus*, *at* http://www.downhillbattle.org/itunes (last visited Jan. 25, 2005).

175. *Id.*

176. Barger, *supra* note 165, at 3 (stating that "[m]usicians should be paid a higher royalty for songs sold online than those sold in CD or album form, Henry said, because in the online world the record companies do not bear the costs associated with manufacturing CDs").

177. *iTunes iSbogus*, *supra* note 174.

178. iTunes offers music from from CD Baby. When an artist joins its service, it takes only nine cents, leaving the artist with fifty-five cents on average. *Id.*

179. *See generally* Banerjee & Holland, *supra* note 89.

quantity of music that illegal sites do.[180] Students will be more likely to take advantage of a program that offers access to multiple legal sites. Indiana University has come to this conclusion—it has not agreed to a deal with just one provider due to its belief that no single legitimate site yet offers enough selection.[181] Second, universities are charging students more to use the legitimate sites than students would pay on their own.[182] Students at Pennsylvania State University complain that the university charges them a $160 fee per semester in addition to the 99 cents per download. The majority of that fee goes toward the university's information technology budget, while only a fraction is actually applied toward the Napster service.[183] If universities hope to combat piracy by offering students a legal alternative, that alternative must be at least cheap enough to be an acceptable alternative to file-sharing.

4. *Urge Technology Companies to Sell Portable Digital Music Players Compatible with Music Purchased from Other Legal Music Sites*

Finally, there are compatibility problems with portable digital music players that the RIAA should work to resolve through liaison efforts with technology companies and standard-setting bodies. iPods currently only play music purchased on the iTunes site. Music purchased from the site is encoded in Apple's Advanced Audio Codec (AAC) format, which is only readable by the iPod.[184] Consumers therefore cannot use the iPod to play music purchased from other sites, such as RealNetworks' Rhapsody.[185] Sony's newest portable music device similarly only plays music purchased from its site.[186] By limiting consumers to one device, the technology industry is forcing consumers to choose and stick with one provider. This may not be good business for the technology industry or the music indus-

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180. Barger, *supra* note 165, at 2.

181. VanOsdol, *supra* note 71 ("Each downloading program is unique. Different programs offer different catalogues, and the ways to access music range from streaming audio to CD burns to MP3 player downloads.").

182. *Morning Edition (NPR) Profile: Penn State University Students Protest Schools Deal with Napster* (NPR Broadcast, Nov. 10, 2003), *available at* http://www.npr.org/templates/story/story.php?storyId=1499285 (subscription site).

183. *Id.*

184. Arik Hesseldahl, *The iPod Is A Battlefield*, FORBES.COM, July 30, 2004, *at* http://www.forbes.com/2004/07/30/cx_ah_0730tentech_print.html.

185. RealNetworks recently announced the development that its software would permit users to play music downloaded from its site on iPods. Whether Apple will permit this remains to be seen. *Id.*

186. Arik Hesseldahl, *The Won't-Be iPod Killer*, FORBES.COM, July 2, 2004, *at* http://forbes.com/personaltech/2004/07/02/cx_ah_0702entech.html.

try. More iPods could be sold if consumers could use them to store music from multiple sites. Moreover, users reluctant to designate one service for all future purchases may instead resort to P2P networks.

D. Improve Educational Efforts

The RIAA has partnered with Scholastic, Inc. to create a program that teaches fifth graders at over 10,000 schools about the value of copyright and the illegality of file-sharing.[187] It would be helpful if the RIAA expanded its educational efforts to teach all age groups copyright basics, and include more specific information about piracy's effect on the industry in its reports.

While the RIAA has been very vocal about the effects of piracy on the record industry as a whole, citing statistics of decreased CD sales, unemployment, and decreased artist compensation, the public needs more tangible examples of this reality. A detailed illustration of how illegal copies of lesser known artists' albums affect the artists' compensation in relation to the costs of production, marketing, and distribution, for instance, might be more effective.[188] The industry should also voice the long-term effects of piracy, namely what will happen to the industry when artists are no longer compensated for their efforts. In addition, it is only fair that if the RIAA is going to pursue litigation against the public that it shed some light on one of the nation's most complicated bodies of law. It is just as important to educate consumers on illegal behavior as it is to clearly state what actions consumers can legally take such as making copies for personal use.[189]

E. Alter Litigation Strategy

Finally, there are two ways in which the RIAA may increase the effectiveness of its current litigation strategy: by making its targets less predictable and by increasing the penalty for illegal file-sharing. Currently, the RIAA lawsuits exclusively target uploaders and, in particular, those that upload approximately 1,000 songs or more.[190] File-sharers can therefore evade the RIAA by uploading less than that target amount. The MPAA

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187. Jane Black, *The Keys to Ending Music Piracy; The Record Labels' Legal Assault Is Winning Battles and Losing the War. Educating Copyright Thieves Is As Important As Prosecuting Them*, BUSINESSWEEK ONLINE, Jan. 27, 2003, *at* http://www.businessweek.com/bwdaily/dnflash/jan2003/nf20030127_9897.htm.

188. Norman, *supra* note 91, at 405.

189. *Id.*; Black, *supra* note 186, at 2.

190. Keavin, *RIAA Gives Advance Warning to Song-Swappers Before Lawsuits Are Filed*, antimusic.com, Oct. 18, 2003, *at* http://www.antimusic.com/news/03/oct/item77.shtml.

has employed this tactic in its litigation strategy, as the first wave of suits named seven alleged offenders who had only shared one film.[191] The RIAA's strategy would benefit from a less predictable approach. In addition, recent case law suggests that punitive damages may be available for copyright owners who seek actual damages and profits for willful and malicious infringement as opposed to statutory damages.[192] However, the deterrence rationale for punitive damages may already be served in an increase of the maximum statutory damage award from $20,000 to $100,000.[193]

IV. CONCLUSION

The RIAA's litigation efforts against direct infringers have caused an initial decrease in file-sharing on P2P networks targeted by the suits, prompted universities to adopt strict copyright policies and initiate negotiations with legitimate sites, and worked to increase the appeal of legal online music services. Morever, for the first time in several years, in the last quarter of 2003, album sales increased by 4.7 percent. In January 2004, sales showed a 10.4 percent increase since January of the previous year.[194] Total sales in 2004 are predicted to exceed those in the last two years, although the rate of increase has slowed.[195]

However, these gains have not come without great costs. Studies call into question the effectiveness of litigation on overall and long term P2P activity. File-sharers are migrating to more sophisticated P2P networks, making illegal downloading more difficult to detect. Furthermore, the recording industry has unquestionably suffered a major loss in the arena of public perception.

Record companies realized the threat of file-sharing late in the game and were forced to play the defensive and seek a swift response to the problem. Many have criticized the RIAA for not looking to other solutions first, such as pursuing the online business model, before resorting to litigation. Yet, just as it would be unrealistic to expect a shop owner to stand by while his goods are being shoplifted, it seems unfair to expect an entire

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191. Evangelista, *supra* note 97.

192. Blanch v. Koons, 329 F. Supp. 2d 568 (S.D.N.Y. 2004); TVT Records v. Island Def Jam, 262 F. Supp. 2d 185 (S.D.N.Y. 2003).

193. *Remedies for the Copyright Owner in the Ninth Circuit*, *at* http://www.makilaw.com/copyright%20remedies%20030303.htm (last visited Feb. 24, 2005) (citing Kamakazi Music Corp. v. Robbins Music Corp, 534 F. Supp. 69, 78 (S.D.N.Y. 1982)).

194. Jeremy Paul Sirota, *Analog to Digital: Harnessing Peer Computing*, 55 HASTINGS L.J. 759, 765 (2004).

195. *Holiday Chill: Music Sales Slow*, WALL ST. J., Nov. 19, 2004, at B2.

industry to remain idle when faced with a potentially fatal piracy problem. In an ideal world, an understanding that file-sharing is illegal and the mere threat of legal repercussions would be sufficient to win the war on piracy. In the real world, one would be hard-pressed to find an industry that would limit itself to one response and not avail itself of all possible solutions to such a problem. Moreover, it takes time for an entire industry to alter a distribution model that has been used for more than three decades.[196]

The RIAA's litigation campaign, therefore, provided an immediate answer to file-sharing that is both defensible and effective on multiple fronts. Perhaps there are means by which it can increase the effectiveness of its litigation strategy and bolster its technological response to file-sharing. In addition, it must propose new initiatives to fight file-sharing in the long term. To survive, the RIAA must answer the question of what purpose the middleman will now serve.[197] Indeed, it may even have to compromise. The recording industry cannot put an end to file-sharing. But the faster it can adapt to this new environment, the more quickly the industry can shift its attention and resources from deterring file-sharing to establishing a presence in the online business community.

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196. Valerie Alter, *Building Rome in a Day: What Should We Expect from the RIAA?*, 26 HASTINGS COMM. & ENT. L.J. 155, 170-73 (2003).

197. For the first time in more than three decades, the music industry is being forced to think creatively about its distribution model and the way it makes money from promoting artists. . . . Digital distribution is putting pressure on the industry's core focus on selling pre-recorded music on CDs. The record labels need to be thinking more creatively about ways they can generate profits from the celebrities they help create.

Id. at 170 (quoting Steven Vonder Harr, a digital media analyst).

THE DIRECTV CASES: APPLYING ANTI-SLAPP LAWS TO COPYRIGHT PROTECTION CEASE-AND-DESIST LETTERS

By Lauren McBrayer

As recently as four years ago, a digital reproduction of a major motion picture was "unwieldy, difficult to transfer, and of mediocre video and sound quality"[1]—in other words, not worth the effort. Today, consumers can create and transfer theatrical quality digital copies worldwide within an hour.[2] Research suggests that anywhere from 300,000 to 350,000 pirated movies are downloaded on the Internet each day.[3] According to the Motion Picture Association of America (MPAA), digital piracy[4] costs the U.S. motion picture industry more than three billion dollars in potential worldwide revenue each year.[5] Moreover, the problem is only getting worse: according to an international study conducted by an online research company, of those who have downloaded films, 58% say they will do so again and 17% of those who have not yet done so said they expect to start doing so within the year.[6]

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1. Christian John Pantages, Comment, *Avast Ye, Hollywood! Digital Motion Picture Piracy Comes of Age*, 15 TRANSNAT'L LAW. 155, 156 (2002).

2. *See id.* (citing Lee Gomes, *Web Piracy Is Hitting Hollywood Sooner Than the Studios Thought*, WALL ST. J., July 17, 2000, at B1.

3. *See* Matthew C. Mousley, Note, *Peer-to-Peer Combat: The Entertainment Industry's Arsenal in its War on Digital Piracy*, 48 VILL. L. REV. 667, 674 (2003).

4. Piracy is defined as "the unauthorized and illegal reproduction or distribution of materials protected by copyright, patent or trademark law." BLACK'S LAW DICTIONARY 1169 (7th ed. 1999).

5. MPA WORLDWIDE MKT. RESEARCH, 2003 PIRACY FACT SHEET OVERVIEW (2003), *at* http://www.mpaa.org/PiracyFactSheets/PiracyFactSheetOverview.pdf.

6. MOTION PICTURE ASS'N OF AM. & ONLINE TESTING EXCH., WORLDWIDE INTERNET PIRACY 1 (2004), *available at* http://www.mpaa.org/MPAAPress/index.htm; *see* Pantages, *supra* note 1, at 156 (noting that "unless immediate efforts are made to stifle Internet motion picture piracy, every product churned out by this multi-billion dollar industry risks ending up as pirates' booty").

Meanwhile, piracy continues to plague the music industry. The Recording Industry Association of America (RIAA) estimates annual domestic revenue losses in excess of 300 million dollars.[7] It is the same story in the software industry: 36% of the software installed worldwide in 2003 was pirated, representing a loss of almost 29 billion dollars.[8]

Digital technology poses a serious threat to the entertainment industry,[9] and the problem shows no sign of abating. As one commentator points out, "while notable scholars have written extensively about digital intellectual property protection, their efforts fall short of creating a concrete, definite solution . . . ."[10] As such, the entertainment industry has been left with the task of developing practical ways to safeguard its rights in a world that generally tolerates copyright infringement.[11]

Rising to the challenge,[12] entertainment companies have launched aggressive enforcement campaigns at individuals.[13] While some have called this tactic a public relations disaster, it has been an overwhelming success

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7. Recording Indus. Ass'n of Am., *What the RIAA Is Doing About Piracy*, *at* http://www.riaa.com/issues/piracy/riaa.asp (last visited Mar. 5, 2005).

8. BUSINESS SOFTWARE ALLIANCE & IDC GLOBAL SOFTWARE, FIRST ANNUAL BSA AND IDC GLOBAL SOFTWARE PIRACY STUDY 1 (2004), *available at* http://www.bsa.org/globalstudy.

9. Kevin Michael Lemley, Comment, *Protecting Consumers From Themselves: Alleviating the Market Inequalities Created by Online Copyright Infringement in the Entertainment Industry*, 13 ALB. L.J. SCI. & TECH. 613, 619-20 (2003).

10. *Id.* at 613.

11. *See id.*; *see also* Mousley, *supra* note 3.

12. *See* Motion Picture Ass'n of Am., *Anti-Piracy*, *at* http://www.mpaa.org/anti-piracy (last visited Mar. 12, 2005) (stating that in 2000, the Motion Picture Association, the international counterpart of the MPAA, launched more than 60,000 investigations into suspected pirate activities, and participated in over 18,000 raids against alleged pirate operations); *see also* Recording Indus. Ass'n of Am. v. Diamond Multimedia Sys., 180 F.3d 1072, 1074 (9th Cir. 1999) (recognizing that "RIAA fights a well-nigh constant battle against Internet piracy, monitoring the Internet daily, and routinely shutting down pirate websites by sending cease-and-desist letters and bringing lawsuits").

13. In September 2003, the RIAA filed lawsuits against 261 individuals for "egregious" copyright infringement. By January 2004, the RIAA had obtained 233 settlements, totaling approximately $699,000, from individuals accused of copyright infringement. Grace J. Bergen, *Litigation as a Tool Against Digital Piracy*, 35 MCGEORGE L. REV. 181, 200 (2004). The RIAA targeted an additional 1,000 individual users in the first two months of 2004. *Public Appropriation of Private Rights: Pursuing Internet Copyright Violators*, 14 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 893, 897 (2004) (statement of Professor Sonia Katyal, Fordham University School of Law). The RIAA launched a new wave of copyright infringement lawsuits against 754 individuals in December 2004. Press Release, Recording Industry Association of America, RIAA Files New Copyright Infringement Lawsuits Against 754 Illegal File Sharers (Dec. 16, 2004), *at* http://www.riaa.com/news/newsletter/121604.asp.

from a copyright protection perspective.[14] For example, in the six months following the RIAA's initial litigation campaign against individual KaZaA users, KaZaA usage dropped forty percent.[15]

While entertainment companies employ a wide variety of strategies and approaches to recoup their losses from individual infringers, demand letters—a.k.a., cease-and-desist letters—remain the most widely-used tool in the enforcement arsenal.[16] Indeed, companies send them "with reckless abandon."[17] Certainly, sending cease-and-desist letters can be an effective way to avoid litigation,[18] but the assumption is that the sender has a good faith reason to believe that his rights are being violated. With the advent of "bots"—automated "robots" that crawl through the Internet to identify allegedly infringing activities[19]—the concern is that entertainment compa-

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14. *See* Katyal, *supra* note 13, at 897.

15. Sean Byrne, *Music Fans Cut Back on Free File-Swapping, 40% Drop in KaZaA Usage*, CDFreaks.com, Oct. 1, 2003 (stating that between March and August of 2003, KaZaA usage dropped 40%), *at* http://www.cdfreaks.com/news/8094.

16. *See* Thomas C. Inkel, Comment, *Internet-Based Fans: Why the Entertainment Industries Cannot Depend on Traditional Copyright Protections*, 28 PEPP. L. REV. 879, 902 (2001); *see also* Steve Wilson, *Online Piracy Turns From Music to Movies*, N.Y. TIMES, July 29, 1999, at 1 (noting that after reports of pirated copies of *Star Wars, Episode I: The Phantom Menace*, attorneys for Lucasfilm immediately sent cease-and-desist orders to website operators who had posted infringing material on their sites).

17. Mark A. Lemley & R. Anthony Reese, *Reducing Digital Copyright Infringement Without Restricting Innovation*, 56 STAN. L. REV. 1345, 1421 (2004). Demand letters are an attractive option for several reasons. First, unlike civil complaints, demand letters need not meet the standards of Federal Rule of Civil Procedure 11. *See id.* While Rule 11 requires that any papers filed with the court be based on a reasonable inquiry and "well-grounded in fact, legally tenable, and not interposed for any improper purpose," FED. R. CIV. P. 11, the allegations made in demand letters need only be based on a good faith belief that the client's rights are being violated, a standard that can be met without conducting an investigation. *See* Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 393 (1990) (discussing the purpose of Rule 11); Rossi v. Motion Picture Ass'n of Am., Inc., No. 02-00239BMK, 2003 U.S. Dist. LEXIS 12864, *9 (D. Haw. Apr. 29, 2003), *aff'd*, 391 F.3d 1000 (9th Cir. 2004) (construing 17 U.S.C. § 512(c)(3)(A)(v) and holding that a copyright holder must only "form a good faith belief of an alleged or "claimed" infringement prior to sending an ISP a notice").

18. Many of the settlements the RIAA has reached with alleged copyright infringers were reached prior to the filing of a complaint. See Press Release, Recording Industry Association of America, 64 Individuals Agree to Settlements in Copyright Infringement Cases (Sept. 29, 2003) (stating that twelve of RIAA's reported settlements were with individuals who had been identified as infringers by the RIAA but had not yet been sued), *available at* http://www.riaa.com/news/newsletter/092903.asp.

19. These automated Web crawler programs continually crawl from one server to another, "compiling lists of Web addresses that offer unauthorized titles of copyrighted material" and generating cease-and-desist letters. Sonia K. Katyal, *The New Surveillance*, 54 CASE W. RES. 297, 341 (2003); *see also* Frank Ahrens, "*Ranger*" *vs. the Movie Pi-*

nies are "sending out automatic take-down notices with no real research or double checks."[20] The fact that these programs frequently mistake legitimate files for copyrighted works means that the entertainment industry generates and sends hundreds of erroneous letters every day.[21] While commentators denounce this "shoot-in-the-dark approach to copyright protection,"[22] entertainment companies maintain that an aggressive strategy is the only way to enforce their rights.[23]

Not all recipients of threatening cease-and-desist letters are willing to overlook false allegations and accept a mere apology for the mistake. False accusations and erroneous demands for monetary settlement can be devastating to the individuals and small businesses on the receiving end, and quite a few have begun to fight back in court. After DirecTV, the leading distributor of television broadcasts through encrypted satellite transmissions, sent nearly 170,000 demand letters to alleged purchasers of signal theft equipment without confirming whether the individuals ever used the equipment illegally, recipients of erroneous letters filed suit against DirecTV asserting several causes of action, including unfair and deceptive business practices, Racketeer Influenced and Corrupt Organizations Act (RICO) violations, and stubborn litigiousness.[24]

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rates: Software Is Studios' Latest Weapon in a Growing Battle, WASH. POST, June 19, 2002, at H1; *What's a Bot*, BOTSPOT, *at* http://www.botspot.com/common/whats_bot.html (last visited Mar. 5, 2005).

20. Brendon Chase, *Linux Group Rebuffs Hollywood Piracy Charge*, CNET NEWS.COM, Sept. 20, 2004, *at* http://news.com.com/Linux+group+rebuffs+Hollywood+piracy+charge/2100-1030_5374528.html?part=dh&tag=ntop. According to Pia Smith, President of Linux Australia, "organizations that participate in such behavior should be held accountable and forced to put at least some effort into researching the validity [of their allegations]." *Id.*

21. For example, the RIAA has mistakenly believed an astrophysics professor with the last name Usher illegally uploaded files by well known R&B artist Usher. Sonia K. Katyal, *A War on CD Piracy; A War on our Rights*, L.A. TIMES, June 27, 2003, at Cal. Metro, Part 2, at 17. Even though companies using automated technology to find pirates insist that they engage in due diligence to confirm evidence of infringement, the large margin of error associated with automated tracking programs makes it impossible for companies to catch everything. *See* Katyal, *supra* note 19, at 345.

22. *See* Chase, *supra* note 20 (quoting Pia Smith, President of Linux Australia).

23. *See* Benny Evangelista, *Digital Dupes; Movies, Music Industries Try to Keep Pirated Copies from Spinning Out of Control*, S.F. CHRON., Jan. 31, 2000 (quoting Jack Valenti, President of the MPAA as stating that "if we have to file a thousand lawsuits a day, we'll do it"), *available at* http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2000/01/31/BU10659.DTL.

24. *See* DirectTV, Inc. v. Cavanaugh, 321 F. Supp. 2d 825, 830 (E.D. Mich. 2003); DirecTV, Inc. v. Cephas, 294 F. Supp. 2d 760 (M.D.N.C. 2003); Buckley v. DirecTV, Inc., 276 F. Supp. 2d 1271, 1273 (N.D. Ga. 2003).

DirecTV claims it should be immune from suit. The company argues that because sending cease-and-desist letters is a form of constitutionally protected "petitioning activity," any cause of action arising from that activity should be considered an impermissible Strategic Lawsuit Against Public Participation, a so-called "SLAPP" suit.[25] Developed to protect citizens from meritless lawsuits filed by large private interests with the intent to discourage the citizens' exercise of their constitutional rights,[26] anti-SLAPP laws provide absolute immunity from tort claims arising out of constitutionally protected speech and petitioning activity. While anti-SLAPP laws were designed to prevent corporate entities with deep pockets from using their resources to quash constitutionally protected speech and petitioning activity,[27] the deep pockets themselves now use these protections as a means to preserve their "right" to use unsubstantiated demand letters as a scare tactic.

Part I of this Note provides general background on SLAPP suits and the legislation designed to target them. Part II examines four of the lawsuits filed against DirecTV and discusses the company's request for anti-SLAPP immunity. Part III argues that in light of the legislative purpose behind anti-SLAPP laws, DirecTV should not have been considered a SLAPP target and thus should not have been able to avail of anti-SLAPP immunity. The Part suggests that extending anti-SLAPP protection to cease-and-desist letters represents not only a misapplication of the laws and a perversion of their First Amendment purpose, but also a misguided approach to rights enforcement. Finally, Part IV argues that the best way for the entertainment industry to handle its mistakes is not to seek immunity, but rather to accept responsibility: the industry should stop relying on anti-SLAPP laws as a shield from liability and instead focus on maintaining the industry's legitimacy, both in the eyes of the court and in the eyes of consumers.

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25. *See, e.g.*, *Buckley*, 276 F. Supp. 2d at 1273-74.

26. *See* Jerome I. Braun, *Increasing SLAPP Protection: Unburdening the Right of Petition in California*, 32 U.C. DAVIS L. REV. 965, 968 (1999).

27. *Id.* (stating that the term "SLAPP" applies when "public or corporate entities with deep pockets use litigation to inhibit or retaliate against those who exercise their constitutionally protected rights of speech and petition in ways that threaten the entities' interests").

I. PRESERVING THE RIGHT TO PETITION: STATE ANTI-SLAPP PROTECTIONS AND THE *NOERR-PENNINGTON* DOCTRINE

A. SLAPP Suits

A "Strategic Lawsuit Against Public Participation"[28] (SLAPP) is the name used to describe a meritless legal action brought against individuals or groups with the intention of "silencing [the] opponents, or at least . . . diverting their resources."[29] By definition, SLAPPs are "generally meritless suits brought by large private interests to deter common citizens from exercising their political or legal rights or to punish them for doing so."[30] Specifically, a SLAPP suit interferes with the target's past or future exercise of his First Amendment right to free speech and to petition the government for the redress of grievances.[31] For example, the paradigmatic SLAPP case involves a group of activists petitioning the government to stop a development; the developer then sues the activist group, alleging one or more of the following causes of action: defamation, interference with economic advantage, judicial process abuse, civil rights violations by the activists, conspiracy, and/or nuisance.[32]

In light of the myriad causes of action used by SLAPP filers and the difficulty in defining the scope of protected petitioning activity, SLAPP suits can be difficult to recognize.[33] Regardless of the cause of action in

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28. Professor George W. Pring of the University of Denver first coined this term. *See* George W. Pring, *SLAPPs: Strategic Lawsuits Against Public Participation*, 7 PACE ENVTL. L. REV. 3, 4 (1989). In his seminal article, Professor Pring identifies a SLAPP suit as: 1) a civil complaint or counterclaim (for monetary damages, and/or injunction), 2) filed against non-governmental individuals, and/or groups, 3) because of their communications to a government body, official, or the electorate, 4) on an issue of some public interest or concern. *Id. See generally* GEORGE PRING & PENELOPE CANAN, SLAPPS: GETTING SUED FOR SPEAKING OUT (1996).

29. John C. Barker, *Common-Law and Statutory Solutions to the Problem of SLAPPs*, 26 LOY. L.A. L. REV. 395, 396 (1993).

30. Wilcox v. Superior Court, 33 Cal. Rptr. 2d 446, 450 (Ct. App. 1994); *see also* Braun, *supra* note 26, at 968.

31. Kathryn W. Tate, *California's Anti-SLAPP Legislation: A Summary Of and Commentary On Its Operation and Scope*, 33 LOY. L.A. L. REV. 801, 802-03 (2000). *See generally* Noah P. Peeters, *Don't Raise That Hand: Why, Under Georgia's Anti-SLAPP Statute, Whistleblowers Should Find Protection From Reprisals For Reporting Employer Misconduct*, 38 GA. L. REV. 769, 780 (2004) (describing the paradigmatic SLAPP suit).

32. *See* Braun, *supra* note 26, at 984.

33. *See* Laura J. Ericson-Siegel, Comment, *Silencing SLAPPs: An Examination of Proposed Legislative Remedies and a 'Solution' for Florida*, 20 FLA. ST. U. L. REV. 487, 492 (1992); *see also* Barker, *supra* note 29, at 403 (noting that a SLAPP filer, by definition, has improper motives).

which they are framed, SLAPP lawsuits are not filed to vindicate legitimate legal claims, but rather to intimidate and discourage opposition from their targets.[34] Indeed, unlike a typical plaintiff, the SLAPP filer "expects to lose and is willing to write off litigation expenses (and even the defendant's attorney's fees where necessary) as the cost of doing business."[35] Typically, the filer is better equipped to handle litigation than its target, possessing more financial resources and more knowledge about the legal process. By contrast, many SLAPP targets have no prior experience in the judicial arena and often lack the kinds of resources necessary to mount a sophisticated defense.[36] While the filer may have little to no chance of succeeding on the merits of his claim, he nevertheless succeeds if his suit, which his target cannot afford to defend, has the effect of silencing the target's petition activity. Although some commentators argue that targets can fight back with requests for sanctions or countersuits for abuse of process or malicious prosecution, these tactics are costly and unlikely to intimidate the filer.[37]

In the face of widespread use of SLAPPs in the 1970s and 1980s, courts and state legislatures began to look for concrete solutions to the SLAPP problem.[38] Remedies ranged from judicial solutions fashioned from existing procedural forms to statutory solutions aimed specifically at SLAPPs.[39]

B. Statutory Solutions: State Anti-SLAPP Laws

In 1989, Washington became the first state to enact an anti-SLAPP statute.[40] Since then, twenty-four states have passed similar legislation.[41] Eleven states have recently or are currently considering anti-SLAPP

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34. *See* Peeters, *supra* note 31, at 779; *see also* PRING & CANAN, *supra* note 28, at 9-10 (adopting terms "target" and "filer" to identify parties to SLAPP litigation). Because SLAPPs often emerge in the context of cross-claims and counterclaims, using the standard terminology of plaintiff and defendant can be confusing. For the purpose of clarity, this Note identifies plaintiffs of SLAPP suits as "filers" and defendants as "targets."

35. *See* Tate, *supra* note 31, at 805.

36. *See* Peeters, *supra* note 31, at 781 (citing PRING & CANAN, *supra* note 28, at 11).

37. *Id.* at 782 (citing Barker, *supra* note 29, at 406).

38. *Id.*

39. Braun, *supra* note 26, at 984.

40. *See* WASH. REV. CODE ANN. §§ 4.24.500 to .520 (West 1999).

41. Other States: Statutes and Cases, California Anti-SLAPP Project, *at* http://www.casp.net/menstate.html (last updated Feb. 25, 2005) (detailing reach of legislative responses to SLAPPs in California, Delaware, Florida, Georgia, Hawaii, Indiana, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Missouri, Nebraska, Nevada, New Mexico, New York, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Utah, Washington, and West Virginia).

bills.[42] These existing anti-SLAPP statutes offer varying degrees of protection for speech and petition rights through procedural hurdles that make it more difficult for a SLAPP filer to pursue its claims. The core provisions common to many of these statutes include: the establishment of a process for motions to dismiss or strike claims targeting public participation; the expedited hearing of such motions and suspension or significant curtailment of discovery until the court rules on the motion; and a cost-shifting award of attorneys fees and costs payable by the filer to the target when the target prevails on its motion to dismiss.[43]

California enacted its anti-SLAPP remedy in 1992. At the time of its enactment, it was "the most ambitious and far-reaching of all the state anti-SLAPP laws,"[44] providing SLAPP targets with an accelerated motion to strike a complaint or cause of action if it arose "from any act in furtherance of the . . . right of petition or free speech . . . in connection with a public issue."[45] Under California's anti-SLAPP statute, protection extends to any act "in furtherance of the exercise of the constitutional right of petition or the constitutional right of free speech," as long as the constitutional activity is done "in connection with a public issue or an issue of public interest."[46]

In 2003, the California legislature enacted California Civil Procedure Code § 425.17 to limit the application of the anti-SLAPP special motion to strike in order to curb the "disturbing abuse" of the anti-SLAPP motion by "the same types of businesses who used the SLAPP action."[47] Under the

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42. *Id.* These states include Arizona, Arkansas, Colorado, Connecticut, Illinois, Kansas, Michigan, New Hampshire, New Jersey, Texas, and Virginia.

43. *See* Peeters, *supra* note 31, at 782.

44. Jerome I. Braun, *California's Anti-SLAPP Remedy After Eleven Years*, 34 MCGEORGE L. REV. 731, 732 (2003).

45. CAL. CIV. PROC. CODE § 425.16 (West 2004). The statute protects:

> (1) any written or oral statement or writing made before a legislative, executive, or judicial proceeding, or any other official proceeding authorized by law; (2) any written or oral statement or writing made in connection with an issue under consideration or review by a legislative, executive, or judicial body, or any other official proceeding authorized by law; (3) any written or oral statement or writing made in a place open to the public or a public forum in connection with an issue of public interest; (4) or any other conduct in furtherance of the exercise of the constitutional right of petition or the constitutional right of free speech in connection with a public issue or an issue of public interest.

Id.

46. *Id.* § 425.16(e).

47. Blanchard v. DirectTV, Inc., 20 Cal. Rptr. 3d 385 (Ct. App. 2004); *see* CAL. CIV. PROC. CODE § 425.17. Subdivision (b) of § 425.17 makes the anti-SLAPP procedure

newly enacted § 425.17(b), public interest lawsuits are specifically excluded from the reach of anti-SLAPP special motions to strike.[48]

C. Judicial Remedies: The *Noerr-Pennington* Doctrine

The *Noerr-Pennington* doctrine got its name from two antitrust cases in which the Supreme Court established that antitrust laws could not be used to penalize genuine political activity.[49] Although initially designed strictly to provide immunity from federal antitrust claims and not as a SLAPP remedy, courts have expanded the doctrine to prevent civil liability for any petitioning activity as long as the petitioning is not a "sham."[50]

While some commentators have criticized its use outside of the antitrust context,[51] "some courts have read *Noerr-Pennington* as establishing an absolute, constitutional privilege against tort claims for bona fide petitioning activity."[52] West Virginia was the first state to apply *Noerr-Pennington* immunity to a SLAPP target. In what some call "the most ex-

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inapplicable to "any action brought solely in the public interest or on behalf of the general public."

48. CAL. CIV. PROC. CODE § 425.17(b).

49. *See* United Mine Workers v. Pennington, 381 U.S. 657 (1965); E. R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127, 137-38 (1961) (recognizing petition immunity); *see also* Robert A. Zauzmer, Note, *The Misapplication of the* Noerr-Pennington *Doctrine in Non-Antitrust Right to Petition Cases*, 36 STAN. L. REV. 1243, 1254 (1984). Under the *Noerr-Pennington* doctrine, petitioning activity is immune from antitrust liability. *See* Daniel R. Fischel, *Antitrust Liability for Attempts to Influence Government Action: The Basis and Limits of the* Noerr-Pennington *Doctrine*, 45 U. CHI. L. REV. 80 (1977).

50. *See* Zauzmer, *supra* note 49, at 1256; *see, e.g.*, Columbia Pictures Indus., Inc. v. Prof'l Real Estate Investors, Inc., 944 F.2d 1525, 1532 (9th Cir. 1991) ("[A]n antitrust plaintiff must make a two-part showing to support a finding of sham: (1) that the suit is baseless—a legal question . . . and (2) that the suit was brought as part of an anticompetitive plan external to the underlying litigation—a question of fact.") (internal citation omitted).

51. *See* Timothy P. Getzoff, Comment, *Dazed and Confused in Colorado: The Relationship Among Malicious Prosecution, Abuse of Process, and the* Noerr-Pennington *Doctrine*, 67 U. COLO. L. REV. 675, 689 (1996); *see also* Zauzmer, *supra* note 49, at 1259 ("[T]he *Noerr-Pennington* doctrine has been applied in a multitude of situations far from the Supreme Court's narrow antitrust application. Further, these cases, like their antitrust counterparts, define the sham exception so narrowly as to protect virtually any actual political or litigious behavior from civil liability.").

52. Thomas A. Waldman, *SLAPP Suits: Weaknesses in First Amendment Law and in the Courts' Reponses to Frivolous Litigation*, 39 UCLA L. REV. 979, 1003 (1992) (noting that "the most vigorous application of the [*Noerr-Pennington*] doctrine outside of antitrust has occurred in SLAPP suits, where the right to petition is raised as a defense to tort claims").

pansive application of *Noerr-Pennington* in any context,"[53] the West Virginia Supreme Court held in *Webb v. Fury* that the *Noerr-Pennington* doctrine "rests upon solid First Amendment grounds rather than upon a limited construction of the Sherman Act."[54]

In contrast, the Fifth and Tenth Circuit Courts of Appeals have expressly rejected the characterization of *Noerr-Pennington* immunity as a "principle of constitutional law," asserting that "*Noerr* was based on a construction of the Sherman Act [and] was not a first amendment decision."[55] In light of the fact that the *Noerr* and *Pennington* decisions establish only that a plaintiff harmed by petitioning activity may not recover under the Sherman Act,[56] many commentators, and indeed some courts, find the application of the doctrine in non-antitrust cases inappropriate and "inconsistent with the Supreme Court's first amendment jurisprudence."[57]

II. THE *DIRECTV* CASES

While legal access to DirecTV's satellite television programming requires that customers purchase a DirecTV access card and receiver, there are devices available that can circumvent DirecTV's signal-scrambling technology, allowing users to view DirecTV's programming without subscribing to DirecTV's service and without making payment to the company.[58] While these 'unscrambling' devices are often pre-configured to pirate DirecTV's signal,[59] researchers and innovators use many such de-

53. *Id.* at 1023.

54. 282 S.E.2d 28, 36 (W. Va. 1981); *id.* at 37 ("Clearly, the *Noerr-Pennington* doctrine is a principle of constitutional law which bars litigation arising from injuries received as a consequence of First Amendment petitioning activity, regardless of the underlying causes of action asserted by the plaintiff."); *see* Waldman, *supra* note 52, at 1024.

55. Cardtoons, L.C. v. Major League Baseball Players Ass'n, 208 F.3d 885, 890 (10th Cir. 2000) (en banc) (quoting Coastal States Mktg., Inc. v. Hunt, 694 F.2d 1358, 1364-54 (5th Cir. 1983)) (footnote omitted). The Fifth Circuit specifically noted in *Coastal States* that the "petitioning immunity" granted by the *Noerr-Pennington* doctrine extends beyond the guarantees of the petition clause: "We reject the notion that petitioning immunity extends only so far as the first amendment right to petition and then ends abruptly." *Coastal States*, 694 F.2d at 1366; *see also* Zauzmer, *supra* note 49, at 1266 (arguing that "to the extent that *Webb v. Fury* found an absolute immunity in the first amendment for [malicious or knowingly false] statements, it was simply wrong").

56. Zauzmer, *supra* note 49, at 1250. *See generally* E. R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961).

57. Zauzmer, *supra* note 49, at 1250.

58. DirecTV, Inc. v. Cephas, 294 F. Supp. 2d 760, 762 (M.D.N.C. 2003).

59. These pre-configured devices include bootloaders, unloopers, and blockers. *See What's Going on Here?*, DirecTVDefense.org, *at* http://www.DirecTVDefense.org (last

vices for other non-infringing purposes: specifically, to secure computer networks, enable user-based identification, and further scientific discovery.[60] However, individuals who use these unscrambling devices to gain unauthorized access to DirecTV's programming do so in violation of the Digital Millennium Copyright Act (DMCA), which makes it unlawful to circumvent technology that limits access to copyrighted work, or to sell a device that will perform that task.[61]

In the spring of 2001, DirecTV obtained the sales records of several companies engaged in the sale of various pirate access devices[62] and initiated a program called the End User Development Group ("EUDG") to track the individuals listed in the records.[63] In 2002, EUDG sent 100,000 "nearly identical" demand letters to consumers who had acquired various electronic devices that could be used to tamper with DirecTV access cards in order to receive free programming.[64] The demand letters accused the individuals of violating various federal statutes by possessing and/or using signal theft equipment, and informed the recipients that DirecTV intended to pursue legal action against them but would refrain from filing a complaint if a settlement could be reached.[65] These demand letters further stated that DirecTV would settle the matter if the individual surrendered his illegal equipment, promised in writing not to obtain similar equipment in the future, and paid an unspecified monetary sum.[66] EUDG sent a follow-up letter to the recipients who did not respond to the initial letter. This follow-up letter reiterated the initial accusation and threatened a lawsuit if

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updated Mar. 5, 2005). DirecTV Defense is a joint effort of the Electronic Frontier Foundation and The Stanford Center for Internet and Society Cyberlaw Clinic.

60. *Id.* ("[S]mart card readers and their various derivatives are capable of so much more: they secure computer networks, enable user-based identification, and further scientific discovery.").

61. *See* 17 U.S.C. § 1201 (2000). Section 1201(a)(2) provides that "no person shall manufacture, import, offer to the public, provide, or otherwise traffic in any technology, product, service, device, component, or part thereof, that . . . is primarily designed or produced for the purpose of circumventing a technological measure that effectively controls access to a work protected under this title. *Id.* § 1201(a)(2).

62. Buckley v. DirecTV, Inc., 276 F. Supp. 2d 1271, 1273 n.2 (N.D. Ga. 2003) ("DirecTV obtained the identities of these individuals from customer lists seized pursuant to civil writs of seizure issued by United States District Court judges authorizing United States Marshals and DirecTV representatives to seize and impound products and related business records from individuals and companies designing, manufacturing, or trafficking in such equipment.").

63. *See* DirectTV, Inc. v. Cavanaugh, 321 F. Supp. 2d 825, 830 (E.D. Mich. 2003); *Cephas*, 294 F. Supp. 2d at 762; *Buckley*, 276 F. Supp. 2d at 1273.

64. *Cavanaugh*, 321 F. Supp. 2d at 830.

65. *Buckley*, 276 F. Supp. 2d at 1273.

66. *Cephas*, 294 F. Supp. 2d at 762.

the recipient did not immediately contact DirecTV regarding a settlement.[67] After sending hundreds of thousands of demand letters to individuals all over the country, DirecTV filed nearly 24,000 lawsuits against alleged signal pirates.[68]

While DirecTV insists that its actions were warranted in light of evidence of rampant piracy of the company's satellite signals, its zealous enforcement campaign prompted a wave of retaliatory litigation. While the causes of action differ, the four cases discussed below have two features in common: in each case the claims against DirecTV arose out of the company's demand letters and in each case DirecTV argued that the letters constituted a protected exercise of the company's First Amendment rights. The fact that DirecTV prevailed on two of its four motions demonstrates the lingering judicial uncertainty regarding the applicability of anti-SLAPP protections to demand letters.

A. Buckley v. DirecTV, Inc.

In Georgia, six recipients of demand letters from DirecTV filed suit against the company asserting several causes of action, including unfair and deceptive business practices, RICO violations, and stubborn litigiousness.[69] DirecTV moved to dismiss the plaintiffs' complaint under Georgia's Anti-SLAPP statute,[70] arguing that the pre-litigation demand letters were protected under the anti-SLAPP statute as an exercise of the company's First Amendment rights.[71] The plaintiffs claimed that the statute did not apply because DirecTV's demand letters did not involve an "issue of public interest or concern."[72]

Relying on a California case interpreting a similar statute, the district court held that statements made "in connection with or in preparation of litigation," including pre-litigation demand letters, were protected as part of the First Amendment right to petition.[73] The court found the plaintiff's argument, that the demand letters did not involve an issue of public interest or concern, unpersuasive in light of plaintiffs' complaint, which made several references to the defendants' impact on "members of the general public."[74] The court pointed out that "the facts establish that the demand

67. *Buckley*, 276 F. Supp. 2d at 1273.
68. *Id.*
69. *Id.*
70. *See* GA. CODE ANN. § 9-11-11.1 (1998).
71. *Buckley*, 276 F. Supp. 2d at 1273-74.
72. *Id.* at 1274.
73. *Id.* (citing Kashian v. Harriman, 120 Cal. Rptr. 2d 576, 588 (Ct. App. 2002)).
74. *Id.* at 1275.

letters were sent to tens of thousands of people in connection with an issue that affects millions [and] . . . any action involving such a large number of people is, by definition, a matter of public interest and concern."[75]

In response to the plaintiffs' claims that DirecTV did not conduct an adequate investigation before sending the demand letters and that the letters contain false, misleading, or deceptive statements, the court stated that the plaintiffs' remedy for these wrongful acts would be to first obtain a dismissal on the merits of any lawsuit filed against them by DirecTV and then pursue sanctions under Rule 11 or an action for malicious prosecution.[76] In barring the plaintiffs' claims, the court illuminated the central problem: according to the court, DirecTV's demand letters warranted the same level of protection as a civil complaint; yet, as the court acknowledged, demand letters, unlike civil complaints, cannot trigger Rule 11 sanctions.

B. DirecTV, Inc. v. Cephas

DirecTV offered the same immunity argument in *DirecTV, Inc. v. Cephas*, this time in a motion to dismiss the defendant's counterclaims for unfair and deceptive trade practices under the North Carolina Unfair and Deceptive Trade Practices Act (UDTPA).[77] The defendant argued that DirecTV had violated the statute by falsely accusing him of a crime, representing that it had the power of law enforcement, and threatening to take action not permitted by law.[78] In its motion to dismiss, DirecTV argued that the *Noerr-Pennington* doctrine immunized its demand letters and thus the letters could not provide a basis for the defendant's claim.[79]

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75. *Id.*

76. *Id.*

77. N.C. GEN. STAT. § 75-16 (2003). To state a claim under the Unfair and Deceptive Trade Practices Act (UDTPA), Cephas was required to show that (1) DirecTV committed an unfair or deceptive act or practice; (2) in or affecting commerce; and that (3) the defendant "'suffered actual injury as a proximate result of [DirecTV's] misrepresentations' or unfair conduct." DirecTV, Inc. v. Cephas, 294 F. Supp. 2d 760, 765 (M.D.N.C. 2003) (citing First Atl. Mgmt. Corp. v. Dunlea Realty Co., 507 S.E.2d 56, 63 (N.C. Ct. App 1998) (quoting Ellis v. Smith-Broadhurst, Inc., 268 S.E.2d 271, 273-74 (N.C. Ct. App. 1980))).

78. Cephas, the defendant, was among the individuals who received a demand letter from DirecTV, accusing him of purchasing and using illegal signal theft equipment. When Cephas replied with a letter denying the accusations, DirecTV sent a second letter, this time stating that Cephas would be given ten additional days to pursue a settlement with the company before it retained counsel and filed suit. Cephas did not respond within this ten-day period. Two months later, DirecTV filed suit. *Cephas*, 294 F. Supp. 2d at 762.

79. *Id.* at 766.

Recognizing that petition clause immunity was "designed to protect petitions to the government when suits based on those petitions would have the effect of deterring them," the court held that pre-litigation demand letters should be protected only if allowing the letters to become the basis of a lawsuit would discourage future meritorious litigation.[80] In the present context, the court reasoned that "[because] parties bringing or threatening to bring meritorious, good faith claims cannot by definition be subject to liability [for unfair and deceptive trade practices]," claims brought under the UDTPA simply do not have a chilling effect on good faith litigation.[81] Noting that parties who threaten consumers with non-meritorious litigation should be subject to liability, the court concluded that petition clause immunity was inappropriate in this context and thus did not bar the defendant's claims.[82]

C. *DirecTV, Inc. v. Cavanaugh*

In a similar ruling, a federal district court in Michigan held that statements made in a letter threatening litigation were not absolutely protected by the petition clause of the First Amendment and therefore could become the basis of a lawsuit.[83] The court found it

> difficult to see how subjecting DirecTV to liability under the [Michigan Consumer Protection Act] would chill its right to petition the government and seek redress, [considering that] at issue in this motion is not DirecTV's right to use demand letters as a means of encouraging settlement, but rather its use of false or misleading statements in the demand letters.[84]

The court pointed out that if DirecTV did, in fact, use false and misleading statements, "[then] punishing DirecTV will not deter future use of demand letters. At best, it will encourage the company to investigate carefully its accusations and to be precise in the language it uses when attempting to settle with suspected signal pirates."[85]

D. *Blanchard v. DirecTV, Inc.*

In the most recent DirecTV decision, a California court of appeal went the other way, finding that DirecTV's demand letters were "absolutely

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80. *Id.* at 767.
81. *Id.*
82. *Id.*
83. DirectTV, Inc. v. Cavanaugh, 321 F. Supp. 2d 825, 830 (E.D. Mich. 2003).
84. *Id.* at 842.
85. *Id.*

privileged"[86] under California's anti-SLAPP statute as "'protected communications' [sent] in furtherance of DirecTV's right of petition under the United States and California Constitutions."[87] According to the court, the plaintiffs' unfair business practice claim[88] "would establish no ringing declaration of the rights of all pirating-device purchasers, nor . . . lead to a wholesale change in the practice of sending demand letters."[89] As a result, the claim against DirecTV could not be considered a "public interest action," and thus was not entitled to heightened protection from the anti-SLAPP special motion to strike.[90] Interestingly, while the *Buckley* court found that DirecTV's demand letters were "by definition, a matter of public interest and concern,"[91] the *Blanchard* court held that an action filed in response to the very same demand letter campaign could not be considered a public interest action.[92]

III. THE INAPPLICABILITY OF ANTI-SLAPP PROTECTIONS TO CEASE-AND-DESIST LETTERS

As the *DirecTV* cases clearly demonstrate, the procedural safeguards enacted to protect citizens from SLAPP suits are being used by intellectual property owners as part of larger digital rights enforcement campaigns; specifically, entertainment companies rely on anti-SLAPP laws to protect not only their right to file lawsuits but also their right to send cease-and-desist letters to suspected infringers, often without any evidence of actual infringement.

Courts disagree as to whether and to what extent state anti-SLAPP statutes and the federal *Noerr-Pennington* doctrine extend to demand letters.[93] In a recent landmark decision, the Tenth Circuit held that "a letter from one private party to another private party simply does not implicate the right to petition, regardless of what the letter threatens."[94] Relying on

86. Blanchard v. DirecTV, Inc., 20 Cal. Rptr. 3d 385, 390 (Ct. App. 2004).

87. *Id.* (citing CIVIL CODE § 47(b) (West 2004)).

88. *See* CAL. BUS. & PROF. CODE § 17200 (West 1997).

89. *Buckley*, 20 Cal. Rptr. 3d at 393.

90. *Id.* at 394.

91. Buckley v. DirecTV, Inc., 276 F. Supp. 2d 1271, 1275 (N.D. Ga. 2003).

92. *See Buckley*, 20 Cal. Rptr. 3d at 394.

93. For the remainder of this Note, I will use the term "Anti-SLAPP Protections" to refer to both state anti-SLAPP statutes and the *Noerr-Pennington* doctrine.

94. Cardtoons, L.C. v. Major League Baseball Players Ass'n, 208 F.3d 885, 892 (10th Cir. 2000) (en banc) (citing PHILIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW 237, § 205e (rev. ed. 1997), and pointing out that "even the antitrust text cited by the panel majority notes that 'a mere threat directed at one's competitor to sue or to seek administrative relief does not involve or 'petition' the government . . .'").

"the plain language of the First Amendment," which "protects only those petitions which are made to 'the Government,'" the Tenth Circuit determined that "purely private threats of litigation" do not fall within the definition of petitioning activity.[95]

Other circuits may have begun to follow the Tenth Circuit's lead: although the Eleventh Circuit has extended antitrust immunity to pre-litigation threats,[96] a recent district court decision in that circuit expressly limited this holding to the antitrust context, stating that "given the absence of authority from the Eleventh Circuit, the court will assume to be persuasive the reasoning of the Tenth Circuit that the *Noerr-Pennington* doctrine does not immunize parties from liability based on claims arising out of purely private communications outside the context of litigation."[97]

In contrast, some courts have held that pre-litigation correspondence is entitled to anti-SLAPP protection as communication preliminary to an official proceeding.[98] The Fifth Circuit has held that "mere threats of litigation" qualify for immunity, on the grounds that "it would be absurd to hold that [the petition clause] does not protect those acts reasonably and normally attendant upon effective litigation."[99]

Echoing these sentiments, the dissent in *Cardtoons* argued that "in order to provide breathing space to the First Amendment right to petition the courts, further the interests that right was designed to serve, and promote the public interest in efficient dispute resolution," cease-and-desist letters should be afforded "the same level of immunity from tort liability as a complaint making the same allegations."[100] This notion—that pre-

95. *Id.* at 893.

96. *See* McGuire Oil Co. v. Mapco, Inc., 958 F.2d 1552, 1560 (11th Cir. 1992) (holding "threats, no less than the actual initiation of litigation" qualify for antitrust immunity).

97. Porsche Cars N. Am., Inc. v. Lloyd Design Corp., No. 1:99-CV-1560A-JEC, 2002 U.S. Dist. LEXIS 9612 (D. Ga. Mar. 28, 2002).

98. Dove Audio, Inc. v. Rosenfeld, Meyer & Susman, 54 Cal. Repr. 2d 830, 835 (Ct. App. 1996). In *Dove Audio*, a recording company sued a law firm for defamation for alleging the record company had failed to pay royalties to certain charities; the law firm brought a special motion to strike under California's anti-SLAPP statute. The court affirmed the defendants' motions, finding that the law firm's letter to celebrities who had participated in the recording was protected from defamation liability under California's anti-SLAPP statute as a communication "preparatory to or in anticipation of the bringing of an action or other official proceeding." *Id.*; *see also* Am. Broad. Co. v. Maljack Prod., Inc., 34 F. Supp. 2d 665, 675 (N.D. Ill. 1998) (fifty cease-and-desist letters sent by alleged owner of copyright in footage of Princess Diana's funeral were privileged when not sent in bad faith and did not form basis for intentional interference).

99. Coastal States Mktg., Inc. v. Hunt, 694 F.2d 1358, 1367 (5th Cir. 1983).

100. *Cardtoons*, 208 F.3d at 899 (Lucero, J., dissenting).

litigation threats do not constitute petitioning activity but nonetheless deserve protection—is echoed in Areeda & Hovenkamp: "Although a mere threat directed at one's competitor to sue or to seek administrative relief does not involve or 'petition' the government, it would be anomalous and socially counterproductive to protect the right to sue but not the right to threaten suit."[101]

It may indeed be socially productive to protect the right to threaten suit in addition to the right to file suit, but it is dangerous to protect the former *at the expense* of the latter. Anti-SLAPP protections were designed to protect specific political rights and apply only when those rights were exercised in connection with a public issue. While the First Amendment offers broad protection for speech and petitioning activity, anti-SLAPP laws offer a more narrow protection: in most states, anti-SLAPP immunity is only available where a citizen has exercised her constitutional rights "in connection with a public issue."[102] Thus, even if sending a demand letter does constitute speech or petitioning activity, anti-SLAPP protections only apply if the letters were sent in connection with a public issue.

In light of the fact that all civil lawsuits arguably involve a matter of public concern "in that they invoke laws or ask for change in the law,"[103] civil complaints by definition qualify for anti-SLAPP protection. It remains unclear, however, whether and to what extent pre-litigation communications are similarly protected.[104] If every "valid effort to influence governmental action" involves a matter of public concern, then the relevant question is whether demand letters in fact represent an effort to influence government action.[105] Since demand letters are often sent in order to

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101. AREEDA & HOVENKAMP, *supra* note 94, at 237, § 205e.

102. *E.g.*, CAL. CIV. PROC. CODE § 425.16 (West 2004); *see also, e.g.*, R.I. GEN. LAWS § 9-33-2 (1997).

103. Carol Rice Andrews, Jones v. Clinton*: A Study in Politically Motivated Suits, Rule 11, and the First Amendment*, 2001 B.Y.U. L. REV. 1, 83; *see also* Carol Rice Andrews, *A Right of Access to Court Under the Petition Clause of the First Amendment: Defining the Right*, 60 OHIO ST. L.J. 557, 676 ("[E]ven a civil tort complaint against one's neighbor raises some issues of public concern. It asks for an application, and sometimes an outright change, in the law that can impact all citizens. A civil complaint, no matter how common, therefore is not the equivalent of private speech between private parties.").

104. Before the emergence of anti-SLAPP laws, it was widely accepted that cease-and-desist letters could provide the basis for tort liability. In a case predating the emergence of state anti-SLAPP legislation, the Second Circuit held that Universal City Studios tortiously interfered with Nintendo's contractual relations by sending cease-and-desist letters to Nintendo's licensees. *See* Universal City Studios, Inc. v. Nintendo Co., 797 F.2d 70, 74-75 (2d Cir. 1986).

105. Allied Tube & Conduit Corp. v. Indian Head, Inc., 486 U.S. 492, 499 (1988).

avoid the need for governmental involvement, the argument that these letters by definition represent an attempt to influence the government seems tenuous at best. Furthermore, while demand letters and other pre-litigation communications by attorneys may fall within a state's litigation privilege,[106] this does not resolve the anti-SLAPP question.

Moreover, in light of the fact that demand letters are a tool favored by big companies and are rarely sent by the proverbial "little guys," the extension of anti-SLAPP laws to cover demand letters seems a perversion of their purpose. Take the *DirecTV* cases for example: courts are favoring a private company's right to pursue its private business interests over a citizen's right to initiate litigation. While there may be policy reasons to protect demand letters, it is "anomalous and socially counterproductive" to do it on First Amendment grounds.[107]

Indeed, the argument that allowing claims based on demand letters would chill sincere efforts to settle disputes without litigation ignores the fact that a demand letter could only become the basis of a claim if the letter contained false or misleading statements. Thus, to allow claims based on erroneous demand letters would not impair the use of demand letters generally, but rather would only encourage senders "to investigate carefully [their] accusations and to be precise in the language [they] use."[108] Preciseness of language is the key here: a company could arguably make the same underlying claims in its demand letters without risking liability simply by modifying its language. DirecTV did not end up in court merely because it sent demand letters to innocent consumers, but rather because it made false and misleading statements in those demand letters. Thus, DirecTV arguably could have avoided liability by sticking to the truth.

IV. IN PURSUIT OF A HAPPY MEDIUM

Certainly, the proliferation of free, illegal copies of film, music, and software on the Internet pose a serious threat to the entertainment industry, but the industry's response to this threat must be managed in such a way as to minimize—or at least account for—its mistakes.[109] If the entertainment industry wants the freedom to vigorously enforce its intellectual

106. Rubin v. Green, 847 P.2d 1044, 1047-48 (Cal. 1993).

107. AREEDA & HOVENKAMP, *supra* note 94, at 237, § 205e.

108. DirectTV, Inc. v. Cavanaugh, 321 F. Supp. 2d 825, 842 (E.D. Mich. 2003).

109. *See* Katyal, *supra* note 19, at 367 (noting that "piracy surveillance methods are calibrated to be overbroad by design in order to deter the widest possible breadth of infringement"); S.E. Oross, *Fighting the Phantom Menace: The Motion Picture Industry's Struggle to Protect Itself Against Digital Piracy*, 2 VAND. J. ENT. L. & PRAC. 149, 158 (2000).

property rights, then it must be willing to pay a price for its vigor. In short, the industry must be willing to compromise. Considering the high margin of error associated with automated tracking systems, without proper safeguards, personal liberty will become a casualty of the war on piracy and entertainment companies will lose the public sympathy they have worked so hard to gain.

Existing legislation is insufficient. By zeroing in on individuals, the industry has changed the stakes of the game. The law must adjust to ensure the proper balance between the copyright owners' proprietary interests and the individual's speech and privacy rights. While the DMCA establishes a good faith standard for ISP take-down notices (specifically, the statute provides recourse if the copyright holder "knowingly" and "materially" misrepresents that copyright infringement has occurred),[110] these protections extend only to ISPs, leaving individual consumers out in the cold. The "good faith" standard[111] may be sufficient, but it must extend beyond ISPs to cover private individuals.

Casting a wide net may seem like a smart strategy in the short run—after all, it garnered immediate results for the recording industry. But "an overuse of heavy-handed tactics . . . will eventually backfire on the industry."[112] "Rather than using every weapon in its arsenal,"[113] the industry should focus on maintaining its legitimacy, both in the eyes of the court

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110. 17 U.S.C. § 512(f).

> "Knowingly" means that a party actually knew, should have known if it acted with reasonable care or diligence, or would have had no substantial doubt had it been acting in good faith, that it was making misrepresentations. "Material" means that the misrepresentation affected the ISP's response to a DMCA letter.

Online Policy Group v. Diebold, Inc., 337 F. Supp. 2d 1195, 1204 (N.D. 2004) (citing BLACK'S LAW DICTIONARY (8th ed. 2004)).

111. A district court has held that the DMCA permits a copyright holder to send a cease-and-desist letter to a suspected infringer without conducting an investigation to establish actual infringement. *See* Rossi v. Motion Picture Ass'n of Am., Inc., No. 02-00239BMK, 2003 U.S. Dist. LEXIS 12864, at *9 (D. Haw. Apr. 29, 2003) (construing 17 U.S.C. § 512(c)(3)(A)(v) and holding that a copyright holder must only "form a good faith belief of an alleged or 'claimed' infringement prior to sending an ISP a notice"). The court found that the MPAA had "more than a sufficient basis to form the required good faith belief that [Internetmovies.com] contained infringing content . . . . The fact that a further investigation may have revealed that movies could not actually be downloaded does not alter this conclusion." *Id.*

112. *See* Peter K. Yu, *The Copyright Divide*, 25 CARDOZO L. REV. 331, 442 (2003). *See generally* Kristina Groennings, Note, Costs and Benefits of the Recording Industry's Litigation Against Individuals, 20 BERKELEY TECH. L.J. 571 (2005)

113. *See* Peter K. Yu, *The Escalating Copyright Wars*, 32 HOFSTRA L. REV. 907, 944 (2004).

and in the eyes of consumers. Instead of denying (or attempting to explain away) its blunders,[114] the industry should own up to them.

The industry's reliance on the anti-SLAPP motion to strike is misguided: gaining absolute immunity for its cease-and-desist letters will do little to advance its war on piracy. Instead, its attempts to legitimate its tactics—calling the letters "petitions" and brandishing the First Amendment as a shield—will only weaken the message the industry is so desperately trying to get across: namely, that artists' rights are worth respecting and that the anti-piracy campaign is a battle entertainment companies are entitled to fight. Putting suspected infringers on notice that they may face penalties for piracy is one thing; making unsubstantiated allegations and demanding immediate settlement is another. Instead of trying to shield themselves from liability for erroneous demand letters, entertainment companies should simply 'fess up to their mistakes and offer to make the innocent consumer whole. If, as they insist, mistakes really are the exception and not the rule, then the cost to the industry will be negligible.

If entertainment companies want to cast wide nets, they should be willing to pay a price for over-fishing. In return for greater latitude in enforcement (which the industry arguably deserves), entertainment companies could agree to provide compensation (including costs and attorneys fees) for injuries caused by erroneous demand letters. Raising the costs of mistakes and creating greater incentives to reduce their occurrence would ensure greater protection for fair use and First Amendment interests.[115]

Another solution would be to encourage entertainment companies to practice self-regulation. Since the type of language used in demand letters often determines whether a recipient will feel compelled to sue, companies could decrease the risk of retaliatory litigation merely by using "softer" language.[116] This type of self-regulation could go a long way in preserving

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114. *See* John Schwartz, *She Says She's No Music Pirate. No Snoop Fan, Either*, N.Y. TIMES, Sept. 25, 2003, at C1.

115. *See* Katyal, *supra* note 19, at 379 (proposing that "by raising standards of proof for copyright infringement as well as the cost of mistaken detections, courts and legislators can aim to strike a much-needed balance between property, speech, and privacy").

116. In rephrasing their correspondence, entertainment companies should also take into account the possibility that even if the recipients have committed piracy, they may be young or uneducated about copyright law. *See* Cecilia Ogbu, Note, *I Put Up a Website About My Favorite Show and All I Got Was This Lousy Cease-and-Desist Letter: The Intersection of Fansites, Internet Culture, and Copyright Owners*, 12 S. CAL. INTERDISC. L.J. 279, 316 (2003).

the industry's public image, which is vital to the success of its campaign.[117]

V. CONCLUSION

To allow entertainment companies to use anti-SLAPP laws to further their private business interests, where the only thing at stake is their ability to send unsubstantiated demand letters, seems a perversion of purpose of the laws. Laws designed to protect the "little guy"—specifically, to safeguard his right to stand up to the big guy whose resources far outnumber his—are being used by the big guy to ensure the opposite result. Courts may allow entertainment companies to avail of anti-SLAPP immunity, but from the public's perspective, the industry's tactics are another example of corporate domination. Consumers are already wary of media conglomerates. Imagine the public backlash when another unassuming grandmother or scrupulous professor ends up on a target list. It will not matter to the public that the industry has gotten it right 99% of the time; it is that one percent—the ones they got wrong—that will convict the industry in the court of public opinion. Because public support is so critical to the war on piracy, an unapologetic attack is bound to backfire. Thus, instead of defending its right to get it wrong sometimes, the entertainment industry should simply own up to its mistakes and work harder to get it right.

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117. Perhaps the tide is already beginning to change. After discussions with the Electronic Frontier Foundation (EFF) and the Center for Internet and Society (CIS) Cyberlaw Clinic, DirecTV has agreed to modify its nationwide campaign against signal piracy in order to reduce threats and lawsuits against innocent users of smart card technology. Specifically, the company has promised to no longer sue or threaten to sue people merely for possessing smart card devices. *See* Press Release, Electronic Frontier Foundation, DirecTV to Narrow Anti-Piracy Campaign: Satellite TV Giant Will No Longer Prosecute Users for Mere Possession (June 14, 2004), *available at* http://www.eff.org/news/archives/2004_06.php#001615.

BONNEVILLE INTERNATIONAL CORP. V. PETERS: CONSIDERING COPYRIGHT RULES TO FACILITATE LICENSING FOR WEBCASTING

By Tomomi Harkey

Among the many questions about the legal landscape for webcasting, *Bonneville International Corp. v. Peters*[1] clarifies how copyright law applies to the "listen live" function on your favorite AM or FM radio station's website. On October 17, 2003, the Third Circuit held that such "AM/FM webcasts"[2] must pay a public performance royalty to owners of sound recordings, thus narrowly defining the digital public performance right exemption for a "nonsubscription broadcast transmission" codified at 17 U.S.C. § 114(d)(1)(A). This decision is prudent for webcasting because it denies terrestrial radio stations a royalty exemption that would provide them with an unfair competitive advantage over web-only stations. Furthermore, AM/FM webcasting is already recovering from the deadly blow that *Bonneville* was predicted to be,[3] showing that fair competition can promote healthy markets online as elsewhere.

Positive though it may be, the *Bonneville* decision sorts out only one small strand within the intricate web of rules and exemptions that Congress has woven to create the limited rights available for sound recordings.[4] The complex statutory compulsory licensing scheme that currently administers the digital public performance right seems out of sync with facilitating the exchange of licenses—presumably its purpose. Thus, as some copyright rules for webcasting become clearer, the system overall remains too byzantine to allow the online broadcasting industry to stabilize.

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1. 347 F.3d 485 (3d Cir. 2003) [hereinafter *Bonneville II*].

2. This Note uses "AM/FM webcast" in accordance with *Bonneville* to refer to simultaneous streaming over the Internet of a traditional AM/FM broadcast by established radio broadcasters. *Id.* at 489. See *infra* Part I.A for descriptions of other forms of webcasting.

3. *See, e.g.*, Azine Farzami, Bonneville v. Register of Copyrights*: Broadcasters' Upstream Battle Over Streaming Rights*, 1 COMMLAW CONSPECTUS 203, 215 (2003) (predicting that royalty requirements imposed by the *Bonneville* decision would be detrimental, and possibly crippling, to AM/FM webcasting); Raffi Zerounian, Note, Bonneville Int'l v. Peters, 17 BERKELEY TECH. L.J. 47, 64 (2002) (same).

4. See *infra* Part II for a discussion of the evolution of limited rights in sound recordings.

This Note examines the implications of *Bonneville*, both for AM/FM webcasting directly and as an indicator of the progress of the online broadcast industry. Part I describes the webcasting industry, including its structure, economic dynamics, and licensing arrangements. Part II outlines the evolution of the digital performance right in sound recordings under the Copyright Act. Part III discusses the holding in *Bonneville*. Finally, Part IV discusses the practical effects of *Bonneville* and concludes that though *Bonneville* was decided correctly for both legal and policy bases, the current compulsory licensing system must be simplified in practice, or replaced by a private system of exchange, to avoid hindering the growth of a healthy market for online music transmission.

I. INDUSTRY AND ECONOMIC BACKGROUND

Webcasting is a relatively new sector of the music industry that presents a special challenge to music licensing practices as they pertain to online transmission. Key differences between traditional broadcasts and digital broadcasts online have called into question the best legal scheme to support the development of the webcasting industry, while also fairly compensating copyright owners for this new type of transmission of their creative works.

A. A Webcasting Primer

The general term "webcasting" encompasses three distinct types of transmission, none of which apply to traditional radio broadcasts. Although categorical titles differ by author, they can be described as: (1) AM/FM radio webcasting; (2) Internet webcasting; and (3) personalized Internet webcasting.[5] AM/FM radio webcasting refers to an online simulcast of a local AM or FM radio station's broadcast, usually via a link on the station's website.[6] In this case, the listener has no ability to control or manipulate the broadcast music. Internet webcasting likewise offers the listener no control over music, but has neither a terrestrial source nor radio wave transmission; it exists solely online.[7] AM/FM radio broadcasts that are not simultaneous with their terrestrial transmission, often by third-party broadcasters, also fall within the Internet webcasting category. Finally, personalized Internet webcasting refers to interactive or subscription sites that provide on-demand Internet radio, often described as the "Celes-

5. Zerounian, *supra* note 3, at 53-54.

6. *Id.*

7. *Id.* For example, see Winamp Radio for a list including many Internet-only radio stations at Nullsoft, *Nullsoft Winamp*, *at* http://www.shoutcast.com/waradio.phtml (last visited Feb. 25, 2005).

tial Jukebox."[8] Some of these sites provide multiple services, including both the ability to program your own webcast radio station and buy songs by digital download.[9] In the context of this Note, personalized Internet webcasting refers to services for on-demand Internet streaming, or *performances*, and not on-demand *purchase* of downloadable songs. *Bonneville*, and the legal rule it implements, deals specifically with the first category: AM/FM webcasting, or the online simulcast of a terrestrial transmission.

B. Deciding the Nature of a Legal Entitlement and Its Licensing Framework—Property or Liability?

Along with the creation of a new "entitlement," such as the digital public performance right for sound recordings, Congress must also determine the nature of administering such a right. To discuss the impact of the current legal framework for administering the digital public performance right, this Note borrows tools from law and economics models. Applying Calabresi and Melamed's legal entitlements theory to the digital performance right for sound recordings, Congress had a choice of two general methods with which to enforce the right: "property rules" or "liability rules."[10] This model defines a "property rule" as an absolute right assigned to a certain party.[11] Property rules are akin to the standard concept of private property: no one can take the entitlement from its owner unless the owner sells it willingly for an acceptable subjective price.[12] Liability rules, on the other hand, allow others to use an entitlement so long as they pay a standard objective price to the owner.[13] Prices in such "use now, pay later" systems are often determined and administered by an external third party, such as a court or government agency, to facilitate transfer.[14] For example, compulsory licensing systems embody the characteristics of a liability rule.

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8. *See* PAUL GOLDSTEIN, COPYRIGHT'S HIGHWAY: FROM GUTENBERG TO THE CELESTIAL JUKEBOX 199 (1995) (describing future interactive technology as "a technology-packed satellite orbiting thousands of miles above Earth, awaiting a subscriber's order—like a nickel in the old jukebox, and the punch of a button—to connect him to any number of selections from a vast storehouse via a home or officer receiver . . . ").

9. For example, see Rhapsody, *at* http://www.listen.com (last visited Feb. 28, 2005).

10. *See* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1092 (1972).

11. *Id.* at 1105.

12. *Id.*

13. *Id.* at 1105-06.

14. *See id.*

In addition to providing a definitional framework, this model helps determine which type of rule—liability or property—should be implemented for a given entitlement. Determining which rule would foster efficiency and facilitate exchange, two main goals for a new entitlement framework, is not an exact science.[15] In fact, scholars disagree as to when to prescribe a liability rule over a property rule.[16] In the case of the digital performance right for sound recordings, Congress chose to implement a statutory compulsory licensing system—or liability rule.[17] This differs from the property based system that traditional radio wave broadcasters were provided, which eventually spurred the creation of a private Collective Rights Organization (CRO) for managing royalty payments to composers and songwriters, which is described in further detail below.[18]

C. Economic Characteristics of the Market for Online Broadcasting

Although webcasting and radio wave broadcasting share certain market characteristics, they also exhibit significant differences that are important when considering how the law should impose royalties upon online music transmission. Both the Third Circuit in *Bonneville* and Congress in legislating the digital performance right for sound recordings have given great weight to preserving the traditional radio market, tending to blur the

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15. *Id.* at 1093. Efficiency considerations include administration and enforcement costs, as well as maximizing social utility. *Id.* at 1093-94. Other considerations in the Calabresi and Melamed framework include distributional goals and "other justice reasons"; however, this Note focuses on efficiency analysis. *Id.* at 1098-105.

16. Calabresi and Melamed prescribe liability rules to overcome high transactions costs that hinder private exchange. *Id.* at 1119. *See generally* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 91-95 (4th ed. 2003) (discussing different types of transactions costs such as search, bargaining, and enforcement costs). This comports with the Normative Coase Theorem, which states that the law should be structured so as to remove impediments to private agreements and to maximize the surplus that is gained from the voluntary exchange of property rights. COOTER & ULEN, *supra*, at 97. Professor Robert Merges argues that other circumstances, such as long-run relationships, can overcome barriers to bargaining without incurring the risks of liability rules, such as inflexibility and error in pricing. Robert P. Merges, *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, 84 CALIF. L. REV. 1293, 1303-09 (1996). *But see* Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasian Trades*, 104 YALE L.J. 1027, 1033 (1995) (arguing that liability rules can also encourage private bargaining).

17. *See* 17 U.S.C. § 114(d)-(f) (2000).

18. *See* Bernard Korman & I. Fred Koenigsberg, *Performing Rights in Music and Performing Rights Societies*, 33 J. COPYRIGHT SOC'Y 332, 350 (1986) (describing the creation and function of Collective Rights Organizations (CRO)).

lines between traditional and web radio;[19] however, the distinct character of the online music industry should not be obscured.

One similarity between online and radio wave broadcasting is the sheer number of musical authors, works, and patrons involved. This wide scope of the broadcast industry provides for two related market characteristics: 1) high transaction costs for individual negotiations—in this case, sound recording performance licenses;[20] and 2) a natural economy of scale.[21] Economies of scale are generally advantageous for producers, in this case broadcasters, because they reduce incremental costs, but scale economies also require greater coordination of inputs such as required licenses to begin business; this can be a difficult hurdle to overcome when many aspiring broadcasters are competing for the same territory.[22] Even when coordination is reached, privately or through government regulation by bodies such as the Federal Communications Commission (FCC),[23] scale economies also erect high barriers into the industry and tend to reduce competition.[24] Such barriers to entry have rendered the traditional industry, especially traditional radio broadcast, one in which a small number of large organizations dominate the field.[25]

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19. *See Bonneville II*, 347 F.3d 485, 488 (3d Cir. 2003) (discussing mainly Congress's concern with the traditional relationship between broadcasters and the recording industry).

20. *See* COOTER & ULEN, *supra* note 16, at 94 (explaining that transactions costs are high when numerous parties are involved in negotiation).

21. An economy of scale is defined as "a condition of production in which the greater the level of output, the lower the average cost of production." *Id.* at 35 (discussing also the relationship between economies of scale and monopolistic markets).

22. *See* Clayton P. Gillette & Thomas D. Hopkins, *Federal User Fees: A Legal and Economic Analysis*, 67 B.U. L. REV. 795, 810, 830 (1987) (discussing the use of government regulation where scale economies and the tragedy of the commons prevent coordination).

23. In radio wave broadcasting, the Federal Communications Commission (FCC) is the government body that regulates entry into the industry by providing an effective monopoly within a geographical area to prevent overcrowding. *See generally*, About Us, Fed. Communications Comm'n, *available at* http://www.fcc.gov/aboutus.html (last updated Sept. 14, 2004).

24. *See* PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 5 (2002); Gillette & Hopkins, *supra* note 22, at 830. A barrier to entry is "any factor that permits firms already in the market to earn returns above the competitive level while deterring outsiders from entering." AREEDA & HOVENKAMP, *supra*, at 57-58.

25. Joseph P. Kendrick, Comment, *Does Sound Travel in Cyberspace?*, 8 J. SMALL & EMERGING BUS. L. 39, 41 (2004) (describing traditional radio broadcasting as nearing oligopoly). There has been some evidence that the consolidation of commercial radio, caused by the deregulation in the Telecommunications Act of 1996, has negatively af-

Although some market characteristics—high transaction costs and economies of scale—are similar for webcasters and terrestrial radio, the landscape of online broadcasting thus far has been significantly different because it has supported many smaller webcasters. Because webcasting does not require an FCC license, and in the past did not require sound recording licenses, the cost of webcasting on the Internet has been relatively low.[26] And though this flourishing landscape of small webcasters in a large, noncompetitive territory is often touted as the advantage of web radio,[27] it is not a static characteristic inherent in online broadcasting. As operational costs increase with inputs, such as the newly required sound recording performance licenses, coordination becomes increasingly difficult, transaction costs increase, and scale economies begin to favor larger organizations.[28]

Such costs may be especially debilitating for web radio because it lacks a critical private institution that the radio wave market uses to systemize and manage the large volume of copyright licenses—a CRO. The three CROs in the United States are the American Society of Composers, Authors, and Publishers (ASCAP), Broadcast Music, Inc. (BMI), and SESAC, Inc.[29] CROs assemble large numbers of intellectual property owners and use their expertise in the industry to set standard bulk rate licenses through extensive negotiations.[30] These blanket licenses generally

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fected consumers. Future of Music Coalition, *Commercial Radio Station Ownership Consolidation Shown to Harm Artists and the Public* (Nov. 18, 2002), *at* http://www.futureofmusic.org/news/prradiostudy.cfm.

26. *See* Eleanor Lackman, *The Silenced Minority: When the RIAA Charges College Radio for Online Broadcasts, Will the Public End Up Paying?*, 21 CARDOZO ARTS & ENT. L.J. 413 (2003) (illustrating the viability of webcasting for small college radio stations).

27. *See, e.g.*, Joseph E. Magri, *New Media–New Rules: The Digital Performance Right and Streaming Music Over the Internet*, 6 VAND. J. ENT. L. & PRAC. 55, 55 (2003) (describing the potential for choice and variation provided to the consumer by Internet radio).

28. *See* Lackman, *supra* note 26, at 416-18, 420-21 (arguing that higher costs, which were subsequently lowered, would prevent college radio stations from simulcasting online).

29. Korman & Koenigsberg, *supra* note 18. SESAC, originally an acronym for Society of European Stage Authors and Composers, is now simply referred to as SESAC. *See* Darcie-Nicole Wicknick, *Performance Rights Societies: ASCAP or BMI?*, MUSICBIZADVICE.COM, Nov. 19, 2004, *previously at* http://www.musicbizadvice.com/feature_home.htm (copy on file with author).

30. *See generally* PAULA SCHEPENS, UNITED NATIONS EDUC., SCIENTIFIC & CULTURAL ORG. (UNESCO), GUIDE TO THE COLLECTIVE ADMINISTRATION OF AUTHOR'S RIGHTS (2000) (explaining the role and functioning of CROs as an aid for developing

give a music user unlimited access to a CRO's licensed repertoire for a contractual period of time, in exchange for a fee based on the type of music user.[31] In practice, a CRO works similarly to a compulsory licensing system, or liability rule, but the crucial difference is that the association's members, and not a third party, set the price menu for blanket licenses.[32] Rates are also adjusted frequently through administrative procedures within the CRO.[33] Because the collective price-setting mechanisms of CROs make them prone to conflict with antitrust laws, many CROs operate under consent decrees.[34]

As private organizations, CROs require a certain amount of energy and market need to develop. The impetus for the first CRO in the United States, ASCAP, came from Italian composer Puccini, who mentioned the importance of Italian performing rights societies to his American publisher.[35] His publisher then promoted the idea to colleagues, and in October 1913, eight writers, a publisher, and a lawyer met in New York City and agreed to form ASCAP.[36] It took ASCAP seven years after creation before revenues exceeded expenses and royalties could be distributed to members.[37]

Radio wave and web broadcasts also create a similar product, which requires the same inputs—songs and performance licenses. For both forms of broadcasting, this product is a joint product, or one that involves re-

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nations), *available at* http://portal.unesco.org/culture/en/ev.php-URL_ID=7784&URL_DO=DO_TOPIC&URL_SECTION=201.html.

31. For example, the radio broadcast industry pays a higher rate for licensing musical compositions than a restaurant because it is categorically a more intensive music user. Barry M. Massarsky, *The Operating Dynamics Behind ASCAP, BMI and SESAC, The U.S. Performing Rights Societies*, *available at* http://www.cni.org/docs/ima.ip-works hops/Massarsky.html (last visited Nov. 19, 2004).

32. Merges, *supra* note 16, at 1328.

33. *Id.*

34. ASCAP operates under a consent decree which requires: (1) non-exclusive rights; (2) nondiscrimination for users; and (3) guaranteed licensing for all users. United States v. ASCAP, 1950-1951 Trade Cas. (CCH) ¶ 62,595 (S.D.N.Y. 1950), *amending* United States v. ASCAP, 1940-1943 Trade Cas. (CCH) ¶ 56,104 (S.D.N.Y. 1941). BMI also operates under a consent decree. United States v. BMI, 1966 Trade Cas. (CCH) ¶ 71,941 (S.D.N.Y. 1966). And, more recently, European CROs are preparing to defend themselves against antitrust claims. Paul Meller, *Europe to Consider Complaints About Online Music Royalties*, NYTIMES.COM, Nov. 15, 2004, *at* http://www.nytimes.com /2004/11/15/technology/16musiccnd.html?oref=login&oref=login.

35. Korman & Koenigsberg, *supra* note 18. This is not surprising because established CROs existed in other countries before the founding of ASCAP. *See id.*

36. *Id.*

37. *Id.*

source interdependence.[38] The music, or joint product, that a consumer receives necessarily requires resources from both the broadcaster and the recording industry. This provides a high incentive for these parties to cooperate with each other.[39] Coupled with the relatively small number of key players in the industry, long-run relationships between these parties play an important role.[40] However, these parties can differ between terrestrial radio wave broadcasters and web broadcasters. One of the key players for terrestrial radio wave broadcasts has been the advertisers, who have provided much of the funding that sustains the terrestrial wave broadcasts' free nonsubscription format.[41] This option is available for some webcasters, but the differences in broadcasting have left Internet advertising for broadcasting an underdeveloped model.[42] This illustrates that these industries may be similar, but the dynamics and relationships involved are not the same.

The divide between digital and analog broadcasts has traditionally been based in the nature of the product—including its large geographic scope and the consumer's ability to make infinite, perfect copies of digital music.[43] This divide may be shrinking as multinational radio conglomerations such as Clear Channel increase their geographic scope, and digital rights management technologies make digital products more difficult to reproduce.[44] Still, other market differences described above should be

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38. *See generally* Terje Gaustad, *Joint Product Analysis in the Media and Entertainment Industries: Joint Value Creation in the Norwegian Film Sector*, *in* MEDIA FIRMS: STRUCTURES, OPERATIONS, AND PERFORMANCE 11, 21-22 (Robert G. Picard ed., 2002) (describing joint products in music); Jonathan David Tankel & Wenmout Williams, Jr., *Resource Interdependence: Radio Economics and the Shift from AM to FM*, *in* MEDIA ECONOMICS: THEORY AND PRACTICE 157 (Alison Alexander et. al eds., 1993) (describing resource interdependence as a model for the radio wave broadcast industry).

39. *See* Gaustad, *supra* note 38, at 12 (describing cooperation among the motion picture industry).

40. *See generally* COOTER & ULEN, *supra* note 16, at 225-35 (describing long-run relationships).

41. *See* Thomas H. White, UNITED STATES EARLY RADIO HISTORY, *Financing Radio Broadcasting (1898-1927)*, *at* http://earlyradiohistory.us/sec020.htm (last visited Feb. 28, 2005) (explaining how "advertising-supported private stations became the standard for U.S. broadcasting stations").

42. *See* Magri, *supra* note 27 (discussing the potential for advertising to fund Internet music); *see also* Lackman, *supra* note 26, at 416 (explaining that soliciting advertising is not a viable option for college radio stations and their webcasts).

43. *See* Peter S. Menell, *Can Our Current Conception of Copyright Law Survive the Internet Age?: Envisioning Copyright Law's Digital Future*, 46 N.Y.L. SCH. L. REV. 63, 103-29 (2002/2003) (discussing the shift from analog to digital technology).

44. *See generally* Adam J. van Alstyne, *Clear Control: An Antitrust Analysis of Clear Channel's Radio and Concert Empire*, 88 MINN. L. REV. 627 (2004); *Digital Rights*

considered when developing a system of exchange and enforcement for a new copyright entitlement, such as the digital performance right for sound recordings.

II. LEGAL BACKGROUND: EVOLUTION OF THE DIGITAL PERFORMANCE RIGHT FOR SOUND RECORDINGS AND ITS EXEMPTIONS

The digital performance right for sound recordings is relatively new, established only in 1995. Today's version of the right developed gradually as Congress successively added many intricate amendments to the Copyright Act. This Part delineates the history of this right and illustrates how it has become so complex.

A. The Beginning of Sound Recordings and Their Limited Rights

In 1908, the U.S. Supreme Court first recognized the category of "sound recordings" as distinct from musical compositions when considering questions of copyright protection.[45] This recognition, however, was followed by a long period where Congress resisted extending any rights to sound recording owners, a gap in the copyright scheme so striking that Professor David Nimmer described it as "historical anomaly."[46] It took over sixty years and the threat of record piracy before Congress finally gave federal copyright protection to sound recordings in the Sound Recording Act of 1971.[47]

The Sound Recording Act established only limited protection because it lacked a public performance right.[48] In 1971, copyright owners for other creative works enjoyed the exclusive right to public performance or dis-

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Management, WIKIPEDIA: THE FREE ENCYCLOPEDIA, *at* http://en.wikipedia.org/wiki/Digital_rights_management (last modified Feb. 8, 2005).

45. White-Smith Music Publ'g Co. v. Apollo Co., 209 U.S. 1 (1908) (holding that the perforated rolls used to make the sounds of a musical work in a mechanical piano are separate from the underlying musical work). Today, sound recordings are defined as:

> works that result from the fixation of a series of musical, spoken, or other sounds, but not including the sounds accompanying a motion picture or other audiovisual work, regardless of the nature of the material objects, such as disks, tapes, or other phonorecords, in which they are embodied.

17 U.S.C. § 101 (2000).

46. *See* David Nimmer, *Ignoring the Public, Part I: On the Absurd Complexity of the Digital Audio Transmission Right*, 7 UCLA ENT. L. REV. 189 (2000).

47. *See* Pub. L. No. 92-140, 85 Stat. 391 (1971).

48. *See id.*

play.[49] But Congress opted not to include this right in the Sound Recording Act because it considered a public performance right unnecessary to accomplish the Act's purpose of protecting against record piracy.[50] The limited scope of the Sound Recording Act was partly due to intense lobbying from the radio broadcast industry, which preferred to continue broadcasting performances of sound recordings without paying a royalty.[51]

When Congress amended the Copyright Act again in 1976, the recording industry and the Copyright Office advocated adding a public performance right for sound recordings.[52] Although the 1976 Act amended the public performance right generally, Congress still refused to extend that right to sound recordings and retained the same provisions as in the 1971 Act.[53] So the Copyright Act remained without a public performance right for sound recordings until 1995.

B. The Digital Performance Right in Sound Recordings Act

The Digital Performance Right in Sound Recordings Act ("DPSRA") first introduced a narrow public performance right for sound recordings in 1995.[54] Responding to the new threat of piracy from the digital revolution of the 1990s, this amendment to the Copyright Act granted copyright protection to public performances by certain *digital* audio transmissions, and thus created a new source of royalties for the recording industry.[55] However, concerned with maintaining the existing relationship between traditional radio broadcasters and the recording industry, Congress included three exemptions to the performance right in the DPSRA for direct transmissions:

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49. *See generally* ROBERT P. MERGES ET AL., INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 438-42 (3d ed. 2003) (discussing public performance and display rights, which have also morphed as the Copyright Act was amended).

50. H.R. Rep. No. 104-274, at 11 (1995) (explaining that sound recordings "were not granted the right of public performance . . . on the presumption that the granted rights would suffice to protect against record piracy"); *see also* Pub. L. No. 92-140, 85 Stat. 391 (1971) (expressing the purpose of the amendment as "protecting against unauthorized duplication and piracy of sound recording . . .").

51. Zerounian, *supra* note 3, at 49.

52. *See* Rebecca F. Martin, *The Digital Performance Right in the Sound Recordings Act of 1995: Can It Protect U.S. Sound Recording Copyright Owners in a Global Market?*, 14 CARDOZO ARTS & ENT. L.J. 733, 737-39 (1996).

53. *Id.*

54. Pub. L. No. 104-39, 109 Stat. 336 (1995). The Act added a subsection to 17 U.S.C. § 106 that gives copyright owners the right, "in the case of sound recordings, to perform [or authorize] the copyrighted work publicly by means of a digital audio transmission." *Id.*

55. *See* H.R. Rep. No. 104-274, at 12-13.

i) a nonsubscription transmission other than a retransmission,
ii) an initial nonsubscription retransmission made for direct reception by members of the public of a prior or simultaneous incidental transmission that is not made for direct reception by members of the public; or
iii) a nonsubscription broadcast transmission.[56]

The purpose of these technical exemptions, whose application confused many, was to avoid imposing new burdens on established broadcasters that lawmakers reasoned "often promote, and appear to pose no threat to, the distribution of sound recordings."[57] Instead, Congress intended the DPSRA to target the threat posed by new Internet broadcasters, especially interactive services, where end users could potentially obtain perfect copies of any song.[58] This legislation was a "perfect idea" as far as politics was concerned: established key players such as the broadcasters, recording industry, and collective rights organizations were content that the status quo was maintained, while new copyright protections brought added revenue to the recording industry from new Internet companies that wielded little political power at the time.[59]

C. Amending the Digital Performance Right: The Digital Millennium Copyright Act

In 1998, Congress passed the Digital Millennium Copyright Act (DMCA) to further confront digital piracy.[60] The DMCA modified the new digital public performance right for sound recordings by eliminating the first two of the three DPSRA exemptions for direct transmissions described above, leaving intact only the exemption for "a nonsubscription broadcast transmission."[61] Congress intended these deletions to simplify the exemption to the digital performance right, in an effort to clarify any confusion with application of the DPSRA. Congress explained that the

56. 17 U.S.C. § 114(d)(1)(A) (2000). Other exemptions for retransmissions, not quoted here, are also created by the DPSRA. *Id.* § 114(d)(1)(B).

57. H.R. Rep. No. 104-274, at 14.

58. *Id.*

59. Kimberly L. Craft, *The Webcasting Music Revolution Is Ready to Begin, as Soon as We Figure Out the Copyright Law: The Story of the Music Industry at War with Itself*, 12 HASTINGS COMM. & ENT. L.J. 1, 11 (2001).

60. Pub. L. No. 105-304, 112 Stat. 2860 (1998) (codified as amended in scattered sections of 17 U.S.C.); *see also* H.R. Rep. No. 105-796, at 79-80 (1998), *reprinted in* 1998 U.S.C.C.A.N. 639, 655-56 (explaining the purpose and scope of the DMCA's changes to 17 U.S.C. § 114).

61. Pub. L. No. 105-304, § 405, 112 Stat. at 2890 (1998) (codified at 17 U.S.C. § 114).

deletion eliminated exemptions that "were either the cause of confusion as to the application of the DPSRA to certain nonsubscription services (especially webcasters) or which overlapped with the other exemptions (such as the exemption in subsection (A)(iii) for nonsubscription broadcast transmissions)."[62] It also emphasized that this change was not intended to affect the remaining exemption for "nonsubscription broadcast transmissions."[63]

Despite Congress's effort to improve the law's clarity with its amendments, many parties remained unhappy or unclear as to their obligations. Specifically, small webcasters voiced concern with the proceedings for determining statutory licenses, which led to further legislation such as the Small Webcaster Settlement Act of 2002[64] and the Copyright Royalty and Distribution Reform Act of 2004.[65] At the same time, the recording industry and established radio broadcasters disagreed on the interpretation of the one remaining exemption to the digital performance right for sound recordings as it applied to AM/FM webcasts. The recording industry demanded royalties while the broadcasters maintained that they were exempt. This dispute led to *Bonneville.*

III. *BONNEVILLE INT'L CORP. V. PETERS*

A. Facts and Procedural History

The *Bonneville* case arose from a challenge to a rulemaking on the digital sound recording performance right by the Copyright Office.[66] In March of 2000, the Recording Industry Association of America (RIAA) petitioned the Copyright Office to clarify whether AM/FM webcasting was exempt from paying a digital audio performance royalty.[67] This inquiry turned on whether AM/FM webcasting qualified as a "nonsubscription broadcast transmission," the remaining exemption to the right codified at § 114(d)(1)(A).[68] In response to this request, the Copyright Office published a Proposed Rulemaking for comment.[69] In December of 2000,

62. H.R. Rep. No. 105-796, at 80 (1998), *reprinted in* 1998 U.S.C.C.A.N. 639, 656.

63. *Id.*

64. Pub. L. No. 107-321, 116 Stat. 2780 (2002) (codified at 17 U.S.C. § 114(f)(5)); *see also* David Nimmer, *Codifying Copyright Comprehensively*, 51 UCLA L. REV. 1233, 1339-43 (2004) (discussing the Small Webcaster Settlement Act of 2002).

65. Pub. L. No. 108-419, 118 Stat. 2341 (2004) (to be codified at 17 U.S.C.).

66. For a discussion of the implications of the Copyright Office as a rulemaking authority, see Zerounian, *supra* note 3.

67. *Bonneville II*, 347 F.3d 485, 489-90 (3d Cir. 2003).

68. *Id.*

69. *See* Public Performance of Sound Recordings: Definition of a Service, 65 Fed. Reg. 14,227 (Mar. 16, 2000). Commentators included many broadcasters, collective

the Copyright Office promulgated a finalized rule establishing that AM/FM webcasting was not exempt from paying public performance royalties.[70] This prompted the plaintiffs, the National Association of Broadcasters (NAB) and some of its members (collectively "Broadcasters"), to seek judicial review of the Copyright Office's decision.[71] The RIAA, also interested in this litigation, joined the case as an intervenor-defendant.[72]

The district court held that the Copyright Office's rulemaking was due judicial deference and accordingly upheld it.[73] The court assessed the scope of the exemption in § 114(d)(1)(A) and found it, at best, ambiguous.[74] This authorized the Copyright Office to reasonably interpret the exemption in its capacity as administrator of the statutory licensing scheme.[75] The court also concluded that the Copyright Office's interpretation of § 114(d)(1)(A) was reasonable.[76] Thus, the district court upheld the Copyright Office's rule and granted summary judgment to the defendants.[77] The broadcasters subsequently filed an appeal.

B. The Third Circuit's Analysis

The Third Circuit affirmed the district court's decision.[78] It declined to determine whether the district court used the correct standard for deference, and it held instead that the Copyright Office's interpretation of § 114(d)(1)(A) was correct regardless of the level of deference the court

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rights organizations, the RIAA, DiMA, and others. Public Performance of Sound Recordings: Definition of a Service, 65 Fed. Reg. 77,292 (Dec. 11, 2000).

70. *Bonneville II*, 347 F.3d at 490.

71. *Id.* The National Association of Broadcasters (NAB) originally asked the Copyright Office to suspend its rulemaking as the NAB sought declaratory judgment from a federal district court of New York that AM/FM webcasting was exempt from public performance royalties. Bonneville Int'l Corp. v. Peters, 153 F. Supp. 2d 763, 770 (2001) [hereinafter *Bonneville I*]. That suit was dismissed and the Copyright Office did not suspend its proceedings. *Bonneville II*, 347 F.3d at 490.

72. *Bonneville II*, 347 F.3d at 490.

73. *Bonneville I*, 153 F. Supp. 2d at 773. The court based its analysis on the two-pronged *Chevron* test for determining whether an agency action warrants judicial deference. This test first directs a court to determine whether Congress's unambiguously expressed its intent in regard to the issue before it. If, however, Congress's intent was silent or ambiguous, the court must determine whether the agency's interpretation was reasonable. *Id.* (citing Chevron, U.S.A., Inc. v. Nat'l Res. Def. Council Inc., 467 U.S. 837, 842-45 (1984)).

74. *Id.* at 779.

75. *See id.*

76. *See id.*

77. *Id.* at 784-85.

78. *Bonneville II*, 347 F.3d 485, 486 (3d Cir. 2003).

accorded.[79] The court came to this conclusion through statutory interpretation that included analyzing the plain meaning of the exemption in § 114(d)(1)(A), the meaning of that exemption in light of other portions of § 114, and the legislative history of the exemption.

1. *Plain Meaning of § 114(d)(1)(A)*

The Third Circuit defined the necessary factors for exempting a webcaster from the performance right by parsing the terms of § 114(d)(1)(A).[80] It determined that AM/FM webcasting would be exempt from the digital audio performance copyright if it was: (1) noninteractive, (2) nonsubscription, and (3) broadcast.[81] Because both parties agreed that AM/FM webcasting is not interactive or subscription, the crux of the dispute became whether AM/FM webcasting is a "broadcast transmission."[82]

The court defined "broadcast transmission" by looking to its definition in 17 U.S.C. § 114(j)(3): "a transmission made by a terrestrial broadcast station licensed as such by the Federal Communications Commission."[83] Its application of this definition focused on whether "broadcast station" refers to the broadcasting entity as a whole or a discrete, physical broadcasting facility.[84] If "broadcast station" referred to the entity, as the broadcasters argued, then established radio stations would be exempt from the digital public performance royalty by their very nature.

Agreeing instead with the Copyright Office, the Third Circuit held that a "broadcast station" refers to a physical broadcasting facility.[85] It found that a "terrestrial" station more plausibly refers to an earthbound facility, distinguished from satellites—and not an earthbound business or entity.[86] The broadcasters countered by arguing that physical buildings are not "licensed as such by the [FCC]," but the court disagreed, finding only a "superficial appeal" in this argument.[87] Finally, the court noted that using

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79. *Id.* at 490. The Third Circuit considered standards of deference given by *Chevron*, 467 U.S. at 837, and *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). *Bonneville II*, 347 F.3d at 486.

80. Section 114(d)(1) states, "The performance of a sound recording publicly by means of a digital audio transmission, *other than as a part of an interactive service*, is not an infringement of section 106(6) if the performance is part of—(A) a *nonsubscription broadcast* transmission." 17 U.S.C. § 114(d)(1) (2000) (emphasis added).

81. *Bonneville II*, 347 F.3d at 491.

82. *Id.* at 491-92.

83. *Id.* at 492.

84. *Id.*

85. *Id.* at 495.

86. *Id.* at 493.

87. *Id.* at 494.

"broadcast station" to refer to the broadcasting entity would make the exemption overly broad, allowing any radio station with at least one FCC-licensed station to have "carte blanche to digitally perform recordings via any conceivable transmission medium."[88]

2. *Interpreting § 114(d)(1)(A) in Light of Other Portions of § 114*

Next, the court considered other portions of § 114 to assess which interpretation of § 114(d)(1)(A) provided harmony within the statute. Specifically, the court considered § 114(d)(1)(B), which exempts certain retransmissions from the digital audio performance right.[89] This exemption refers to retransmission by "a terrestrial broadcast station, terrestrial translator, or terrestrial repeater licensed by the [FCC]."[90] This bolstered the court's ruling that "broadcast station" referred to the physical station because § 114(d)(1)(B) listed "broadcast station" with other physical facilities (translators and repeaters).[91] Further, § 114(d)(1)(B) used "licensed by the [FCC]" to modify those other physical facilities, diminishing the argument that a physical facility cannot be "licensed."[92]

Section 114(d)(1)(B) also limits the exemption for retransmission of a nonsubscription broadcast to a radius of 150 miles. The Third Circuit agreed with the district court's analysis, stating that it would make little sense "to exempt AM/FM webcasting, which is global in nature, while simultaneously limiting retransmission to a 150-mile radius."[93] Thus, the court held that the more harmonious reading of § 114 is to not exempt AM/FM webcasting from the digital audio performance right.

3. *Legislative History of § 114*

Finally, the court looked to the legislative history of the DPSRA and DMCA to complete its statutory interpretation of § 114(d)(1)(A). The court noted that Congress, in knowing opposition to the comprehensive performance right preferred by the Copyright Office, intended to create "*a carefully crafted and narrow performance right*, applicable only to *certain* digital transmissions of sound recordings."[94] The court reasoned that Congress's purpose for this narrow exemption was to avoid "new and unrea-

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88. *Id.* at 493.
89. *Id.* at 495.
90. 17 U.S.C. § 114(d)(1)(B) (2000).
91. *Bonneville II*, 347 F.3d at 495-96.
92. *Id.* at 496.
93. *Id.*
94. *Id.* at 497 (citing S. Rep. No. 104-128, at 13 (1995) (emphasis in original)).

sonable burdens on radio and television broadcasters."[95] But the court found that this concern was directed specifically at traditional over-the-air broadcasts and not AM/FM webcasting.[96]

The court also looked to the DMCA, which deleted two prior exemptions to the DPSRA. When making these deletions, Congress expressly stated that "the digital sound recording performance right applies to nonsubscription digital audio services such as webcasting."[97] However, this language did not specifically address the question of nontraditional transmissions by traditional broadcasters. The broadcasters argued that the exemption was for "broadcasting *and related transmissions*," but the Third Circuit remained unconvinced.[98] It instead held that the exemption was meant to protect over-the-air broadcasts, whether in a "digital or nondigital format."[99] Thus, the court maintained that Congress's intended exemption was narrow—to protect only the symbiotic relationship between *established* over-the-air radio broadcasts and the recording industry.

IV. DISCUSSION

The Third Circuit in *Bonneville* reached the correct result on both legal and policy bases by carefully following the direction and intent of the legislature embodied in § 114(d)(1)(A) and extending the performance right to AM/FM webcasters. Considering the symbiotic relationship between radio broadcasters and recording companies that influenced the exemptions to the digital performance right, the court reasonably determined that AM/FM webcasting was not intended to be exempt from the digital performance royalty.[100] Although the limited holding in this case withstands analytic scrutiny, questions remain about the prudence of the immensely complex statutory licensing system that implements the digital public performance right.

A. AM/FM Webcasting Survives the *Bonneville* Decision

In *Bonneville*, the Third Circuit properly gave a narrow construction to the § 114(d)(1)(A) exemption for a "nonsubscription broadcast transmission."[101] In essence, the court determined that this exemption was meant to apply solely if established radio broadcasters decide to upgrade their *ter-*

95. *Id.* (citing S. Rep. No. 104-128, at 15).
96. *Id.* at 499.
97. H.R. Rep. No. 105-796, at 80 (1998).
98. *See Bonneville II*, 347 F.3d at 498.
99. *Id.* at 498 (citing S. Rep. No. 104-128, at 19).
100. *Id.* at 490.
101. *See id.*

restrial analog broadcast technology to digital technology.[102] This interpretation is prudent because it takes a step toward a "level playing field" for webcasters with regard to royalty obligations for the music they transmit.[103] *Bonneville* was not just a case of radio broadcaster versus recording industry; had radio broadcasters won this battle, they would have also gained a large advantage over non-radio station webcasters.[104] Congress added the § 114(d)(1)(A) exemption so that the new digital performance right would not disrupt the well-established radio broadcasting industry—not to create new advantages for radio broadcasters online.[105] Of any webcaster, large and politically powerful radio broadcast stations seem the least justifiable beneficiaries of such a competitive advantage. The court denied this advantage, effectively making public performance royalties universal to all webcasters.[106]

Despite earlier predictions that *Bonneville* would be the death knell for AM/FM webcasting,[107] a significant portion of radio stations still provide a "listen live" option on their websites.[108] There are many reasons, including infrastructure, personnel, and additional exposure to liability, that may explain why all radio stations do not provide AM/FM webcasts,[109] but AM/FM webcasting is far from dead. Without further study, it is unclear whether any characteristics of a radio station correlate with providing an AM/FM webcast. A wide variety of AM/FM webcasts are available, including popular commercial stations, public radio stations, college radio

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102. *See id.*

103. *See* Bob Kohn, *A Primer on the Law of Webcasting and Digital Music Delivery*, 20 ENT. L. REP. 4, 18 (1998), *available at* http://www.kohnmusic.com/articles/newprimer.html.

104. *See id.*

105. *See* H.R. Rep. No. 104-274, at 14 (1995).

106. *See Bonneville II*, 347 F.3d at 490.

107. *See, e.g.*, Farzami, *supra* note 3, at 215. These predictions also foretold an easier adjustment to the royalty requirement for small webcasters that had the flexibility to adapt their business models; however, adjustment has yet to be attained as small webcasters continue to fight difficult battles before Congress. *See, e.g.*, DiMA, *at* http://www.digmedia.org/content.cfm?id=7206 (last visited Jan. 25, 2005) (listing the organization's participation in legislation concerning small webcasters and royalties).

108. *See* Radio-Locater, *at* http://www.radio-locator.com/cgi-bin/locate?select=city&city=94704&state=&sid=&x=0&y=0 (last visited Dec. 20, 2004) (providing a search function that creates a list of streaming sites and their signal strength in your area). According to Radio-Locator, twenty-four of sixty-five radio stations provide AM/FM webcasts within close listening range of Berkeley, California, on December 20, 2004. *Id.*

109. *See generally* PEGGY MILES, INTERNET WORLD GUIDE TO WEBCASTING: THE COMPLETE GUIDE TO BROADCASTING ON THE WEB (1998) (discussing business opportunities and costs in webcasting).

stations, news/talk stations, and religious stations.[110] Like terrestrial broadcasts, it also seems that stations' financing of AM/FM webcasting varies: some websites ask for contributions from listeners, some thank corporate contributors, and some provide no information.[111] Because the ability to webcast is a relatively new phenomenon, it may simply take time before other stations provide AM/FM webcasts. In any case, it seems royalty costs are not prohibiting a number of various radio stations from providing an AM/FM webcast.

B. The Bigger Picture: Reconsidering the Liability Rule and Refocusing on its Purpose

Although the court interpreted § 114(d)(1)(A) correctly and AM/FM webcasting has survived the Copyright Office's rulemaking, *Bonneville* does not address whether the liability-based compulsory licensing system for digital performance rights in sound recording created through the DPSRA and its various amendments serves the needs of the stakeholders in the first place. Congress chose to institute a compulsory licensing scheme, presumably to facilitate licensing and develop a healthy market for music transmission online where private negotiations would otherwise have been difficult.[112] But, it seems the purpose of this liability system—to *simplify* exchange—has been lost somewhere between amendments. Congress's back and forth attempts to use information from opposing industry lobbyists, such as the broadcasters and RIAA, in determining the proper copyright scheme has created a "Frankenstein."[113]

Even assuming that a liability system was necessary to overcome the barriers to bargaining in online broadcasting at the outset of the digital performance right, this complex scheme provides a great example of the risks to avoid when implementing such a liability system. The goal of a liability system is to create exchange where there otherwise would be none due to market failures.[114] But this system has left parties either pursuing further legislation, like the Small Webcaster Settlement Act of 2002,[115] or

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110. *See* Radio-Locater, *supra* note 108.

111. *See e.g.*, 106 KMEL: Hip Hop & R&B, *at* http://www.kmel.com/main.html (last visited Mar. 18, 2005); KALX 90.7 FM Berkeley, *at* http://kalx.berkeley.edu (last visited Mar. 18, 2005); KQED Public Radio, *at* http://www.kqed.org/radio (last visited Mar. 18, 2005).

112. *See* Calabresi & Melamed, *supra* note 10, at 1119 (discussing that liability rules should be used to overcome transactions costs).

113. Nimmer, *supra* note 46, at 189.

114. Calabresi & Melamed, *supra* note 10, at 1119.

115. *See, e.g.*, Pub. L. No. 107-321, 116 Stat. 2780 (2002) (codified at 17 U.S.C. § 114(f)(5)).

litigation against the results, as in *Bonneville*.[116] The procedures for determining licensing fees are difficult to comprehend, slow to change, and many parties still complain about inadequate pricing.[117] Furthermore, judicial deference to the Copyright Office's arbitration proceedings makes successfully challenging any incorrect pricing difficult.[118]

It has been nearly ten years since the passage of the DPSRA and nearly seven since the DMCA, yet questions about the administration of the statutory licensing system are just beginning to be answered by the courts, through cases such as *Bonneville* and *Beethoven.com*,[119] and legislation, through acts such as the Copyright Royalty and Distribution Reform Act of 2004.[120] While the historical context is different, even privately organized ASCAP, built from the ground up, outdid this result by completing coordination and distributing profits in about seven years.[121]

Although there are great sunk costs in the time spent on the statutory compulsory licensing scheme, one possible solution would be to encourage the creation of a CRO or the expansion of existing CROs to include record labels and exchange of sound recording performance licenses. Currently, obtaining statutory licenses is more difficult than obtaining a license from a CRO, which still leaves large radio stations—with the resources to pursue these licenses—with the very competitive advantage on the broadcasting side that the rule in *Bonneville* sought to avoid for sound recording licenses.[122] Also, because negotiations have largely been with Congress or the Copyright Office, and not between interested industry parties, diminished intra-industry communication seems to be hindering the coordination necessary to "jump-start" the online broadcast industry. Such a start often requires more ephemeral characteristics than a statutory scheme can provide. For example, the credibility or charisma of a person or entity beginning a private standard or scheme can create momentum for

116. *See, e.g.*, *Bonneville II*, 347 F.3d 485, 485 (3d Cir. 2003).

117. *See, e.g.*, Beethoven.com v. Library of Congress, No. 02-1244, 2005 U.S. App. LEXIS 667, at *1 (D.C. Cir. Jan. 14, 2005) (illustrating dissatisfaction with pricing and the timeline for challenging such procedures); *see also* Merges, *supra* note 16, at 1303-09 (1996) (arguing that the risks of inflexible and incorrect pricing by liability rules should be avoided if possible).

118. *See Beethoven.com*, 2005 U.S. App. LEXIS 667, at *34-*35.

119. *See id.*; *Bonneville II*, 347 F.3d at 486-87.

120. Pub. L. No. 108-419, 118 Stat 2341 (2004) (to be codified at 17 U.S.C.).

121. Korman & Koenigsberg, *supra* note 18.

122. *See* Kohn, *supra* note 103, at 22-23.

a burgeoning industry.[123] The beginnings of this phenomenon are visible in the marketing of iTunes, where previously untrusting musicians overcame their fear of piracy and provided licenses to their songs because they trusted Apple and Steve Jobs.[124] Thus, private negotiations over a new copyright licensing system may allow a forum for interaction in which industry members can find the right messenger to create momentum for a solution to the challenge posed by online music transmission. The time and frustration spent dealing with Congress and its statutory licensing scheme, as well-intentioned as the system may be, likely detracts from the energy in the broadcast and music industries that might afford this momentum.

The online broadcast industry is a good candidate for the successful implementation of a CRO, given market characteristics like the importance of cooperation and long-run relationships. Since CROs are now established in music publishing, it would likely take less time to negotiate blanket licenses for digital public performance rights under this scenario. This is not to say that a private exchange system would be problem-free. A CRO is likely to require regulation under antitrust law. Nonetheless, the cost of enacting the requisite legal framework to support the creation or expansion of a CRO for sound recording performance licenses is likely to be limited because existing consent decrees for ASCAP and BMI can provide models for behavior to avoid.[125] In hindsight, perhaps a property rule at the outset of the new digital performance right for sound recordings would have left private parties confused and unable to bargain or implement a CRO due to transaction costs.[126] But the liability system, specifically imposed to facilitate bargaining, is also unimpressive. In any case, the question now will be whether Congress and stakeholders will continue to pursue perfection of the statutory system, or whether they will instead turn to private methods.

There are signs of moving toward privatizing webcasting licensing despite the current statutory scheme. ASCAP has signed a deal with the Radio Music License Committee, which represents most of the nearly 12,000

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123. *See* Korman & Koenigsberg, *supra* note 18 (describing the momentum created by the energy and credibility that Puccini and his associates offered to the creation of ASCAP).

124. *See* Walter S. Mossberg, *The Music Man*, WALL ST. J., June 14, 2004, at B1.

125. *See* United States v. BMI, 1966 Trade Cas. (CCH) ¶ 71,941 (S.D.N.Y. 1966); United States v. ASCAP, 1950-1951 Trade Cas. (CCH) ¶ 62,595 (S.D.N.Y. 1950), *amending* United States v. ASCAP, 1940-1943 Trade Cas. (CCH) ¶ 56,104 (S.D.N.Y. 1941).

126. *See* Calabresi & Melamed, *supra* note 10, at 1119.

U.S. commercial radio stations.[127] Although this is a small portion of Internet broadcast music, it may signal a trend towards the use of CROs like ASCAP for digital public performance rights. Until this point, Congress's time legislating the digital performance right for sound recordings, the music industry's time lobbying for legislation, and everyone else's time attempting to understand the statutory scheme produced little that is helpful at best. And at worst, the complex statutes developed from this effort will become obsolete and difficult to deal with in the future. Thus, whether or not private mechanisms develop independently, Congress should either encourage privatization or at least pursue a simpler liability system that could support meaningful exchange of sound recording performance licenses to minimize further costs to the online music industry. Hindsight is a wonderful lens for such analyses, but it is likely that debate over the choice of legal rules is not over for webcasting, and thus hindsight may yet serve us in planning for the future.

C. Glimpses of the Future: The Impact of the Nature of Legal Entitlements and Licensing for Webcasting

Now that Congress has committed to providing a limited public performance right for sound recordings, it seems only a matter of time before the industry finds a way to efficiently manage intellectual property rights. Perhaps statutory licensing procedures will become more routine as industry lobbyists finally come to an acceptable compromise, possibly through legislation that refines arbitration procedures for statutory licenses.[128] Or, private CRO models will be expanded or created for digital rights management of sound recordings, which seems more likely given the characteristics of online music and the success of CROs in managing performing rights for traditional broadcasting. Once these types of institutions become regularized, the nature of the online broadcast market will become clearer. For example, one developing question is whether online webcasting will be pushed further toward oligopoly, like terrestrial radio, or whether differences in regulation will allow online broadcasting to become more competitive and to expand choice.[129] Current decisions about the nature of new copyright rules and institutional procedures for licensing will likely

127. Reuters, *Music Publishers Sign Deal on Web Radio*, MSNBC NEWS, Oct. 18, 2004, *available at* http://msnbc.msn.com/id/6274640.

128. *See* Pub. L. No. 108-419, 118 Stat 2341 (2004) (to be codified at 17 U.S.C.).

129. *See* Magri, *supra* note 27 (describing the possibilities in choice provided by Internet radio); Kendrick, *supra* note 25, at 41 (describing traditional radio broadcasting as nearing oligopoly).

affect this outcome, illustrating the importance of analyzing the broader legal landscape for webcasting now.

V. CONCLUSION

The holding in *Bonneville* was consistent with the intent of the public performance right in digital sound recordings and was prudent for the online broadcasting industry in light of the need to provide a level playing field for the industry's future development. Established radio stations have now proven, despite prior skepticism, that they are able to adapt to new technology and the new copyright protection that accompanies it. It is important that Congress does not underestimate this ability to adapt when it considers accommodating established interests such as the broadcast industry in the future. Furthermore, Congress should not allow lobbying to overpower the first priority for any liability system: to facilitate mutually beneficial exchange. This is only the beginning for online broadcasting. As more questions regarding the stability of the copyright framework for webcasting arise in the future, discussions should focus on supporting innovation and capturing possibilities, instead of applying the ill-suited models of traditional broadcasting.

TRANSFORMATION IN PUBLISHING: MODELING THE EFFECT OF NEW MEDIA

By Gabe Bloch

The publishing world is experiencing a puzzling phenomenon. Although courts have recently ruled that publishers may not sell freelance works to Internet databases without the author's permission,[1] the position of freelance authors has not changed: authors continue to go to the same publishers and accept essentially the same terms in their contracts. Conversely, in scientific, technical, and medical (STM) publishing, absent any court decisions or grant of rights, authors are increasingly submitting their works to nontraditional publishers on entirely different terms. For example, under "open access" publishing terms, STM authors pay the journal for the right to be published, and the journal then gives the public free access to the article.

In both the commercial news and STM publishing contexts, the emergence of the Internet has created new options for the display of content. The Internet's lower costs of production and distribution allow would-be publishers to enter the market with greater ease and established publishers to find new ways to circulate their content. Yet while it is clear that the Internet is a key catalyst, it is unclear why this catalyst is only sometimes effective. This Note seeks to explain why the Internet causes transformation in some settings and not others.

To do so, the Note will draw on recent court decisions, news sources, and other related materials in order to construct a model to describe how the Internet has affected publishing. The model offers four factors which are useful for analyzing whether a new medium will cause significant change, positing that while some factors are more important than others, change of the sort seen in STM publishing will not be possible without the presence of most of the four. The four factors are: (1) a changed rights structure; (2) sufficient bargaining power to reject unsatisfactory contract terms; (3) opportunities for competition generated by new media; and (4) the ability of new competitors to become prestigious.

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1. N.Y. Times Co. v. Tasini, 533 U.S. 483 (2001); Faulkner v. Nat'l Geographic Soc'y, Nos. 04-0263-cv(L), 04-0388-cv(CON), 04-0265-cv(CON), 04-0475-cv(CON), 04-0318-cv(CON), 04-0481-cv(CON), 2005 U.S. App. LEXIS 3642 (2d Cir. Mar. 4, 2005).

After examining the legal background of copyright and new media in Part I, the Note will briefly describe the business of commercial publishing in Part II. Then, the four factors will each be applied to commercial and STM publishing in Part III. That analysis establishes that changed rights are present in commercial but not STM publishing; bargaining power is present for STM publishing but not for mainstream commercial news; opportunity for competition is present in both areas of publishing; and it remains an unresolved question as to whether the new competitors can attain a sufficient level of prestige to seriously rival established print-based publishers. The Note concludes that transformation in publishing is more related to bargaining power and prestige than to changes in the rights structure.

I. LEGAL BACKGROUND

The United States Constitution grants Congress the power to "promote the Progress of . . . useful Arts, by securing for limited Times to Authors . . . the exclusive Right to their . . . Writings . . . ."[2] Copyright law's central purpose is not to protect authorial profit per se, but rather to promote progress through incentivizing creative works.[3] When authors are rewarded with legal rights such as a copyright, they and others like them are encouraged to create more works. In the publishing context, these rights are complicated by two factors: the concept of "collective works" and the difference between freelance work and "work for hire."

A. Collective Works

The multiple columns found in most magazines, newspapers, and journals are typically the product of multiple authors, whereas books normally have just one author. The Copyright Act refers to a work with multiple contributions as a "collective work,"[4] which is defined as "a work, such as a periodical issue, anthology, or encyclopedia, in which a number of contributions, constituting separate and independent works in themselves, are assembled into a collective whole."[5] Thus, most magazines and newspapers are collective works.

Ownership of a collective work operates at two levels: first, the authors of individual photographs, articles, and other individual works each

2. U.S. CONST. art. I, § 8, cl. 8.

3. *See, e.g.*, Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975).

4. *See generally* 1 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 3.02 (2004).

5. 17 U.S.C. § 101 (2000).

retain their own copyright to their contribution.[6] Second, the author of the work as a whole, by virtue of his creative arrangement, retains a copyright in the collective work. This second author retains only a copyright in what he adds by creating the whole, and has no rights in the individual works, aside from a right to "revision." Section 201(c) of the Copyright Act governs ownership of copyright with respect to contributions to collective works:

> Copyright in each separate contribution to a collective work is distinct from copyright in the collective work as a whole, and vests initially in the author of the contribution. In the absence of an express transfer of the copyright or of any rights under it, the owner of copyright in the collective work is presumed to have acquired only the privilege of reproducing and distributing the contribution as part of that particular collective work, *any revision of that collective work*, and any later collective work in the same series.[7]

For example, the copyright in a freelance newspaper article is owned by its author, while the copyright in the newspaper as a whole is owned by the paper itself. The newspaper cannot reprint the article without permission, except in a revision or collection of newspapers.

B. Freelance Work and "Work for Hire"

A "work for hire" is a copyrighted work created pursuant to an employment relationship.[8] Works for hire are always owned by the employer. Thus, copyrights in contributions to collective works, when pursuant to an employment relationship, default to the owner of the collective work. Because of this rule, many major newspapers employ full time staff writers, all of whose works will automatically become property of the newspaper. By contrast, freelancers are not "employees," and therefore retain their copyrights when they contribute to the newspaper. Freelancers write their works on a contract-to-contract basis, sometimes writing works on their own volition and then selling them, other times signing up for a specific contract with an established publisher.

C. Collective Work Ownership and New Media Law

The Internet may be the latest installment, but unanticipated new media technologies have created rights ownership problems from the dawn of copyright protection. Past new media technologies have included "silent

6. *Id.* § 201(c).
7. *Id.* (emphasis added). The significance of "revision" is discussed below.
8. 17 U.S.C. § 201(b). *See generally* 1 NIMMER & NIMMER, *supra* note 4, § 5.03.

motion pictures, 'talking' motion pictures, television, and videocassettes."[9] Problems arise from the fact that a given work may have multiple copyrightable parts. For example, a book may consist of copyrightable material in the original pages on which it was written, in the reproductions of the book which are sold to the public, and in motion picture rights as well.[10] Indeed, "'copyright' is now a label for a collection of diverse property rights each of which is separately marketable."[11] After acquiring one of these property rights, it is often unclear where the property line is drawn. For example, do reproduction rights in a book extend to publication as an "e-book"?

Although contracts have often overlooked the issue, when there is a new media contract provision it is usually either an "all media" clause or a "future technology clause."[12] A typical "all media" clause grants the right to perform "perpetually and throughout the world . . . in and by all media and means whatever," which courts have construed to include new media.[13] A "future technology" clause typically grants "[a]ll rights in the Work now existing, or which may hereafter come into existence, not specifically herein granted."[14] This too is usually construed to encompass new media that may not have been in existence at the time of the contract.[15]

In the publishing context, freelance journalists have normally granted "first North American serial rights," which granted the publisher the right to "put out the work first and to use it exclusively for some period of time, 60 or 90 days, traditionally in print form."[16] Often the contracts were the classic "napkin agreements" which were written with little regard to future legal problems.[17] Publishers and authors are now more careful in their contracting, probably because of *New York Times v. Tasini*[18] and the asso-

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9. Sidney A. Rosenzweig, Comment, *Don't Put My Article Online!: Extending Copyright's New-Use Doctrine to the Electronic Publishing Media and Beyond*, 143 U. PA. L. REV. 899, 908-10 (1995).

10. *See* 3 NIMMER & NIMMER, *supra* note 4, § 10.01.

11. *Id.*

12. Carolina Saez, *Enforcing Copyrights in the Age of Multimedia*, 21 RUTGERS COMPUTER & TECH. L.J. 351, 369-71 (1995).

13. *Id.* at 369 (citation and internal quotation marks omitted).

14. *Id.* at 370 (quoting MACMILLAN PUBLISHING CO., STANDARD BOOK PUBLISHING CONTRACT 2 (1985)).

15. *Id.*

16. June Besek & Jane C. Ginsburg, *The Future of Electronic Publishing: A Panel Discussion*, 25 COLUM. J.L. & ARTS 91, 101 (2002).

17. *See* Rod Dixon, *Profits in Cyberspace: Should Newspaper and Magazine Publishers Pay Freelance Writers for Digital Content?*, 4 MICH. TELECOMM. & TECH. L. REV. 127, 149-50 (1998).

18. 533 U.S. 483 (2001).

ciated cases *Greenberg v. National Geographic Society*[19] and *Faulkner v. National Geographic Society*,[20] non-digital rights cases that clarified the rights structure for writers and publishers. These cases, detailed below, are important because they establish the importance of Factors One (Changed Rights Structure) and Two (Sufficient Bargaining Power to Reject Unsatisfactory Contract Terms).

1. Greenberg v. National Geographic Society

In *Greenberg*, Jerry Greenberg, a freelance photographer, sued the National Geographic Society (NGS) over its use of his copyrighted photographs in a CD-ROM compendium of all *National Geographic* magazines published from 1888 to 1996.[21] The NGS was undisputedly the holder of the right to publish the copyrighted works, in this case photographs from four different assignments over the course of about thirty years, at least once in the original print editions of its *National Geographic* magazine.[22] After it decided to market a compendium of its magazines on CD-ROM, NGS entered into various agreements with software developers and sponsors, ultimately scanning every page of every magazine, dating from 1888 up to 1996, and entitling the finished product the "Complete National Geographic" (CNG).[23] Users of the CD-ROM first see a series of ten magazine covers that automatically plays when the CD-ROM is activated, and then either go through the archived magazines one by one or search for specific articles in the archive.[24] Greenberg sued for copyright infringement, arguing that the magazine was not entitled to use his works in the compendium without permission.[25]

The court held that what it deemed were independently copyrightable elements such as the magazine cover introduction and software with search capability pushed the archive past "revision" into nonrevisional original authorship. In other words, the CD-ROM was an "entirely different magazine or other collective work" as opposed to a mere revision or reproduction.[26] In reaching this decision, the court cited legislative history

19. 244 F.3d 1267 (11th Cir. 2001).

20. 533 U.S. 483 (2001); 244 F.3d 1267 (11th Cir. 2001); Faulkner v. Nat'l Geographic Soc'y, Nos. 04-0263-cv(L), 04-0388-cv(CON), 04-0265-cv(CON), 04-0475-cv(CON), 04-0318-cv(CON), 04-0481-cv(CON), 2005 U.S. App. LEXIS 3642 (2d Cir. Mar. 4, 2005).

21. *Greenberg*, 244 F.3d at 1268-70.

22. *Id.* at 1269.

23. *Id.*

24. *Id.*

25. *Id.* at 1270.

26. *Id.* at 1273.

in which Congress raised the example of an encyclopedia: the "revision" rule would allow for reprinting an old entry or updating it in a new encyclopedia, but forbids revising the entry itself or "includ[ing] it in a new anthology or an entirely different magazine or other collective work."[27]

2. New York Times Co. v. Tasini

In *Tasini*, six freelance authors of *New York Times*, *Newsday*, *Sports Illustrated*, and *Time* articles sued their publishers for copyright infringement, claiming the latter had sold their articles to online database LEXIS/NEXIS and two other databases, violating their copyrights.[28] The databases contained articles from hundreds of newspapers and magazines that had been collected over many years.[29] LEXIS/NEXIS acquired the articles at issue through licensing agreements with the *New York Times* and other defendant publishers.[30] These agreements authorized the databases to copy and sell any portion of the texts. Once in the database, a reader could search for and retrieve each article, then read it "in isolation, clear of the context the original print publication presented."[31] The defendants claimed that their use was a Section 201(c) "revision."[32]

The Supreme Court did not agree with the defendants. The majority was most concerned with whether the articles were being cut out of their original context and placed in an entirely different one, holding that because "the databases reproduce and distribute articles standing alone and not in context," rather than as "part of that particular collective work" in the same series, there was no Section 201(c) protection.[33] For comparison, the court analogized to microfiche, explaining that that format was acceptable because "articles appear . . . writ very small, in precisely the position in which the articles appeared in the newspaper," whereas LEXIS/NEXIS does not "perceptibly reproduce articles as part of the collective work to which the author contributed or as part of any 'revision' thereof."[34] The *Tasini* rule is therefore very clear: publishers who want to sell freelance authors' work without permission will be able to do so only if the purchaser places the work in exactly the same context as it originally appeared, including advertisements, other articles, and photographs. In other

27. *Id.* (citing H.R. REP. NO. 94-1476, at 122-23 (1976)).
28. N.Y. Times Co. v. Tasini, 533 U.S. 483, 490 (2001).
29. *Id.* at 489.
30. *Id.*
31. *Id.* at 487.
32. *Id.* at 487-88.
33. *Id.* at 488.
34. *Id.* at 501-02.

words, the work must be reproduced in precisely the same environment as that in which it originally appeared.

In line with some of the majority's reasoning, Justice Stevens argued in his dissent that Congress, in revising the Copyright Act to allow authors to retain some rights in a contribution to a collective work "even if the contribution does not bear a separate notice in the author's name," had evidenced an intent to protect authors' rights.[35] Moreover, Congress intended to further limit what authors "give away" by eliminating the old collective works rule, which "had the effect of encouraging an author to transfer her entire copyright to the publisher of a collective work," and replacing it with the new rule that the publisher receives the limited bundle of rights enumerated in Section 201(c).[36] However, Justice Stevens believed this legislative intent was undermined by the majority's decision because publishers would naturally begin demanding a complete transfer of rights in order to continue selling individual works to databases.[37] He argued that while translating articles into ASCII files was admittedly different from translating the newspaper into microform, those differences were "necessitated by the electronic medium," and that the majority, in ruling against defendants, was violating the "principles of media neutrality" by ostensibly allowing one format and not another.[38] Finally, while the articles were viewed individually, the rest of the newspaper in which the article appeared was available on the databases, allowing Justice Stevens to conclude that the databases' use was a "revision."[39] Commingling the article with articles from other collective works would be no different than putting different collective works on one microfiche.[40]

The majority replied that it did not share "the dissent's confidence that the current form of the Databases is entirely attributable to the nature of the electronic media,"[41] implying that there are indeed ways to electronically display the collective works in precisely the way they originally appeared, as was the case with the archived *National Geographic* magazines in *Greenberg*. The majority holding seemed to overrule *Greenberg*, a question that was resolved in the next case.

35. *Id.* at 507-09 (Stevens, J., dissenting).
36. *Id.* at 508-09 (Stevens, J., dissenting).
37. *Id.* at 520 n.17 (Stevens, J., dissenting).
38. *Id.* at 513-14 (Stevens, J., dissenting).
39. *Id.* at 514-15 (Stevens, J., dissenting).
40. *Id.* at 517 (Stevens, J., dissenting).
41. *Id.* at 502.

3. Faulkner v. National Geographic Society

Faulkner applied the *Tasini* ruling to facts very similar to those in *Greenberg*.[42] The same CD-ROM was at issue, including the introductory sequence of photographs and replicated issues from NGS's 108-year history.[43] Plaintiffs again sued for copyright infringement, arguing that the magazine was not entitled to use their works in the compendium without permission.[44] Relying on *Greenberg*, the authors claimed that NGS should be collaterally estopped from arguing that the archive was a revision, since the Eleventh Circuit had already ruled in their favor on that issue in *Greenberg*.[45] The district court disagreed and granted summary judgment for the defendants.[46]

On appeal, the appellate court upheld the district court's determination. The appellate court held that the legal landscape had been sufficiently changed by *Tasini*'s revision rule, and thus the case could be heard on the merits.[47] The court then applied *Tasini*'s revision rule, that a "revision denotes a new version . . . [that is] a distinct form of something regarded by its creator or others as one work,"[48] and found that "[t]he CNG present[ed] the underlying works to users in the same context as they were presented to users in the original versions of the Magazine."[49] Indeed, the court found such a presentation was a contrast to the databases in *Tasini*, which precluded readers from viewing the underlying works in their original context.[50] The CNG was therefore a revision, and the freelance authors were not entitled to additional payment.

Although the holding in *Faulkner* contradicted the holding in *Greenberg*, the core issue is no longer controversial: authors cannot expect extra payment for use of their works in compendiums and anthologies, but they may demand payment when their publisher sells works to online databases that do not retain the "original context" in which the work first appeared.

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42. *See* Faulkner v. Nat'l Geographic Soc'y, Nos. 04-0263-cv(L), 04-0388-cv(CON), 04-0265-cv(CON), 04-0475-cv(CON), 04-0318-cv(CON), 04-0481-cv(CON), 2005 U.S. App. LEXIS 3642 (2d Cir. Mar. 4, 2005).

43. *Id.* at *4-*9.

44. *Id.* at *2-*3.

45. *Id.* at *24-*25.

46. *Id.* at *12-*13; *see also* Faulkner v. Nat'l Geographic Soc'y, 294 F. Supp. 2d 523 (S.D.N.Y. 2003).

47. *Faulkner*, 2004 U.S. App. LEXIS 3642, at *27 ("In our view, the *Tasini* approach so substantially departs from the *Greenberg* analysis that it represents an intervening change in law rendering application of collateral estoppel inappropriate.").

48. *Id.* *28 (citation and internal citations omitted).

49. *Id.*

50. *Id.* at *29.

This outcome was seen as a victory by freelance authors, but as will be discussed later, contractual variation and bargaining power limitations will significantly limit the scope and impact of this "victory."[51]

II. THE BUSINESS OF PUBLISHING

This Part briefly describes the commercial news and STM industries, and how the Internet and new media have influenced these industries.

A. The Commercial News Industry

Newspapers have been around in some form since news sheets were publicly posted in ancient Rome,[52] but the newspaper as we know it—with its wide circulation, illustrations, and bold headlines—did not appear until the 1890s.[53] Modern newspaper economics are driven by subscriptions and advertising: the advertising-to-subscription income ratio of American newspapers stands at 70:30,[54] and two-thirds of all daily newspaper pages are taken up by advertising.[55] In 2000, there were about 1,500 daily newspapers in circulation, with *USA Today* having the largest circulation.[56] There were also 7,600 weekly newspapers in circulation.[57] As for magazines, the earliest news periodicals appeared in Europe during the seventeenth century.[58] In the nineteenth century, Congress passed laws allowing for cheaper mailing rates, and the business model became increasingly driven by advertising.[59]

Commercial news contracts used to be fairly informal.[60] After *Tasini* and cases like it began winding their way through the courts in the mid-

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51. *See, e.g.*, Nat'l Writer's Union, Victory for Creators: A Guide to the Supreme Court, *at* http://www.nwu.org (last visited Mar. 19, 2005). To retrieve the exact webpage of this citation, go to the National Writer's Union homepage at http://www.nwu.org, select the "Tasini vs NY Times" link in the left frame, then select the "Supreme Court Victory, June 25, 2001" link under the "Current" heading.

52. *See Newspaper*, MSN® ENCARTA® ONLINE ENCYCLOPEDIA (2005), *at* http://encarta.msn.com/encyclopedia_761564853/Newspaper.html.

53. *See* Phil Barber, *A Brief History of Newspapers*, *at* http://www.historicpages.com/nprhist.htm (last updated Dec. 31, 2004).

54. PATRICK HENDRIKS, NEWSPAPERS: A LOST CAUSE? 11 (1999).

55. *See Newspaper*, *supra* note 52.

56. *Id.* Circulation was at 2.3 million people in 2000.

57. *Id.*

58. *See Periodicals*, MSN® ENCARTA® ONLINE ENCYCLOPEDIA (2005), *at* http://encarta.msn.com/encyclopedia_761567699/Periodicals.html#p13.

59. *Id.*

60. Indeed, even the contracts in *Greenberg* were "set out in a series of relatively informal letters." Greenberg v. Nat'l Geographic Soc'y, 244 F.3d 1267, 1269 (11th Cir. 2001).

1990s, major newspapers and magazines began to add specific contract provisions that addressed the digital rights problem.[61] Therefore, only works published until around 1995 are likely to lack (or have ambiguous) new media clauses.

All freelancers who signed contracts with ambiguous new rights clauses (or contracts lacking new media clauses) could be eligible for royalties under *Tasini/Faulkner*. Publishers are faced with three options. First, publishers can get digital rights from each freelancer for each article.[62] At a minimum this entails high transaction costs for the publisher, as it requires tracking down authors and bargaining with them. Publishers' second option is to simply delete the articles from their databases, and because they can threaten authors with this possibility, they benefit from superior bargaining power in any transactions that occur.[63] Some publishers have utilized a third option, asking freelancers to convey rights retroactively.[64]

Post-1995 contracts have taken three basic forms. "All-rights contracts" grant publishers all rights in a given work.[65] Condé Nast, Boston Globe, New York Times Co., Scholastic, and some Hearst publications have adopted all-rights contracts.[66] These contracts are natural choices for publications with superior bargaining power, and indeed many "freelancers must choose between signing the agreement and receiving a paycheck or asserting their rights and going hungry."[67]

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61. *Id.*; *see also* Saez, *supra* note 12, at 351 ("[P]roducers and content providers are starting to provide explicit language in their contracts regarding the issue of electronic rights' ownership."); Rosenzweig, *supra* note 9, at 930 ("Since *Tasini* . . . rose to national prominence in December 1993, the publishing industry has begun explicitly to address future technology issues."); Laurie A. Santelli, Notes and Comments, *New Battles Between Freelance Authors and Publishers in the Aftermath of Tasini v. New York Times*, 7 J.L. & POL'Y 253, 274 (1998) ("[T]he commencement of *Tasini* in 1993 compelled most publishers to replace their handshake agreements with contracts that explicitly addressed electronic rights.").

62. Mark B. Radefeld, Note, *The Medium Is the Message: Copyright Law Confronts the Information Age in New York Times v. Tasini*, 36 AKRON L. REV. 545, 575 (2003).

63. *See* Michael A. Forhan, Note, Tasini v. New York Times*: The Write Stuff for Copyright Law?*, 27 CAP. U. L. REV. 863, 884 (1999) ("[M]ost writers will 'bargain' away their rights out of necessity in order to be published (and paid).").

64. Radefeld, *supra* note 62, at 577.

65. Santelli, *supra* note 61, at 278.

66. *Id.* at 279 nn.127 & 129.

67. *Id.* at 279.

"Time period contracts" grant exclusive rights for a set period of time.[68] For example, the *Village Voice* asks freelancers to grant exclusive rights for 37 days.[69] After that, the rights revert to the authors.[70]

"Payment contracts" grant set compensation (typically 50%) to freelancers for all royalties derived from electronic uses.[71] *Harpers*, *Science*, *MIT Technology Review*, *American Health*, and *Women's Day* use payment contracts. *Harpers* states that it is paying 50% royalties because of the "uncertainty in the future market for electronic content."[72] This model is unlikely to gain in popularity because of the transaction costs involved in tabulating royalties.

B. The Scientific, Technological, and Medical Publishing Industry

STM journal publishing is a surprisingly big business, generating as much as $2.1 billion for publishers like Elsevier-Reed, the world's largest STM publisher, with revenue growth from 2001-2002 at 39.8%.[73] In total, there are over 2,000 publishers in the STM industry, and they "publish 1.2 million articles a year in about 16,000 journals."[74] In a study conducted in the United Kingdom in 2003, 85% of STM journal income came from subscriptions, and in stark contrast to commercial news only 5% came from advertising.[75] Production accounts for 58% of typical costs, with postage and distribution accounting for another 8%, leaving 34% in gross margins.[76] An important feature of STM publishing is the peer review process, in which authors submit their manuscripts to an editorial board, which then sends the paper out to a panel of peers in the field who assess the paper's quality and methods.[77] If they are satisfied, the paper will be

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68. *Id.* at 280.

69. *Id.*

70. *Id.*

71. *Id.* at 280-81.

72. Thomas K. Landry, *Columbia-VLA Journal of Law & the Arts Roundtable on Electronic Rights*, 20 COLUM.-VLA J.L. & ARTS 605, 628 (1996).

73. *See* STM and Elsevier Publishing Information, California Digital Library (Sept. 22, 2203), *at* http://www.law.berkeley.edu/faculty/rubinfeldd/Ac.%20Jour.%20Publishing/Academic%20Journal%20Project/CA%20digital%20library_STM%20and%20Elsevier.pdf.

74. *See Access All Areas*, ECONOMIST, Aug. 5, 2004, *available at* http://www.economist.com/science/PrinterFriendly.cgm?Story_ID=3061258.

75. ECONOMIC ANALYSIS OF SCIENTIFIC RESEARCH PUBLISHING 13 (Wellcome Trust ed., 2003), *at* http://www.wellcome.ac.uk/assets/wtd003182.pdf.

76. *Id.*

77. *See Science*, MSN® ENCARTA® ONLINE ENCYCLOPEDIA (2005), *at* http://encarta.msn.com/encyclopedia_761557105/Science.html#p27.

published; if not, the author is faced with revisions or outright rejection.[78] A final difference is that unlike commercial news sources, which may have millions of purchasers, STM journals are normally purchased by a relatively small number of libraries for much higher individual prices.[79]

C. The Internet and New Media

By the end of the 1990s, more than a thousand North American newspapers were offering their content online.[80] Online publishing is attractive because it cuts down on distribution costs (no physical delivery is needed) and production costs (nor is paper).[81] From a reader's point of view, accessing the Internet is relatively inexpensive. The Internet also allows any individual with the proper technical knowledge the opportunity to "publish" whatever they like on their own website, as the thousands of webloggers across the country can confirm. The lower costs mean more opportunity for new entrants, and this is how Factor Three (Opportunities for Competition Generated by New Media) was derived. However, it is sometimes difficult for new entrants to be taken seriously, a problem discussed in Factor Four (The Ability of New Competitors to Become Prestigious).

Large commercial news and STM publishers have been able to use the Internet in three basic ways. First, publishers have put their content online and charged users subscription fees. For example, the *Wall Street Journal*,[82] *The Economist*,[83] and *The Lancet Neurology*[84] operate on this model. Second, publishers have put their content online, allowed users to view the content for free, and then sold advertising space around the content. *The New York Times*[85] and the *New England Journal of Medicine*[86] operate this way. Third, publishers have sold works in their possession to online databases like LEXIS/NEXIS. This is common for many publishers.[87] As previously discussed, the rights structure has evolved such that any of these

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78. *Id.*

79. *See* ECONOMIC ANALYSIS OF SCIENTIFIC RESEARCH PUBLISHING, *supra* note 75, at 14.

80. *See Electronic Newspaper*, MSN® ENCARTA® ONLINE ENCYCLOPEDIA (2005), *at* http://encarta.msn.com/media_461550796/Electronic_Newspaper.html.

81. *Id.*

82. *See* http://online.wsj.com/public/us (last visited Mar. 9, 2005).

83. *See* http://www.economist.com (last visited Mar. 9, 2005).

84. *See* http://neurology.thelancet.com (last visited Mar. 9, 2005).

85. *See* http://www.nytimes.com (last visited Mar. 9, 2005).

86. *See* http://content.nejm.org (last visited Mar. 9, 2005). Articles are available after six months of publication.

87. *See* Peter S. Menell, *Can Our Current Conception of Copyright Law Survive the Internet Age?*, 46 N.Y.L. SCH. L. REV. 63, 127 (2002-2003).

uses require the author's permission if the author is a freelancer and the work is placed out of its original context.

An important development in STM publishing is "open access publishing," a new business model in which STM journals charge authors a fee for placement in the journal and then offer their articles free online.[88] Open access journals now account for 5% of all international scientific publications,[89] a total of about 1,200 journals.[90]

III. ANALYSIS: MODELING CHANGE IN TWO AREAS OF PUBLISHING

Large publishers have entered into a discomfited dance with the Internet, with persistent threats from new entrants and powerful bargaining realities pulling in opposite directions. In commercial publishing, the legal allocation of digital rights has changed, but their real-world allocation for the most part has not. In the world of STM publishing, however, vigorous academic and political support has given open access competitors sufficient strength to allow for a continual increase in the number of open access journal titles.

How can the open access publishing movement's success in transforming STM publishing be explained when commercial authors have been unable to change their situation? This Note suggests that four factors are useful in answering this question: (1) a changed rights structure; (2) sufficient bargaining power to reject unsatisfactory contract terms; (3) opportunities for competition generated by new media; and (4) the ability of new competitors to become prestigious.

A. Factor One: Changed Rights Structure

Media contracts have not always precisely assigned the copyrights in the event that a new medium becomes relevant to the agreement.[91] One of the ways in which new media historically have caused change is by forcing courts to allocate rights to parties in such situations. For example,

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88. See *Open Access Publishing*, PubMed Central, http://www.pubmedcentral.org/about/openaccess.html (last updated Jan. 7, 2005), for a complete definition written by several high profile promoters of open access publishing.

89. Sophie Morris, *Pay-to-Publish Could Make Journals More Accessible*, AUSTRALIAN FIN. REV., July 26, 2004, *available at* 2004 WL 79462428.

90. Dan Vergano, *Scientists Want Research Papers Freely Available*, USA TODAY, Aug. 30, 2004, *available at* 2004 WLNR 6670693. In 1992, there were only five open access journals. *Id.*

91. *See, e.g.*, Bartsch v. Metro-Goldwyn-Mayer, Inc., 391 F.2d 150, 154 (2nd Cir. 1968) (a leading case dealing with this issue).

when publishers began to sell individual contributions to their collective works to online databases like LEXIS/NEXIS, freelance authors of the individual works sued for copyright infringement. Courts had difficulty determining whether the freelancer or the publisher was entitled to the digital rights. The issue ultimately was decided by the Supreme Court in *Tasini*, which held that the rights belonged to the authors of the individual works—in other words, to the freelancers.[92] In this way, rights allocation becomes part of the calculus of new media transformation, although as is discussed below, it appears for various reasons that this factor is not as important as one might expect.

1. *Commercial News*

Recent digital rights controversies have involved publishers who used individual works in one of two ways: some added the individual works to anthologies or compendiums that reproduced the original work in the same context as it originally appeared, while others sold the copyrighted work to online databases. In both situations the copyright is firmly in the hands of the author, so the only issue is whether the grantee's uses are new uses or merely "revisions" of old uses. It was not clear what constituted a "revision" until the issue was litigated in *Greenberg*, *Tasini*, and later *Faulkner*.[93] These cases established the rule that publishers may not sell individual pieces of a collective work to online databases like LEXIS/NEXIS without the individual copyright, but may generally issue compendiums and anthologies as "revisions."

The new allocation of rights in commercial news represents a change in the balance of power between authors and publishers, and since the former have reason to seek change, our expectation that transformation will occur thereby increases. Factor One therefore weighs in favor of transformation in the commercial news setting. However, the current absence of transformation in commercial news leads to the conclusion that this factor is not sufficient on its own to cause the sort of change seen in STM publishing, and that other factors are more important.

2. *STM Publishing*

STM publishing has no counterpart to *Tasini*, and yet it has seen significant changes. It is thus interesting to note that although the redistribution of legal rights seems important in some intuitive sense, rights redistribution is only present in the context in which change has not occurred. This makes Factor One the most dispensable of the four, and indicates that

92. *See* N.Y. Times v. Tasini, 533 U.S. 483, 501-02 (2001).

93. *See supra* Part I.C.

change in the publishing market is far more related to the economics of bargaining power than to the distribution of legal rights. Although the factor does not prove much in and of itself, it is a useful means of establishing the importance of economic influences.

B. Factor Two: Sufficient Bargaining Power to Reject Unsatisfactory Contract Terms

Changes in the rights structure may be one way for new media transformation to occur. However, when taken alone, that sort of change is not sufficient or perhaps even necessary. More significant is the ability of authors to choose publishers and contracts that are to their satisfaction, based on strong bargaining power.

1. Commercial News

Some observers of the *Tasini* litigation feared that a decision in favor of the authors would "tip the scales in favor of authorial rights, to the detriment of society at large."[94] The fear was that large holes would develop in electronic databases when bargaining broke down between authors and publishers. Incomplete databases would mean inferior research tools, a problem for society at large. Indeed, the Supreme Court dissent had this concern,[95] and some freelancers have complained that their work has suffered from a *Tasini* "backlash."[96] For example, one freelancer complained that "my previous work, like that of other freelancers, has been expunged by newspapers so they don't need to comply with the conditions of the *Tasini* ruling."[97]

However, the observers who predicted that "*Tasini* will have little practical effect on future contributions to collective works" appear to have been much closer to the mark.[98] This is because most publishers use one of the contracts described previously to specifically deal with electronic rights, with the result usually being the conveyance of the rights to the publisher. These contracts are made possible by an imbalance in bargaining power.

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94. Jennifer L. Livingston, Note, *Digital "Revision": Greenberg v. National Geographic Society*, 70 U. CIN. L. REV. 1419, 1435 (2002).

95. *Tasini*, 533 U.S. at 520 (Stevens, J., dissenting).

96. Wendy A. Hoke, *We Hear You—and We Like What You're Saying: Response from SPJ Freelancers Has Been Overwhelming*, QUILL, May 1, 2004 at 38-39.

97. *Id.*

98. Josh J. May, Note, Tasini v. New York Times Co., 16 BERKELEY TECH. L.J. 13, 28 (2001).

It is no secret that authors have traditionally lacked bargaining power in contractual transactions with publishers.[99] The question that remains is whether cases like *Tasini* and *Faulkner* have improved freelance news authors' relative bargaining power. At a minimum, publishers now have no choice but to bargain with authors over the terms of digital rights.[100] In this sense, authors' bargaining power is improved by the decisions because they may not have been aware of the issue and will now encounter it in their contracts. Contact Press Images, a group of about twenty well-known photojournalists based in New York, responded to Time Warner contracts featuring all-rights clauses by refusing to sign that portion of the contract.[101] Further, Contact refused projects from "a major U.S. news weekly" who made all-rights contracts a condition of the assignment.[102] The *New York Times* Assistant Counsel has also stated that "[w]ith respect to more entrepreneurial nonfiction works, works authored by 'name' authors (who have in essence established their own brand) and fiction works, the arrangements will probably be different"—in other words, the bargaining power will be more evenly spread between the two parties.[103]

However, as Contact's Executive Director admits, "for every author/artist fighting to reserve or establish fees for electronic or ancillary rights, there are perhaps five to ten others that would sign now without precondition. The power of the publisher is undeniable."[104] As the *Tasini* dissent pointed out, that decision may have the ironic effect of increasing the number of wholesale rights transfers whenever a publisher's bargaining power is sufficiently superior.[105] Thus, aside from organized groups of well-known freelancers like Contact, the bargaining landscape will continue to be driven by the reality that commercial publishing is a buyer's market, and despite voluntary payments from some publishers like *Harp-*

99. Santelli, *supra* note 61, at 280.

100. *See* Wendy J. Gordon, Essay, *Fine-Tuning* Tasini*: Privileges of Electronic Distribution and Reproduction*, 66 BROOK. L. REV. 473, 497-98 (2000) ("*Tasini* . . . provide[s] a mechanism for alerting the less informed freelancer that there is something to contract about, thereby mitigating the informational asymmetry.").

101. Landry, *supra* note 72, at 616. Time Warner offered "a higher day rate ($100 more than their standard $400) in order to acquire 'unrestricted,' nonexclusive electronic rights for all the photographs taken on assignment." Contact and "a select group of [their] colleagues" refused to sign. *Id.*

102. *Id.*

103. *Id.* at 615.

104. *Id.* at 617.

105. N.Y. Times Co. v. Tasini, 533 U.S. 483, 520 n.17 (2001) (Stevens, J., dissenting).

ers, there does not appear to be any legal reason for a publisher not to demand electronic rights whenever possible.[106]

An important aspect of bargaining power is the nature of the work itself, and in particular its time value. Articles published in the *New York Times* have far less individual value on average than any given STM journal article. As New York Times Co.'s Assistant General Counsel has pointed out, individual news articles lose value quickly as time passes, and often will not be very valuable a few months after publication.[107] The result is that "publishers of collective works comprising relatively short articles presenting news and information (e.g., newspapers and news magazines) will acquire broad (if not all) electronic rights at the same time print rights are acquired for the payment of a one-time fee."[108] In other words, the value of each electronic right will be fixed by contract, on the New York Times' terms, due to the weak position of short-lived news pieces. Authors with name recognition or some other form of bargaining chip will stand a better chance of negotiating higher payments for their electronic rights. It may be advisable for freelance authors to shift their focus to whatever extent possible towards "entrepreneurial nonfiction works" and fiction works, because these, as compared with news pieces that become worth little after a few months, retain their value and may garner higher payments or better terms.[109]

2. *STM Publishing*

The typical STM author is paid not by her publisher but rather by her employer, usually a university. The absence of any pecuniary relationship immediately bolsters the academic author's bargaining position because there is less at stake when the author decides to try something new or stand on principle and reject a flawed contract. This is not to say that academic authors can drive hard bargains with impunity—their careers are often at stake (a point demonstrated below in Factor Four). However, they

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106. In the words of one freelancer,

> I signed a particularly bad and odious contract with *Playboy* last year . . . . You spend an enormous amount of time establishing contact with an editor. Then he sends you the contract and all that he can say is, "This is what my boss or my lawyer is telling me to do."

Christina Ianzito, *Who Owns That Online Story?*, COLUM. JOURNALISM REV., May 15, 1997, at 15. It is also interesting to note that freelancers average $7500 of income a year from their writing. Santelli, *supra* note 61, at 260.

107. Landry, *supra* note 72, at 628.

108. *Id.* at 614.

109. *Id.* at 615.

are in a relatively stronger position because they do not rely on their publisher directly in order to put food on the table.

A second dynamic working in academic authors' favor is the mounting pressure on traditional STM publishers from libraries and other institutional discontents. As new competitors enter the market in response to this discontent, authors find themselves presented with a greater range of alternatives. As the Factor Four analysis will suggest, there are still plenty of reasons for them not to join the open access movement, but the changes taking place in STM publishing are indisputably in part due to the institutional support of authors.

A third area in which STM articles naturally possess greater bargaining power is in their time value and specialized nature. Unlike normal news articles, STM works continue to be useful so long as other researchers turn to them. Many articles may not be much more than a small part of a large archive, but even so the Internet makes even the largest archive searchable, and therefore there is some value retained in the possibility of a future citation.

Thus, the nonpecuniary nature of the relationship, the pressures on the STM industry, and the stronger individual value of each article all contribute to greater bargaining power for authors in the STM industry. This contrasts with the bargaining power of commercial news authors, and helps explain why only the STM industry has seen transformation.

C. Factor Three: Opportunities for Competition Generated by New Media

The emergence of new media allows more competitors to enter the market, but can make the market too competitive for established companies because of the number of entrants. Yet, it is not uncommon for new media to also improve the lot of all competitors in the market. In the case of videotaping, for example, new ways to copy television broadcasts and movies seemed at the outset to be a boon for consumers but an unmitigated catastrophe for Hollywood. As it turned out, VHS sales and rentals turned out to be a major source of revenue for studios.[110] The DVD format has likewise become an important source of revenue, accounting for 71% of total rental spending in the United States.[111]

110. *Id.*

111. Judith McCourt & Judith Saccone, *DVD Juggernaut Can't Offset Double-Digit Rental Drop*, VIDEO STORE, May 16, 2004, at 27.

1. *Commercial News*

Courts have recognized that once a work is put into an individualized digital format, a separate market is created in which authors could again sell their works that have already been sold in print.[112] This conceivably created the opportunity for freelancers to bargain for a second round of payments from their publisher, or to shop around for a new place to publish their work in its electronic form. For example, a freelancer who sold a news dispatch to the *New York Times* might wish to sell the electronic version of her work to a different news organization. This potential opportunity has been nullified by form contracts that require freelancers to sign over all their rights, a situation made possible by stronger bargaining power in the hands of commercial publishers.

2. *STM Publishing*

Competition in the STM world would not exist but for the Internet, because the costs of "acquiring, selecting, editing, presenting (in print or electronic form), marketing, and selling content" are dramatically lower for online publishers.[113] The availability of Internet-based peer review, archiving, and discussion have also made publishing more accessible than ever before in the STM world.[114] Further, the Internet removes several traditional barriers to new entrants. First, a new paper journal "can be successful only if it is able to displace an existing journal" because of limited library funds.[115] Internet-based journals do not have this problem: they can co-exist with competing journals because from the library's point of view it costs nothing to give the newcomer a try. Second, readers are hesitant to try new paper journals because they "cannot know in any level of detail what benefit they will receive from an article . . . ."[116] Yet here too, because readers can peruse the online journal for free, they *can know in detail* what benefits they will receive from an article, and they will return if they derive sufficient benefit. Despite publishers' arguments that going online can eliminate only 20-30% of the cost of a paper journal, these are obvious advantages and they demonstrate the opportunity that the Internet provides would-be competitors.[117]

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112. N.Y. Times Co. v. Tasini, 533 U.S. 483, 488 (2001).

113. ECONOMIC ANALYSIS OF SCIENTIFIC RESEARCH PUBLISHING, *supra* note 75, at 12.

114. *Id.* at 9.

115. *Id.* at 14.

116. *Id.* at 15.

117. *Id.* at 7.

This opportunity is being seized largely due to dissatisfaction with the nature of the STM publishing business: universities and governments around the world have examined journal prices and availability and concluded that there is a problem. Cornell University noted with disapproval in a recent study that its library budget has increased by 149% from 1986 to 2001, while the number of periodicals purchased grew by only 5%.[118] The UK House of Commons Science and Technology Committee in an August 2004 report said that research journal pricing was "unsatisfactory,"[119] and the Scottish Confederation of University and Research Libraries together with the National Library of Scotland issued a declaration that "the traditional way of disseminating research through subscription-based journals 'severely restricts access to leading edge research'" and that "[t]he kind of profit that is being made by some of the very large commercial publishers is inappropriate in that it is predicated on publicly funded research."[120]

Currently, the most common business model is open access publishing, where authors pay a fee to place their articles in journals, which are then distributed online (and sometimes in print) for free.[121] The most high-profile organization using this format is likely the Public Library of Science (PLoS), founded in 2000 by former National Institutes of Health Director and Nobel Prize winner Harold Varmus[122] and UC Berkeley Lawrence Lab scientist Michael Eisen,[123] among others. PLoS publishes two journals under its open access model, *PLoS Biology* and *PLoS Medicine*.[124] The journals are taking direct aim at "gold standard"[125] journals *Nature*, *Science*, and *The Lancet*.[126]

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118. *See Access All Areas*, *supra* note 74.

119. Emma Dorey, *Open Access Needs Public Strategy*, CHEMISTRY & INDUS., Aug. 2, 2004, at 7.

120. Richard Wray, *Commercial Publishers Face Scottish Open Access Challenge*, GUARDIAN CITY PAGES, Aug. 20, 2004, at 6.

121. Saeed Shah, *US Public Library of Science Launches Rival to 'The Lancet'*, INDEPENDENT (London), Oct. 20, 2004, 2004 WLNR 10791665.

122. *'Open Access' Medical Journal Provides New Model for Publishing Original, Peer-Reviewed Research*, PR NEWSWIRE, Oct. 20, 2004, *available at* http://sev.prnewswire.com/health-care-hospitals/20041021/DCW07720102004-1.html.

123. Will Harper, *Publisher For the People*, E. BAY EXPRESS (Alameda and Contra Costa Counties, California), Sep. 29, 2004, *available at* http://www.eastbayexpress.com/issues/2004-09-29/feature.html.

124. *See* PLoS Public Library of Science, *at* http://www.plos.org (last visited Mar. 14, 2005).

125. Harper, *supra* note 123.

126. Shah, *supra* note 121.

BioMed Central (BMC), which calls itself an "Open Access Publisher," has established a similar model.[127] Under its model, institutional members, such as the University of California, pay a flat rate based on institutional size in order to become a member.[128] Researchers at member institutions do not pay any fee to have their articles published online.[129] Currently BMC publishes 110 web-only journals in biology and medicine, all of which are offered for free online immediately.[130]

There is no shortage of support in the global academic community for open access publishing. OhioLINK, Ohio's higher educational library system, announced in July 2004 that it would fund half of all fees for faculty and researchers wishing to publish articles with PLoS.[131] The world's largest medical research charity, the Wellcome Trust, has strongly supported open access.[132] And the German government awarded $4.2 million to two German publishers to develop "web-based collaborative scientific work and self-publishing."[133]

Most significantly, the United States House of Representatives Appropriations Committee recently approved a provision in the 2005 appropriations bill that would provide free online access to any research articles funded by the National Institutes of Health (NIH) six months after publication. NIH spends $24.6 billion annually on basic research that produces approximately sixty thousand research articles,[134] which accounts for a quarter of the world's "quality" medical research according to conservative estimates.[135] The NIH proposal makes all research that it funds available on a "comprehensive, searchable electronic archive of NIH-funded

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127. Andrew Albanese, *UK Report Calls for Publicly Available STM Research*, LIBR. J., Aug. 15, 2004, at 16, *available at* http://www.libraryjournal.com/article/CA443930?display=NewsNews&industry=News&industryid=1986&verticalid=151.

128. "Very large institutions" like the University of California pay $8,625 a year in membership fees. *BioMed Central Institutional Membership*, *at* http://www.biomedcentral.com/info/about/instmembership (last visited Mar. 9, 2005).

129. *Id.*

130. Richard Poynder, *Ten Years After; Poynder on Point*, INFO. TODAY, Oct. 1, 2004.

131. Andrew Albanese, *OhioLINK to Support* PLoS, LIBR. J., July 15, 2004, *available at* http://print.google.com/print/doc?articleid=qO3WGC81sEL. The fee is $1500. *Id.*

132. *See* Richard Wray, *Science for All*, GUARDIAN, Oct. 25, 2004, at 4. Wellcome's director says "[r]esearch findings need to be freely and widely available . . . ." *Id.*

133. Bobby Pickering, *German Government Funds OA Initiative*, INFO. WORLD REV., Oct. 1, 2004, *available at* http://www.accountancyage.com/news/it/1158510. Other interesting examples include George Soros's Open Society Institute, which provided $3 million to fund the Budapest Open Access Initiative. Poynder, *supra* note 130.

134. Harper, *supra* note 123.

135. Barbara Quint, *NIH Requires Open Access for Its Funded Medical Research*, INFO. TODAY, Sept. 13, 2004, *at* http://www.infotoday.com/newsbreaks/nb0409131.shtml.

research publications, providing publicly available access to all."[136] The archive would operate out of the already-existing pubmedcentral.nih.gov (PubMed Central) site operated by the National Library of Medicine, which is an NIH institute.[137] NIH-funded articles would be published in a nongovernmental journal just as they always have, and then posted on the NIH site six months after original publication.[138] Proposals similar to the NIH's are being considered in Canada, Scotland, Australia, India, and Norway.[139]

Thus, the Internet has created opportunities for competition in both commercial and STM publishing, but those opportunities have been less useful in the commercial publishing context because of other factors.

D. Factor Four: The Ability of New Competitors to Become Prestigious

The emergence of the Internet has created opportunities for new publishers, but not all Internet publishers are considered equal. There is a perception that Internet-based publishing may not be as credible as print-based publishing.[140] As will be shown, authors are reluctant to submit their works to publications that lack prestige. The ability of Internet-based challengers to become prestigious is hence an important factor in determining whether transformation is possible in a given publishing area.

1. Commercial News

Factor Four considers the prestige of "new competitors," but we concluded above that from a freelance author's point of view, there has not been any transformation in commercial news publishing. It is worth noting, however, that although the business model for commercial news publishing is quite different from that used in STM publishing, authors in both areas are compelled by similar forces to cooperate with the most powerful publishers. For commercial authors, the competition to get paid for their freelance work is too fierce for most to have much power at the bargaining table.[141] These authors contend with a situation where they attempt to pay

136. NAT'L INST. OF HEALTH, QUESTIONS AND ANSWERS: NIH PUBLIC ACCESS POLICY (n.d.), *available at* http://www.nih.gov/about/publicaccess/022405QA.pdf.

137. Quint, *supra* note 135.

138. *NIH Public Access: Questions and Answers*, *supra* note 136.

139. Poynder, *supra* note 130.

140. "The quality of electronic versions of paper journals is taken for granted. Journals issued purely electronically are viewed with some suspicion by the academic community but this appears to be decreasing." ECONOMIC ANALYSIS OF SCIENTIFIC RESEARCH PUBLISHING, *supra* note 75, at 22.

141. *See* Landry, *supra* note 72, at 616.

the bills as best they can.[142] Within these constraints, it is likely that these authors will try to maximize prestige in the hopes of higher pay now and greater bargaining power in the future. Therefore, if transformation were to occur at some point in commercial news, it would be important for the new competitors to garner prestige.

2. *STM Publishing*

Likewise, while academic authors may not be seeking money, the largest publishers have another bargaining chip at their disposal: prestige. STM open access publishers like to claim that traditional publishers no longer add value,[143] but it appears that in the eyes of academic authors there is no substitute for being associated with a journal of high status.

Academic publishers traditionally added value by featuring eminent scholars on an editorial board and by conducting peer review.[144] The process of review can be expensive, and this is primarily how the journals justify their high prices.[145] The major publishers claim that it is risky for an author to publish with the open access groups because the lack of good review diminishes the value of the journal and the articles that appear in it.[146] However, the leading open journals also conduct peer review: PLoS's board has several Nobel Prize winners and other eminent scientists,[147] and is said to "undertake rigorous peer-review and high editorial standards."[148] Thus, the value added by traditional academic publishers in the form of peer review appears feasible in the open access context.

Yet open access publishers may still lack that which is most important to prospective authors: authoritative prestige. PLoS's cofounder Michael

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142. Ianzito, *supra* note 106.

143. *See STM Open Access: Point-counterpoint*, Data Conversion Library, Oct. 26, 2004, *at* http://www.dclab.com/open_access_interviews.asp.

144. *Id.*

145. Harper, *supra* note 123 ("It costs us more money to reject an article than to publish an article.").

146. Michael T. Clarke, *When Information is Free, What Will it be Worth?*, CHRON. HIGHER EDUC., Oct. 15, 2004, at 55.

147. Harper, *supra* note 123. The PLoS Biology board includes Lee Hartwell and Richard Roberts, both Nobel Prize winners for medicine, while Joseph Goldstein, another Prize winner, is on the PLoS Medicine board. *Id.* They have lured editors from other prestigious publications to take managerial spots at PLoS, including former editors at *Cell* and *Nature Genetics*, both "top shelf" publications. *Id. But see* Richard Wray, *Open-Access Editor Defects Back to Lancet*, GUARDIAN, Oct. 30, 2004, at 29 (describing the defection of one of PLoS Medicine's four editors back to *The Lancet Neurology*, from whence he had been snatched earlier by the open access group).

148. ECONOMIC ANALYSIS OF SCIENTIFIC RESEARCH PUBLISHING, *supra* note 75, at 25.

Eisen may scoff at competitor BioMed Central for lacking "the kind of rep that [gets] you tenure at Harvard,"[149] but that is precisely the problem his journal faces as well, at least relative to journals like *Science* and *Nature*. No matter in what format their work is presented, all authors know that "the standard by which major universities have long measured their faculty" has been "[p]ublish or perish," and the prestige of the journal in which an author appears has much to do with the prestige of the university at which they eventually land a position.[150] The bottom line here is that academic authors who derive benefits from publishing their work in well-regarded, widely distributed journals may be unwilling to jeopardize their chances for career advancement in academia for the sake of taking a stand against monopoly rents or maximizing their legal rights.[151]

Intensifying this bias towards prestige is the position of libraries. Libraries are the main purchasers of journals and are thus a powerful buying block. One might therefore expect that given their concerns with current prices, they would throw their weight behind open access publishing.[152] Yet libraries are a "relatively passive group . . . who find it difficult to coordinate and assert their market power."[153] Because they must supply the most prestigious journals first, libraries have recently begun canceling "less-desirable journals" due to budget constraints.[154] Libraries may also have doubts about the viability of electronic information, which is seen as "fleeting."[155]

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149. Harper, *supra* note 123.

150. Robert Samuel, *Researchers Shed Light on Academic Press*, DUKE U. (Durham, N.C.), Oct. 20, 2004, LEXIS, Nexis Library, University Wire; *see also* ECONOMIC ANALYSIS OF SCIENTIFIC RESEARCH PUBLISHING, *supra* note 75 at 16 ("Academic authors seek to place their articles in journals which are widely read and highly acclaimed . . . . The career path of authors and their opportunity to acquire research funds is partly determined by the journals in which they publish. In such circumstances *authors are primarily concerned with achieving publication in the highest quality journal they can reach*.") (emphasis added.).

151. This is well illustrated by PLoS cofounder Michael Eisen's difficulty convincing his own brother to submit his much sought-after article to PLoS instead of *Nature* or *Science*. *See* Harper, *supra* note 123. Eisen eventually prevailed upon his brother to choose PLoS. *Id.*

152. ECONOMIC ANALYSIS OF SCIENTIFIC RESEARCH PUBLISHING, *supra* note 75, at 15.

153. *Id.* at 20.

154. Harper, *supra* note 123.

155. Katie Hafner, *Digital Memories, Piling Up, May Prove Fleeting*, N.Y. TIMES, Nov. 10, 2004, at A1 ("To save a digital file for, let's say, a hundred years is going to take a lot of work.").

The future of open access publishing therefore remains uncertain, chiefly because it is unclear if it can marshal the degree of prestige necessary for it to truly rival established journals.

IV. CONCLUSION

This Note proposes that via the four factors presented above we can track potential new media transformations, understanding their incidence and degree of success. In the case of publishing, the first factor, a changed rights structure, is present, but only in commercial news publishing, which has not seen transformation. In STM publishing, there have been no significant legal developments, and yet transformation is occurring, allowing us to conclude that this factor is relatively unimportant. The second factor, sufficient bargaining power to reject unsatisfactory contract terms, is perhaps the one factor in which STM and commercial news publishing most differ: commercial news freelancers lack bargaining power, whereas STM authors are freer to challenge the status quo. We can conclude that this factor is relatively important in the overall analysis. The third factor, opportunities for competition generated by new media, is obviously indispensable and is present in the Internet. The fourth factor, the ability of new competitors to become prestigious, likewise is very important and remains the most unsettled of the four. In sum, the analysis suggests that when a new medium generates opportunities for competition, authors with bargaining power and new publishers that can attain a certain measure of prestige will be able to cause significant changes in the status quo, irrespective of how courts arrange individual rights.

The significance of the Internet cannot be disputed, but precisely what effects it is having on publishing remains an open question. The factors illustrated here may help analyze the climate, but only the passage of time will illuminate how much transformation the publishing industry will undergo.

GAIMAN V. MCFARLANE: THE RIGHT STEP IN DETERMINING JOINT AUTHORSHIP FOR COPYRIGHTED MATERIAL

By Teresa Huang

Currently no universal guidelines exist for determining whether or not a person's contribution to a copyrighted work constitutes joint authorship. While the Copyright Act of 1976 ("the Act") does not define joint authorship, it does define a joint work. As a result, courts traditionally have been stingy with grants of joint authorship status and have rewarded contributors of copyrightable material only if all parties intended to be joint authors. Thus, it came as a surprise when Judge Posner bucked the tradition in the latest joint authorship dispute.

In *Gaiman v. McFarlane*, the Seventh Circuit held that where two or more people intend to create an indivisible copyrightable work and succeed in doing so, each contributor is a joint author.[1] More importantly, and contrary to precedent, the contributor can be a joint author even if the portion he provided would not be independently copyrightable.[2] Judge Posner reasoned that if more than one person labored to create a single, copyrightable work, then it would be "paradoxical" if no one was able to claim copyright because the individual contributions were not themselves copyrightable.[3] In reaching this decision, Judge Posner did not explicitly overturn prior decisions holding that the individual contributions must be independently copyrightable. Instead, he distinguished the facts of *Gaiman* from prior cases and stated that the lower standard for joint authorship only applies to "mixed media" works.[4]

However, Judge Posner did not define "mixed media." For example, many, if not all, comic books and characters—the subject of the *Gaiman* dispute—are the products of a concerted effort and qualify as "mixed media" works. Movies also fall under Judge Posner's idea of "mixed media" works.[5]

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1. 360 F.3d 644, 658-59 (7th Cir. 2004), *reh'g en banc denied*, 2004 U.S. App. LEXIS 6387 (7th Cir. Mar. 31, 2004).
2. *Id.* at 659.
3. *Id.* at 658-59.
4. *Id.*
5. *Id.* at 658.

The issue of copyright ownership in a comic book character becomes more important as the stakes get higher. Based on the success of other comic book heroes in the movie theaters, such as Batman and Spiderman, owning the copyright in a popular comic book character can generate a great deal of profits from licensing and royalty fees.[6] However, Judge Posner's decision in *Gaiman* is not limited to graphic novels and cartoon characters. The decision applies to all joint efforts in movies, sound recordings, and computer programs—all of which can be considered "mixed media."

At first glance, *Gaiman* might spark a flood of litigation from everyone who has ever contributed ideas to a profitable project in any of the above mentioned industries.[7] Furthermore, the suggestion that an idea can be copyrightable is anathema to copyright doctrine itself.[8] However, a careful reading of Judge Posner's analysis reveals that the ruling is not as heretical as it seems. The Seventh Circuit adopted a joint authorship test which requires both an intention to create a unitary work and a more than "de minimis" contribution.[9] In most situations, people will have a very difficult time proving the intent existed (let alone the contribution of ideas);[10] therefore, it is highly unlikely that the *Gaiman* decision will in-

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6. *See, e.g.*, RONALD V. BETTIG, COPYRIGHTING CULTURE: THE POLITICAL ECONOMY OF INTELLECTUAL PROPERTY 41 (1996) (stating that Time Warner acquired the copyright in Batman, produced Batman comic books (new editions), movies, soundtracks, music videos, and novels, and licensed a variety of Batman products such as cereal and bedding); Duane Dudek, *Movie List Reads Like an Out-of-Date TV Guide*, MILWAUKEE J. SENTINEL, Aug. 17, 1997, at 10 (noting that the first Batman movie grossed over $250 million, and that the sequels each grossed over $100 million); Steve Gormon, *Hands Off: Marvel Wants Its Hero* Back, DAILY TEL., Apr. 26, 2003, at 37 (stating that the first *Spiderman* movie based on the Marvel Comics character grossed over $1.3 billion worldwide and that Marvel's shares have rallied "as investors assess the licensing potential of its 4700 comic book characters").

7. Ideas are the foremost examples of what cannot be copyrighted and hence are the focus of this Note. 17 U.S.C. § 102(b) (2000) (denying copyright protection, among other things, to facts, titles, or ideas); *see also* Feist Publ'ns, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 344-45 (1991) (holding that facts are not copyrightable). Ideas can mean an abstract idea for the overall project or specific, concrete suggestions for improving a project. This Note refers to the latter whenever "idea" is used.

8. Copyright protection will not extend to "any idea, procedure, process, system, method of operation, concept, principle, or discovery." 17 U.S.C. § 102(b).

9. *Gaiman*, 360 F.3d at 659 (adopting Nimmer's example); *see also* 1 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 6.07 (2004).

10. *See, e.g.*, Thomson v. Larson, 147 F.3d 195, 206-07 (2d Cir. 1998) (affirming the district court's finding that plaintiff was not a co-author because, even though plaintiff had contributed copyrightable material, Larson did not accept Thomson as his co-author).

crease litigation on the issue. Additionally, what is ultimately copyrighted is the expression of the merged ideas of all the contributors in a fixed, tangible medium.

Part I of this Note provides the possible interpretations of the Act with regard to joint authorship and describes the approaches embodied in two major copyright treatises. These two approaches include the Nimmer approach, which states that joint authorship exists when two or more parties make more than a minimal contribution to a unitary work, and the Goldstein approach, which states that joint authorship exists when each party intends to jointly own the copyright in the final work and makes a contribution that is independently copyrightable (as distinct from the copyrightability of the end product). Part II summarizes *Gaiman*. Part III analyzes Judge Posner's opinion and examines the implications of his decision. Finally, Part IV concludes that the Nimmer approach, applied in *Gaiman*, is preferable because it is the better statutory interpretation, is fairer to the parties, grants broader protection, and promotes creativity.

I. BACKGROUND

The Act does not provide guidance on how to identify joint owners in a copyright other than a brief definition of a "joint work."[11] Nonetheless, it is understood that a joint author is a co-owner of an undivided interest in the copyright.[12] Status as a joint author is coveted because a joint owner in the copyright can license the work without the consent of the other owners.[13] However, a joint owner who exploits the work for profit must make an accounting to the other joint owners.[14] Furthermore, all such licenses are nonexclusive unless granted by all the joint owners.[15] Protection for a joint work lasts for the life of the last surviving author plus seventy years.[16] The importance of authorship in a copyright makes it critical to

11. 17 U.S.C. § 101.

12. *Id.* § 201(a).

13. *See* 1 NIMMER & NIMMER, *supra* note 9, § 6.10, at 6-30 (stating that since one cannot infringe his own copyright, a joint owner cannot be held liable for copyright infringement to the other joint owners).

14. *See, e.g.*, Seshadri v. Kasraian, 130 F.3d 798, 801 (7th Cir. 1997); 1 NIMMER & NIMMER, *supra* note 9, § 6.10.

15. *United States Copyright Office and Sound Recordings as Work Made for Hire: Hearing on the Issue of Sound Recordings as Works Made for Hire Before the House Subcomm. on Courts and Intellectual Property of the Comm. on the Judiciary*, 106th Cong. 37 (2000) (statement of Marybeth Peters, Register of Copyright).

16. 17 U.S.C. § 302(b). While the section only addressed works created on or before January 1, 1978 (the effective date of the Act), § 303 grants protection for the terms in § 302, with some caveats. *Id.* § 303.

interpret the Act, with the aid of the legislative history, so that parties are correctly identified as joint authors and can enjoy the fruits of their labor, and that free-riders are not incorrectly identified as joint authors.

A. Statutory Interpretations

The Act defines a "joint work" as "a work prepared by two or more authors with the intention that their contributions be merged into inseparable or interdependent parts of a unitary whole."[17] Components of a unitary work are "inseparable" when they have little or no meaning standing alone (for example, the paragraphs in a novel), and the parts are "interdependent" when they could stand alone but achieve a greater effect when combined (for example, the lyrics and melody of a song).[18] As for the rest of the definition, the committee reports state:

> [A] work is "joint" if the authors collaborated with each other, *or* if each of the authors prepared his or her contribution with the knowledge and intention that it would be merged with the contributions of other authors as "inseparable or interdependent parts of a unitary whole." The touchstone here is the intention, at the time the writing is done, that the parts be absorbed or combined into an integrated unit . . . .[19]

The first clause focuses on the act of collaboration. The verb "collaborate" principally means "to work together."[20] The second clause looks at the parties' intent. All parties must have the same intentions at the time the work is created to satisfy the intent requirement. The treatises and the courts focus on the second criteria because of the "touchstone" sentence.[21] Judges have found it difficult to imagine collaborative efforts without the intent to create a unitary work and have collapsed the two clauses into one requirement of intent.[22] However, it is possible to collaborate without the requisite intent: people may brainstorm with one another but agree (explic-

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17. *Id.* § 101. The Act does not define "joint author" in this or any other section. Nimmer argues that the explanation actually defines "joint authorship" and is simply designated incorrectly in the Act. 1 NIMMER & NIMMER, *supra* note 9, § 6.01.

18. H.R. REP. NO. 94-1476, at 120 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5736.

19. S. REP. NO. 94-473, at 103 (1975) (emphasis added).

20. WEBSTER'S NEW WORLD DICTIONARY 118 (3d ed. 1990); *see also* RANDOM HOUSE WEBSTER'S UNABRIDGED DICTIONARY 402 (2d ed. 1998) (defining the verb principally as "to work, one with another; cooperate as on a literary work").

21. *See, e.g.*, Childress v. Taylor, 945 F.2d 500, 505-06 (2d Cir. 1991); 1 NIMMER & NIMMER, *supra* note 9, § 6.07.

22. *See, e.g.*, *Childress*, 945 F.2d at 505.

itly or implicitly) to write separately after the session, or people may collaborate but with different intentions.

Additionally, the relation of the "touchstone" sentence is not obvious, and it may refer to the first clause as well as the second. If the drafters believed the word "collaborated" encompassed both the situation where people worked together in the same physical location and the situation where people worked in separate locations but then combined their inputs later to create a whole work, then the first clause would be redundant and unnecessary. Therefore, the two clauses should be distinguished on the basis of a physical requirement rather than on the sole basis of intent. Congress could have contemplated a definition of "joint work" without a separate intent requirement—the physical act of working together would be sufficient evidence of any intent to create a unitary work. Moreover, the "or" may be disjunctive, too—either prong is sufficient. Thus, the statute embodies a "dual" test: 1) actual collaboration (working physically together) and 2) working separately but with the requisite intent.

Courts have not interpreted the statute to have a physical collaboration test, and they have focused instead on the intent.[23] Two of the major treatises also focus on the intent requirement. The Nimmer treatise requires only an intention to form a unitary work. The Goldstein treatise requires the intention to be co-owners in the copyright and independently copyrightable contributions. The Goldstein approach is currently the dominant rule of joint authorship.

B. The Nimmer Approach

The Nimmer treatise, widely viewed as the leading treatise in the field, proposes that what a person needs to achieve joint author status is to make more than a "de minimis" contribution to the resulting copyrighted work.[24] In other words, "more than a word or line must be added by one who claims to be a joint author."[25] The contribution must be "one of authorship" (creativity) and not merely one of financing.[26] In order to satisfy the intent requirement in the definition of a "joint work," all collaborators must work in furtherance of a common goal.[27]

Thus, under the Nimmer approach, a collaborator who contributes only the ideas for a work (that another executes or fixes in a tangible medium) is a co-owner in the copyright so long as the contributions are more than

23. *See id.*
24. 1 NIMMER & NIMMER, *supra* note 9, § 6.07.
25. *Id.*
26. *Id.*
27. *Id.*

minimal, but a person working alone receives no copyright for pure ideas.[28] In justifying the approach, the Nimmer treatise notes that "copyright's goal of fostering creativity is best served . . . by rewarding all parties who labor together to unite idea with form, and that copyright protection should extend both to the contributor of skeletal ideas and the contributor who fleshes out the project."[29] The Nimmer approach has not been widely received and has been "soundly rejected in the architectural context" and in many other cases.[30]

C. The Goldstein Approach

Professor Goldstein states, "For a joint work to exist, each author must have intended to create a joint work at the time he made his contribution."[31] He further explains, "A collaborative contribution will not produce a joint work, and a contributor will not obtain a co-ownership interest, unless the contribution represents original expression that could stand on its own as the subject matter of copyright."[32] Taken together, those two statements suggest that each author must intend to be a co-owner in the copyright and contribute separately copyrightable materials to qualify as a joint author. Goldstein justifies the second requirement by noting that the Act's use of the word "authors" suggests that each person's contribution must be copyrightable "works of authorship" within the meaning of § 102(a).[33] Thus, a person cannot be considered an author unless he has fixed an expression of his ideas in a tangible medium.[34]

D. Cases Adopting the Goldstein Approach and Rejecting the Nimmer Approach

The Second, Seventh, Ninth, and Eleventh Circuits have adopted Goldstein's formulation of joint authors.[35] While the Third Circuit has de-

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28. *Id.*

29. *Id.*

30. *Id.*

31. PAUL GOLDSTEIN, COPYRIGHT: PRINCIPLES, LAW, AND PRACTICE § 4.2.1.1 (2d ed. supp. 2004).

32. *Id.* § 4.2.1.2.

33. *Id.*; *see also* 17 U.S.C. § 101 (2000) ("A 'joint work' is a work prepared by two or more authors . . . ."); 17 U.S.C. § 102(a) (granting protection to "original works of authorship fixed in any tangible medium of expression . . . ."); 17 U.S.C. § 302(b) ("In the case of a joint work prepared by two or more authors . . . .").

34. *See also* Russ VerSteeg, *Defining "Author" for Purposes of Copyright*, 45 AM. U. L. REV. 1323, 1327 (1996).

35. *See, e.g.*, Aalmuhammed v. Lee, 202 F.3d 1227, 1235-36 (9th Cir. 2000) (holding that the plaintiff was not a joint author because the defendant lacked the requisite intent); Thomson v. Larson, 147 F.3d 195, 206-07 (2d Cir. 1998) (same); Erickson v.

clined to decide which approach to adopt, a district court in that circuit opted for Goldstein's approach.[36]

The most well-known of these cases is *Childress v. Taylor*.[37] Taylor wished to make a play about the comedienne Jackie "Moms" Mabley.[38] She researched the details of Mabley's life and then asked Childress to write the script based on the results of her research.[39] Although neither party signed a contract, Childress completed the script and Taylor paid her $2,500.[40] Childress filed for and received the copyright in her name alone. After efforts to formalize their relations failed, Taylor commissioned another playwright to modify the original play and she produced the new version, for which Childress brought suit alleging copyright infringement.[41] The Second Circuit affirmed the district court's finding that Taylor was not a joint owner because her contribution—ideas and research—was not copyrightable independently, and Childress never intended to share the ownership in the copyright.[42]

The Second Circuit examined both the Nimmer and Goldstein treatises, but it ultimately adopted the Goldstein approach. The court noted the considerable number of cases already in line with Goldstein's views.[43] The court also reasoned that the Goldstein approach would prevent people from making "spurious claims" and sharing in the "fruits of the efforts" of a sole author.[44] More importantly, the court viewed the test as the right balance between copyright and contract law.[45] Those who contribute copyrightable material will be protected through copyright law, and those who

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Trinity Theatre, Inc., 13 F.3d 1061, 1071-72 (7th Cir. 1994) (holding that suggestions, ideas, and refinements standing alone are not separately copyrightable and finding that the actors were therefore not joint authors); M.G.B. Homes, Inc. v. Ameron Homes, Inc., 903 F.2d 1486, 1493 (11th Cir. 1990) (holding that the house builder was not entitled to copyright protection for his suggestions to the floor plan).

36. Andrien v. S. Ocean County Chamber of Commerce, 927 F.2d 132, 136 (3d Cir. 1991) (declining to decide "whether each author of a joint work must make an independently copyrightable contribution"); Ballas v. Tedesco, 41 F. Supp. 2d 531, 540 (D.N.J. 1999) (ruling that plaintiff could not "claim joint authorship in the sound recordings merely because he contributed the idea for the work in the form of suggestions and desires").

37. 945 F.2d 500 (2d Cir. 1991).

38. *Id.* at 502.

39. *Id.* at 503.

40. *Id.*

41. *Id.* at 503-04.

42. *Id.* at 509.

43. *Id.* at 506.

44. *Id.* at 507.

45. *Id.*

contribute non-copyrightable material can protect their rights through contracts.[46]

As for what kind of intent is required on the part of the contributors, the court reasoned that the statutory requirement cast too broad a net and would capture people whom Congress did not intend to be classified as joint authors.[47] For example, the court stated that an editor or research assistant would be a joint author under the statutory definition of intent, but all parties would ordinarily not expect to share the copyright in the resulting work with the primary writer.[48] Again, the Second Circuit emphasized the balance between copyright and contract law. The court suggested that a default rule identifying all collaborators as joint authors would burden the dominant author, but the narrower rule that the court adopted would allow those parties "not in a true joint authorship" to bargain (contract) for rights.[49] The court's primary concern was to prevent situations where someone making a passing remark could reap the benefits of another's hard and creative labor.[50]

Following *Childress*, the Goldstein approach became the majority rule.[51] The Second Circuit did not depart from its approach in *Thomson v. Larson*. In *Thomson*, the New York Theater Workshop ("NYTW") hired Thomson to help Larson, the original playwright, in "clarifying the storyline" of the musical "Rent."[52] NYTW signed an agreement with Thomson and paid her for her services, but the contract failed to mention copyright interests.[53] After Larson's death, Thomson fine-tuned the script with others, but she brought suit when Larson's heirs refused to grant her royalties for the services provided and in recognition of her authorship status.[54] The court concluded that Thomson was not a joint author.[55] Some of the objective factors that the court examined included Larson's contract with NYTW (it listed him as the sole author and gave him rights over all

46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.* at 508-09.
50. *Id.* at 507.
51. *See supra* notes 35-36 and accompanying text; *see also* Balkin v. Wilson, 863 F. Supp. 523, 528 (W.D. Mich. 1994) (finding defendant did not make copyrightable contributions).
52. Thomson v. Larson, 147 F.3d 195, 197 (2d Cir. 1998)
53. *Id.*
54. *Id.* at 198.
55. *Id.* at 206-07.

changes), how he held himself out to third parties, and how he listed Thomson in the playbill.[56]

Moreover, the Seventh Circuit adopted the Goldstein approach in *Erickson v. Trinity Theatre, Inc.*, after a lengthy examination of both tests.[57] In *Erickson*, Erickson co-founded Trinity Theatre and wrote the scripts for three plays.[58] Other actors made suggestions and contributed ideas, but Erickson made the final editing decisions.[59] Furthermore, plaintiff licensed her plays to the defendant, who paid her royalties until the license expired.[60] After plaintiff left Trinity Theatre, she requested that defendant discontinue performances of her plays, and she sued when defendant did not comply.[61] The court applied the Goldstein rule and found that the actors' suggestions were not copyrightable on their own, and therefore ruled the actors were not joint authors.[62]

In a surprising turn of events ten years later, the Seventh Circuit adopted the Nimmer approach in *Gaiman*.[63] It remains to be seen whether Nimmer's approach will gain in popularity.

II. CASE REPORT

A. Facts and Procedural History

Appellee Neil Gaiman ("Gaiman") and Appellant Todd McFarlane ("McFarlane") are famous in the world of graphic novels.[64] Gaiman writes scripts for graphic novels but does not draw.[65] McFarlane writes and illustrates his stories.[66] Both have their own publishing companies (also in-

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56. *Id.* at 198, 202-05.
57. Erickson v. Trinity Theatre, Inc., 13 F.3d 1061, 1067-74 (7th Cir. 1994).
58. *Id.* at 1063.
59. *Id.* at 1064.
60. *Id.*
61. *Id.* at 1064-65.
62. *Id.* at 1072.
63. Gaiman v. McFarlane, 360 F.3d 644, 659 (7th Cir. 2004), *reh'g en banc denied*, 2004 U.S. App. LEXIS 6387 (7th Cir. Mar. 31, 2004).
64. *Id.* at 649. Gaiman wrote the award-winning *Sandman* series. Neil Gaiman, *About Neil: Biography*, *at* http://www.neilgaiman.com/about/bio.asp (last visited Feb. 9, 2005) [hereinafter Gaiman, *About Neil*]. McFarlane has worked on numerous comic book characters, including The Incredible Hulk, Spider-man, Batman, and Spawn. *Todd McFarlane*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, *at* http://en.wikipedia.org/wiki/Todd_McFarlane (last modified Jan. 14, 2005).
65. *Gaiman*, 360 F.3d at 649.
66. *Id.* Gaiman also writes traditional novels. Gaiman, *About Neil*, *supra* note 64.

volved in the suit), but Gaiman also produces materials for Marvel Comics and DC Comics on a "work made for hire" basis.[67]

McFarlane wrote and illustrated the comic book *Spawn*, which featured an anguished, undead superhero trapped in a pact with a demon.[68] After readers criticized the poor writing in the first few issues of *Spawn*, McFarlane entered into an oral agreement with Gaiman where Gaiman would furnish the script for one issue (volume 9) of *Spawn*.[69] The agreement did not mention copyright ownership and compensation, save that McFarlane would treat Gaiman "'better than the big guys'" did.[70] In *Spawn* No. 9, Gaiman introduced three new characters: Medieval Spawn, Angela, and Count Nicholas Cogliostro.[71] Gaiman named the latter two, and described and wrote dialogue for all three characters.[72] Based on the huge success of the issue, McFarlane paid Gaiman $100,000 (about what Marvel Comics and DC Comics would have paid him for his work according to Gaiman).[73] McFarlane then asked Gaiman to write a mini-series based on the now popular Angela character.[74] McFarlane subsequently created a toy company to produce action figures of *Spawn* characters, including Medieval Spawn; paid Gaiman royalties for his work on the *Angela* series and Spawn No. 26, which served as a transition between the main plot and the *Angela* series; and licensed the series for paperback reprints.[75]

In 1996, Gaimain heard McFarlane might sell his enterprise, so he asked for a written contract.[76] Negotiations ultimately fell through, and in 1999, McFarlane sent Gaiman a final offer where McFarlane unambiguously denied that Gaiman ever had a copyright interest in Medieval Spawn and Count Cogliostro, though he did not contest the co-ownership of the copyright in Angela.[77] As a result, Gaiman brought suit for declaratory judgment under the Act for acknowledgment as a joint copyright owner in the two disputed characters, damages for breach of his right of publicity,

67. *Gaiman*, 360 F.3d at 649.
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.* at 650.
72. *Id.*
73. *Id.* at 651.
74. *Id.*
75. *Id.* at 651-52. The record did not clearly state for what, exactly, McFarlane paid Gaiman.
76. *Id.* at 651.
77. *Id.* at 652.

and an accounting of McFarlane's profits.[78] The jury found for Gaiman, and the district court entered judgment in his favor and awarded him all the relief he sought.[79] McFarlane appealed to the Seventh Circuit.

B. Posner's Decision and Reasoning: Joint Authorship

Writing for the Seventh Circuit, Judge Posner limited the appeal to the injunction requiring McFarlane to acknowledge Gaiman as a joint author.[80] The court held that in cases of works involving two or more inputs, each contributor does not need to make a contribution that would be copyrightable if it stood alone.[81] The court acknowledged that the general case was to require an intention to be joint owners of the copyright and provide separately copyrightable contributions.[82]

Judge Posner considered a hypothetical situation where one professor had extremely good writing skills but mundane ideas, while another professor had great ideas but poor writing skills.[83] The two professors combined their abilities and produced an academic article.[84] Referring to *Nimmer on Copyrights* § 6.07, Judge Posner concluded that where both professors collaborate to produce an article and sign as coauthors, the intent to produce a joint work and be joint owners of the work is plain, thus rendering both professors as joint authors under 17 U.S.C. § 201(a).[85] Although one contributed the ideas and the other contributed the wording, both professors together have created an expressive work qualifying for copyright protection. Judge Posner did address the Goldstein approach, approved of in *Erickson*, but he distinguished *Gaiman* on the basis of the

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78. *Id.* at 648.

79. *Id.*

80. *Id.* The accounting was not complete at the time, and so the lower court's judgment was not final. Therefore, the Seventh Circuit limited its review to the injunction. *Id.*

81. *Id.* at 658-61.

82. *Id.* at 658. Most of the opinion examined the three year statute of limitations defense under the Act. Judge Posner went through a detailed analysis (involving the notices and the equitable estoppel doctrine) only to conclude that the jury's determinations were not unreasonable. *Id.* at 652-57. McFarlane's alternate theory was that the disputed characters were not copyrightable under the scenes à faire doctrine, the idea-expression dichotomy, and the derivative works doctrine. *Id.* at 657-62. However, the court duly noted that McFarlane still claimed that he owned the copyrights in those characters (based on his later contributions). *Id.* at 657. After measuring McFarlane's claims against the copyright doctrines, the court rejected his claims. *Id.* at 662. It is beyond the scope of this Note to address these issues, so they will not be mentioned further.

83. *Id.* at 659.

84. *Id.*

85. *Id.* (citing 1 NIMMER & NIMMER, *supra* note 9, § 6.07).

media used: *Erickson* involved a play (single, written medium), whereas *Gaiman* involved a comic book (written medium and a visual medium).[86]

Judge Posner then noted that comic books are generally the joint works of four contributors: the writer, penciler, inker, and colorist.[87] In a hypothetical situation where each contributor creates a stock character (lacking the distinctiveness necessary for copyright protection), it is feasible to create a finished product that is copyrightable.[88] Judge Posner implied that in that situation, the fairest decision is to split the ownership among all the authors where the individual contributions cannot be identified or where the intent to create one unified work exists.[89]

In the case at hand, only two artists were involved; however, the analytical construct remained the same: multiple artists created the work and at least one contributor unable to copyright his portion independently. Judge Posner viewed Gaiman's and McFarlane's contributions as equal.[90] Therefore, Judge Posner ruled that they were co-owners in the copyrights in the disputed characters by virtue of their combined efforts in creating the characters.[91] Accordingly, the Seventh Circuit unanimously affirmed the lower court's grant of declaratory judgment in favor of Gaiman.[92]

III. DISCUSSION

This Part analyzes the doctrinal approaches to joint authorship, *Gaiman*'s analytical framework, and the potential impact of the decision on highly collaborative works. Section A compares the two treatises with the statutory definition of "joint work" and the legislative history. Section B notes that Judge Posner correctly applied the Nimmer approach but delves into the possible reasons for adopting an approach contrary to the majority rule. Finally, Section C discusses the implications of the decision on future collaborative works and describes the problems that Judge Posner's holding may have.

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86. *Id.* at 658-59.

87. *Id.* at 659. Like magazines, comic books are thinly bound and are published weekly or monthly. Graphic novels, often used interchangeably with comic books, are collections of several comic book issues and may be published as a hardback or paperback book. Graphic novels can also be stand-alone issues. *See Comic Book*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, *at* http://en.wikipedia.org/wiki/Comic_book (last modified Jan. 22, 2005).

88. *Gaiman*, 360 F.3d at 659.

89. *Id.*

90. *Id.* at 661.

91. *Id.*

92. *Id.* at 662.

A. The Treatises, Their Statutory Interpretations of the Act, and Their Problems

1. The Nimmer Approach

The Nimmer approach follows the language in the definition of "joint work" very carefully. The standard requires potential joint authors to intend to create one copyrightable product, without the qualification that the contributions be separately copyrightable.[93] Consequently, if one favors a literal interpretation of 17 U.S.C. § 101, then the Nimmer approach is very appealing.

The Nimmer approach has other advantages. Because of the Nimmer approach's lower threshold—it only requires an intention to create a unitary work and some contribution above a minimum level—it rewards more people for their contributions and provides an incentive to collaborate. The approach also prevents parties from taking advantage of others.[94] Therefore, this approach also promotes creativity and reaches a fairer result.

However, critics of the approach have pointed out several objections. At first glance, the Nimmer approach seems to grant copyright protection to ideas, which the Act strictly forbids.[95] In another publication, Judge Posner also pointed out the high administrative costs with enforcing rights in ideas.[96] Upon reconsideration, copyright protection is given to the final product, which is an expression of many ideas in a fixed, tangible medium. It might seem unfair that the person who actually expresses the idea must share his reward with the person or people who contributed only ideas, but the project would not exist but for the impetus provided by the idea generators.

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93. 1 NIMMER & NIMMER, *supra* note 9, § 6.07. Contrast that intent with Goldstein's intent to be joint authors (share copyright ownership) from the start, as explained in Part I.C.

94. For example, A convinces B to help him create a work. They sign a contract, but the contract fails to mention copyright ownership. B makes a significant contribution and helps refine the work for publication. A never pays B for his services and never intends to share the copyright in the work with B. Under the traditional test, B is not a joint owner because A lacked the intent to be a joint owner. See Thomson v. Larson, 147 F.3d 195 (2d Cir. 1998), for a similar fact pattern. Under the Nimmer approach, B is a joint author and is entitled to royalties from the profits that the work generates.

95. 17 U.S.C. § 102(a) (2000) (denying copyright protection to "any idea, . . . concept, [or] principle, . . . regardless of the form in which it is described, explained, illustrated, or embodied in such work").

96. WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 93 (2003) (explaining that courts would have to "define each idea, set its boundaries, determine its overlap with other ideas, and, most difficult of all, identify the original idea in the works of the alleged infringer").

In addition, the Nimmer approach is not a bright-line rule and therefore is harder to apply. It also does not provide guidelines as to how a court finds the requisite intent in the absence of a contract. Moreover, the approach makes it difficult to value the significance of a person's contribution. The standard requires more than a word or line or suggestion, but it remains silent as to where the threshold contribution lies. What one person views as a minimal contribution may be what another person views as a significant contribution. For example, consider the situation where a person suggests moving a sculpture two inches to the left. On one hand, the move may affect the entire aesthetic feel to the sculpture, and the suggestion is very substantial. On the other hand, one could argue that the move may have merely practical reasons (such as leaving a window unobstructed or avoiding a power line), and therefore the suggestion is less than a minimal contribution to the work.

However, the Nimmer approach is not unreasonable. Courts are used to resolving disputes in the absence of bright-line rules. For example, in the context of a copyright infringement case, fact finders must determine on a case-by-case basis whether a substantial similarity exists between a plaintiff's copyrighted work and the defendant's work.[97] In copyright fair use analysis, judges also lack a bright-line rule and must consider four factors.[98] Judges can also make an analogy to patent law, which codifies a rule for joint inventors that is similar to the Nimmer approach for joint authors.[99]

Critics also contend that an intent to create a unitary work might also be simply too low a threshold. For example, suppose a writer and an editor intend to produce a solitary literary creation. Under the Nimmer approach, an editor could be a joint author along with the writer. On one hand, it

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97. *See, e.g.*, Sid & Marty Krofft Television Prods., Inc. v. McDonald's Corp., 562 F.2d 1157, 1164 (9th Cir. 1977) (stating that while the determination of substantial similarity in ideas may be simple, the determination of substantial similarity between the forms of expression "is necessarily more subtle and complex").

98. 17 U.S.C. § 107; *see, e.g.*, Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 577 (1994) (stating that the fair use factors are to be "weighed together, in the light of the purposes of copyright").

99. With patents, two or more people may be joint inventors "even though (1) they did not physically work together or at the same time, (2) each did not make the same type or amount of contribution, or (3) each did not make a contribution to the subject matter of every claim of the patent." 35 U.S.C. § 116 (2000). A person qualifies as a joint inventor if he contributes "in some significant manner to the conception or reduction to practice of the invention," or he makes a contribution "that is not insignificant in quality," or he does more than "merely explain" existing concepts and current state of the art. Pannu v. Iolab Corp., 155 F.3d 1344, 1351 (Fed. Cir. 1998).

seems unfair to grant copyright ownership to the editor when the writer's act created the work. On the other hand, it seems just as unfair to reward only the writer when the editor has rewritten portions of the text and made other substantial edits to the work. The Nimmer approach would not grant joint authorship to editors who changed a word here or there, but it would reward editors who made more than a minimal contribution; thus, it satisfies an instinctive sense of justice. In any event, this point may be moot since most writers and editors have a contract with each other or through the publisher.[100]

The software industry is another example of where a finding of joint authorship might be problematic. A single program often involves the work of many developers, and clients will often draw specifications and make suggestions so that the end product meets their expectations.[101] If the independent contractors hired to create the software are not covered by the work-made-for-hire doctrine, barriers to the commercial exploitation of the program arise.[102] Under the Nimmer approach, both the client and the developers are joint owners in the copyright.

Problems also arise in the open source licensing context. Computer programs are written in source code (which is what a human can read) and compiled into object code (which is the language of ones and zeroes that a computer can read).[103] Source code contains the innovations in computer engineering which comprise a company's proprietary secrets, so most companies distribute programs in object code only.[104] Open code software projects post the source code to the Internet, and other people can modify the program.[105]

The copyright ownership in modifications poses a similar challenge. One could argue that the modifiers are more like editors for a traditional novel (they both fix errors in the writing), and therefore, modifiers should not be entitled to joint authorship. However, one could also argue that a great deal of innovation is involved in eliminating errors or creating new

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100. Laura G. Lape, *A Narrow View of Creative Cooperation: The Current State of Joint Work Doctrine*, 61 ALB. L. REV. 43, 53 (1997) (explaining that editors are normally covered under the work-made-for-hire doctrine).

101. Matthew R. Harris, Note, *Copyright, Computer Software, and Work Made for Hire*, 89 MICH. L. REV. 661, 694-95 (1990).

102. *Id.* at 695.

103. Lawrence Lessig, *The Limits in Open Code: Regulatory Standards and the Future of the Net*, 14 BERKELEY TECH. L.J. 759, 764 (1999); *see also* Joseph Scott Miller, *Allchin's Folly: Exploding Some Myths About Open Source Software*, 20 CARDOZO ARTS & ENT. L.J. 491, 494 (2002).

104. Lessig, *supra* note 103, at 764.

105. *Id.*

uses for the program or making the program interoperable with others, and therefore, the modifiers should be entitled to joint authorship. Some organizations require all contributors (the original programmers and the modifiers) to assign the copyrights, thus dealing with the problem through licenses.[106] However, the University of California at Berkeley—in its Berkeley Software Distribution (BSD) license—only requires that any redistribution of the source (modified or not) retains the copyright notice in the original source code.[107] Under the Nimmer approach, the project founders intend the source code to be used in other projects or modified in other ways and arguably satisfy the intent to create a unitary work.

However, the problems in the software industry are not insurmountable. Like editors and writers, parties involved in the software industry can resolve copyright ownership issues through contracts, as the Free Software Foundation has done.[108] Again, the Nimmer approach does not grant joint authorship to every individual who satisfies the intent requirement. People must make more than a "de minimis" contribution, and the difficulties in proving such a contribution in the software programming context, combined with the high costs of bringing suit, is likely to act as a deterrent to free-riders. In the open source context, people probably will not claim joint authorship if the program is not well known, so the problem hardly exists.

Joint ownership becomes very problematic when many people share in the copyright. Judge Posner explained:

> If every owner of a Batman comic book were also a joint owner of the copyright, someone wanting to make and sell copies would have no difficulty persuading one of the millions of joint owners to license him for a pittance to make an unlimited number of copies. . . . If to solve this problem the law required the consent of the joint owners to be obtained, the transaction costs would be utterly prohibitive; someone one wanting to copy the Batman characters for a movie, television series, or clothing collection would have to obtain licenses from millions of copyright holders. The alternative of the copyright holder's retaining title

106. *See, e.g.*, Free Software Foundation, Frequently Asked Questions About the GNU GPL, *at* http://www.gnu.org/licenses/gpl-faq.html#AssignCopyright (last updated Dec. 16, 2004).

107. FreeBSD, The 4.4BSD Copyright, *at* http://www.freebsd.org/copyright/license.html (last modified Aug. 31, 2003).

108. *See supra* note 106 and accompanying text.

> to every Batman comic book and leasing (not selling) them to readers is only a little more attractive.[109]

Although Judge Posner paints a grim picture, his example remains a hypothetical. The Nimmer approach does not encompass every person who is connected to the work remotely or otherwise. Even in the context of a motion picture, courts could define minimal contributions such that only a few people qualify as joint authors under the Nimmer approach.

In sum, some difficulties exist in applying the Nimmer approach, which grants copyright protection to the final product and not bare ideas, but those problems are relatively small or can be addressed through contracts. Furthermore, if the contracts are not feasible or fail, the Nimmer approach is reasonable and leads to just results. A careful application will narrow the pool of possible joint authors to parties who have labored for that right. The Nimmer approach is also a better literal interpretation of the Act.

2. *The Goldstein Approach*

In contrast, the Goldstein approach does not follow the definition of a "joint work" closely. Goldstein requires all parties to intend to be joint authors (share the copyright) at the time of the work's creation.[110] The statutory definition lacks such an intent requirement; the Act only requires the parties to intend that their contributions be merged.[111] The stricter intent requirement (to be joint authors instead of to create a unitary work) comes from an interpretation of the legislative history. In adopting the Goldstein treatise, the Second Circuit collapsed the two criteria in the committee reports—an intent to collaborate and an intent to create a unitary work—into one requirement of intent, and thus read the second sentence as modifying the first.[112] However, the reports do not require an intention to be co-owners in the copyright at the time of creation. All that the legislative history requires is an intention "that the parts be absorbed or combined into an integrated unit."[113]

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109. LANDES & POSNER, *supra* note 96, at 126-27.

110. GOLDSTEIN, *supra* note 31, § 4.2.1.1; *see supra* Part II.C.

111. 17 U.S.C. § 101 (2000).

112. However, it is hard to imagine activity that would constitute meaningful 'collaboration' unaccompanied by the requisite intent on the part of both participants that their contributions be merged into a unitary whole, and the case law has read the statutory language literally so that the intent requirement applies to all works of joint authorship.

Childress v. Taylor, 945 F.2d 500, 505-06 (2d Cir. 1991).

113. H.R. REP. NO. 94-1476, at 120 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5736.

Nevertheless, the Goldstein approach arguably serves the intent of the Act. The Act protects "works of authorship" and federal copyright protection only exists for original expressions fixed in a tangible medium.[114] Therefore, a person cannot be an author unless he has fixed the work in a tangible medium. Consequently, a person cannot be an author, let alone a joint author, unless he has produced a copyrightable work or contributed copyrightable material. The Second Circuit described the nature of the contribution as the "more substantial issue" in the joint authorship context.[115]

There are drawbacks to Goldstein's approach as well. The requirement of separately copyrightable contributions conflicts with the Act, which contemplates the existence of inseparable contributions.[116] For example, movie producers sit in a room and bounce ideas off of each other. It is inefficient for everyone to write down all the ideas; only one person needs to do so. If everyone makes an equal contribution, Goldstein's approach would yield a perverse result: copyright protection would be granted to the note taker, who may have been selected arbitrarily. It seems unfair to deny copyright protection to the other producers—when no one could have made a creative work without their ideas and suggestions stimulating the project—just because a court cannot determine who contributed what.

The Second Circuit, in adopting the Goldstein approach, noted that those who are not free-riders and contribute non-copyrightable ideas and labors of some significance can protect themselves through contracts.[117] However, contracts are not the perfect substitute for copyright protection.[118] Parties often do not enter into agreements before collaborating, and that leads to difficulties when conflicts arise later. If parties enter into

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114. 17 U.S.C. § 102(a) (2000).

115. *Childress*, 945 F.2d at 506.

116. In fact, the definition of "joint work" states that creators must intend "that their contributions be merged into *inseparable* or interdependent parts of a unitary whole." 17 U.S.C. § 101 (emphasis added).

117. *Childress*, 945 F.2d at 507; *see also* LANDES & POSNER, *supra* note 96, at 43.

118. *See, e.g.*, RICHARD WINCOR, DEALING WITH COPYRIGHTS 15 (2000) ("Literature as a commodity is unlike the bales of hay and other tangibles. . . . In some degree it eludes doctrine, frequently it defies contract drafting and always, always it stands unique among property assets as a complex of potentials in new form."); Rochelle Cooper Dreyfuss, *Collaborative Research: Conflicts on Authorship, Ownership, and Accountability*, 53 VAND. L. REV. 1162, 1168-82 (2000) (arguing that "first order private solutions"—otherwise known as contracts—are ineffective because of the transaction costs and because parties often cannot reach a consensus, predict the outcomes of a cooperative project, or value contributions accurately).

agreements prior to collaborating and the contracts are only oral, as in *Gaiman*, then the oral agreements are difficult to interpret.[119]

Depending on the party's bargaining power, those who contribute significant (albeit sometimes unfixed) materials may not get the protection they should get. Consider the mentoring system of graduate students. The students may run a significant portion of the experiments and write the majority of the draft report. However, rarely will professors acknowledge student contributions.[120] Additionally, developments are difficult to predict and provide for in a contractual provision. Finally, collaborators' interests are adversarial outside of the creation of the joint work, and a contract may not be able to resolve those issues.[121] For example, parties may never be able to resolve the issue of compensation when a person, who contributed 20% of the materials, boosted the success of the resulting work by an undeterminable amount.[122]

Though courts are concerned with the free-rider problem, one commentator has suggested that the intent to be co-authors could allow the dominant party "to lure others into contributing material to a unitary work, all the while withholding the intent to share in its economic and reputational benefits."[123] The subjective intent of the parties is insufficient to meet the requirement.[124] However, objective determination of the parties' intent may yield an unsatisfactory decision.[125] For example, in *Thomson*, the court determined that the original playwright never intended to share the ownership in the copyright and, therefore, ruled that Thomson was not a joint author of "Rent."[126] One commentator notes the difficulty in dis-

119. *See, e.g.*, Gaiman v. McFarlane, 360 F.3d 644, 650 (7th Cir. 2004), *reh'g en banc denied*, 2004 U.S. App. LEXIS 6387 (7th Cir. Mar. 31, 2004).

120. Dreyfuss, *supra* note 118, at 1230 (stating that "there has always been something of a tradition to ignore student input into faculty research").

121. WINCOR, *supra* note 118, at 3 (stating that "collaborators are adversaries one to the other").

122. *Id.* at 21 (concluding that the only solution to this hypothetical may be an arbitration clause in the contract).

123. Dreyfuss, *supra* note 118, at 1206.

124. *Id.* at 1206; *see also* Childress v. Taylor, 945 F.2d 500, 507-08 (2d Cir. 1991).

125. It seems somewhat unfair to require an objective intent when the parties often lack it or entertain misconceptions about the other's intent. *See, e.g.*, *Childress*, 945 F.2d at 508-09 (finding that defendant's claim of co-authorship was "properly rejected" though she commissioned the work, contributed research and suggestions, and had the notion that they were co-authors of the play); *see also* WINCOR, *supra* note 118, at 22 (stating that courts will have to impute intent when the parties failed to consider the authorship issues in the first place).

126. Thomson v. Larson, 147 F.3d 195 (2d Cir. 1998).

covering Larson's intent in advance and hence the inability to avoid being taken advantage of.[127]

Furthermore, when a court finds that a product is not a joint work, questions remain as to who has rights in the output of non-author contributions.[128] Usually movies, sound recordings, and the like are created under the work-made-for-hire doctrine.[129] However, other collaborations, such as serial collaborations (works with consecutive contributions) may not qualify under that doctrine, especially works created over the Internet.[130] Under the traditional test for joint authorship—intent to be joint authors and materials furnished must be separately copyrightable—a court is not likely to find that an Internet serial collaboration is a joint work.[131]

For example, suppose a person posts a poem to a listserv or online bulletin board, a second person adds a melody and posts the modified result to the same bulletin, and then either the poet or the songwriter markets the song and makes a fortune. When the song was created, the poet did not intend to make a song at all, and so the requisite intent is absent since both parties must have intended to be joint authors at that time. But, a classification of the song as a joint work benefits all parties: one joint author gets to use and license the work, and the other shares in the profits generated.[132] If the song is not a joint work, then it is an infringing, unauthorized derivative work or a licensed derivative work (the license being implied from the circumstances).[133] If classified as an infringing derivative work, then the infringer cannot copyright the work (thus, losing the ability to exploit the work), and he cannot use the work without permission and is now liable to the other for damages.[134] If considered a licensed derivative

127. Dreyfuss, *supra* note 118, at 1206.

128. *Id.* at 1180 (stating that the entire play in *Thomson* "fell into a kind of void" because the court's decision failed to determine who had rights in Thomson's contributions).

129. F. Jay Dougherty, *Not a Spike Lee Joint? Issues in the Authorship of Motion Pictures Under U.S. Copyright Law*, 49 UCLA L. REV. 225, 228 (2001).

130. Lape, *supra* note 100, at 75 (stating that the work-made-for-hire doctrine will have "little impact in the Internet setting, where a recipient could rarely be construed as having been hired by the author of transmitted material").

131. *Id.* at 76.

132. *Id.* at 80-81.

133. *Id.* at 76.

134. *See, e.g.*, Gracen v. Bradford Exch., Inc., 698 F.2d 300, 303 (7th Cir. 1983) (stating that if plaintiff "had no authority to make derivative works from the movie, she could not copyright the painting and drawings, and she infringed [defendant's] copyright by displaying them publicly"); Anderson v. Stallone, No. 87-0592 WDK (Gx), 1989 U.S. Dist. LEXIS 11109, at *29 (C.D. Cal. Apr. 26, 1989) (finding that plaintiff's movie

work, then the non-marketing party loses out on the profits. With both contributions being equal, the finding of a derivative work seems most unfair. Yet that is the only outcome left under Goldstein's approach.

B. Analysis of *Gaiman*

Judge Posner's decision is perplexing for several reasons. First, the key part of his decision is that for mixed media works, there is no requirement that the individual contributions be eligible for copyright protection on their own; instead, he emphasized the intent to create an expressive work together as the lynchpin for deciding whether collaborators are joint authors.[135] One cannot distinguish the cases on the media used, and further, the outcomes of those cases would be different under the Nimmer approach. Thus, while Judge Posner stated that his decision does not overturn precedent, he has effectively mandated a new standard for copyright joint authorship cases. Second, Posner's rejection of Goldstein's bright-line rule also conflicts with his past preference for clear evidentiary rules. Finally, Judge Posner also adopted a new approach when he did not necessarily need to. In the end, perhaps he decided to in order to reach an equitable solution.

1. "Mixed Media" and Past Precedent

Judge Posner has not defined "mixed media." Rather, he has given examples of comic books and movies.[136] The definition may encompass any work other than a novel, but such a definition is probably too broad. But, perhaps it refers to only works with a visual and a narrative component. However, Judge Posner uses as his primary example an academic article, a work that clearly involves only a single medium.[137] It is impossible to distinguish *Gaiman* from past cases on the basis of an undefined term.

"Mixed media" most likely encompasses movies, computer programs, sound recordings, and other highly collaborative works.[138] Yet, those works have been around for some time now, and judicial treatment of cartoons and comic books is certainly not new.[139] Courts have not treated

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treatment was not entitled to copyright protection because it was an unauthorized derivative work).

135. Gaiman v. McFarlane, 360 F.3d 644, 659 (7th Cir. 2004), *reh'g en banc denied*, 2004 U.S. App. LEXIS 6387 (7th Cir. Mar. 31, 2004).

136. *Id.* at 658.

137. *Id.* at 659.

138. Each item listed has multiple components. For example, computer programs may utilize written media as well as audio and visual media.

139. *See, e.g.*, D.C. Comics Inc. v. Reel Fantasy, Inc., 696 F.2d 24 (2d Cir. 1982) (Batman); Walt Disney Prods. v. Air Pirates, 581 F.2d 751 (9th Cir. 1978) (Mickey

such "mixed media" any differently than traditional literary works, such as novels, poems, and plays.[140] The underlying analysis remains the same regardless of the medium in dispute: while there are more contributors, only one person or a handful of people *control* the translation from ideas to expression. Courts still require an intention to be joint authors before they will grant co-ownership in the copyright.[141]

Given that mixed media are not really new media, it is puzzling why Judge Posner adopted the Nimmer approach when the Seventh Circuit had already adopted Goldstein's approach in *Erickson*.[142] Additionally, application of the Nimmer approach to older cases yields different outcomes. The court would have found joint authorship in *Childress* because both parties intended to create a unitary work (a play about Mabley's life) and the defendant made more than a minimal contribution (Taylor extensively researched Mabley's life and suggested general scenes and characters).[143] The court would also have found joint authorship in *Thomson* under the Nimmer approach because the parties intended to create a unitary work ("Rent") and Thomson contributed a substantial amount (she worked "intensively" with Larson and continued fine-tuning after his death).[144]

Most likely, the *Gaiman* court distinguished the case on the basis of "mixed media" to reach an equitable result and tactfully avoid stating that it was ignoring precedent.[145] Therefore, the "mixed media" distinction is not significant, and for all practical effects, Judge Posner has now decreed that the approach in the Seventh Circuit is the Nimmer approach for all copyright joint authorship cases, at least until a party challenges his decision. If the Seventh Circuit, hearing a matter en banc, ever formally ap-

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Mouse and others); Detective Comics, Inc. v. Brun Publ'ns, 111 F.2d 432 (2d Cir. 1940) (Superman); Fleischer Studios, Inc. v. Ralph A. Freundlich, Inc., 73 F.2d 276 (2d Cir. 1934) (Betty Boop).

140. *See* WINCOR, *supra* note 118, at 17 (warning that "obsession with technology never must eclipse its magic content"). *Compare* Childress v. Taylor, 945 F.2d 500 (2d Cir. 1991) (play), *and* Kaplan v. Vincent, 937 F. Supp. 307 (S.D.N.Y. 1996) (manuscript), *with* Ulloa v. Universal Music & Video Distrib'n Corp., 303 F. Supp. 2d 409 (S.D.N.Y. 2004) (sound recording), *and* Morill v. Smashing Pumpkins, 157 F. Supp. 2d 1120 (C.D. Cal. 2001) (videotaped band performance), *and* Ashton-Tate Corp. v. Ross, 728 F. Supp. 597 (N.D. Cal. 1989) (computer spreadsheet program).

141. *See supra* note 140 and accompanying text.

142. Erickson v. Trinity Theatre, Inc., 13 F.3d 1061 (7th Cir. 1994).

143. 945 F.2d at 502.

144. Thomson v. Larson, 147 F.3d 195, 197-98 (2d Cir. 1998).

145. As a member of a three-judge panel, Judge Posner lacked the authority to do so. Technically speaking, only en banc decisions may overturn prior precedent in a circuit.

proves the *Gaiman* decision and overturns the *Erickson* decision, the circuits will be split.[146]

2. *Evidentiary Consequences*

In the past, Judge Posner favored rules that minimized administrative costs.[147] In *Gracen v. Bradford Exchange, Inc.*, he held that derivative works must be original (in the legal sense as opposed to the artistic one) or else proof of copyright infringement would be monumental.[148] Plaintiff entered a competition to paint Dorothy as played by Judy Garland in "The Wizard of Oz."[149] When she refused to sign a contract, her employer turned to another artist and gave him the plaintiff's painting to help him do his own.[150] Gracen sued defendants for copyright infringement for selling plates with her painting on them, and defendants counterclaimed for infringement of the copyright in the movie.[151]

Judge Posner affirmed the dismissal of the complaint because plaintiff's copyright registrations were invalid.[152] In reaching this decision, he offered the following hypothetical:

> Suppose Artist A produces a reproduction of the Mona Lisa, a painting in the public domain, which differs slightly from the original. B also makes a reproduction of the Mona Lisa. A, who has copyrighted his derivative work, sues B for infringement. B's defense is that he was copying the original, not A's reproduction. But if the difference between the original and A's reproduction is slight, the difference between A's and B's reproductions will also be slight, so that if B had access to A's reproductions the trier of fact will be hard-pressed to decide whether B was copying A or copying the Mona Lisa itself.[153]

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146. *See supra* notes 35-36 and accompanying text.

147. Douglas Lichtman, *Copyright as a Rule of Evidence*, 52 DUKE L.J. 683, 706 (2003) (stating that "the most famous and complete articulation of the evidence theory" was in Judge Posner's *Gracen* opinion). The evidence theory suggests that evidentiary issues would be "too complex if courts were to allow copyright in miniscule variations." *Id.* The logical conclusion is that courts should adopt rules that simplify evidentiary issues to conserve judicial resources.

148. Gracen v. Bradford Exch., Inc., 698 F.2d 300, 304-05 (7th Cir. 1983).

149. *Id.* at 301.

150. *Id.*

151. *Id.*

152. *Id.* at 304-05 (holding that Gracen's works lacked originality and therefore were derivatives that were ineligible for copyright protection).

153. *Id.* at 304.

To avoid the difficulty and problems of evidence, Judge Posner ruled that plaintiff's depictions were not original derivative works contemplated in the Act.[154]

Yet, the Nimmer approach which Judge Posner has adopted presents evidentiary problems similar to those in *Gracen*. Courts will have a difficult time deciding when someone has made more than a minimal contribution when the alleged portion is a bundle of ideas, suggestions, facts, or other non-copyrightable material. It is unlikely that parties will keep strict records for future litigation (for example, meeting minutes, copies of suggestions or research). Judge Posner seems to have shifted away from the bright-line rules adopted in *Gracen* and *Erickson*.

Admittedly, bright-line rules are easier to apply. But in some cases, such as computer programs, the difficulty in proving more than a minimal contribution may deter some parties from bringing suit, which increases administrative efficiency because the court would hear fewer cases. In any event, courts are accustomed to adjudicating disputes in the absence of such rules, and judges can look to patent cases for guidance.[155]

3. *Equities*

Perhaps Judge Posner rejected the Goldstein treatise in *Gaiman* because he wanted to ensure that declaratory judgment in favor of Gaiman would not be disturbed in case other judges disagreed with his application upon appeal. However, Gaiman arguably qualified as a joint author even under Goldstein's approach. One could argue that McFarlane intended to jointly own the characters with Gaiman when he promised to treat Gaiman "better than the big guys" did and when he sent Gaiman royalty reports referring to Gaiman as a "co-creator" of one of the characters.[156] In any event, the "more substantial issue" in the Goldstein approach, as the Second Circuit applied it, was whether each contribution is separately copyrightable.[157] Gaiman's contributions satisfied this requirement.

Gaiman wrote the dialogue for the characters—a fact that Judge Posner did not emphasize.[158] While copyright protection of a cartoon charac-

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154. *Id.* at 305. Judge Posner limited his ruling to derivative works and noted that nothing prevents an artist from claiming copyright if he paints from real life, even though it looks exactly like a photograph of the subject. *Id.*

155. *See supra* notes 97-99 and accompanying text.

156. *Gaiman*, 360 F.3d at 650, 652.

157. *Childress*, 945 F.2d at 506.

158. While Judge Posner acknowledged that Gaiman contributed "expressive content," he stated that Gaiman's contributions "may not have been copyrightable by itself." *Gaiman*, 360 F.3d at 661.

ter does not extend to "intangible attributes," a character's speech is "written expression contained in the work," which is protectible.[159] Perhaps McFarlane regarded the character's speech as irrelevant to the determination of royalties for an action figure. However, every joint author is entitled to a portion of those royalties, and the dialogue is a significant factor in the finding of joint authorship.[160]

For instance, suppose person A writes the script for "The Masked Infringer" (a cartoon character) and person B illustrates the character. "The Masked Infringer" is considered a joint work. If A and B license "The Masked Infringer" to company C, and C keeps the text but hires a new illustrator when C publishes the character, B (the original illustrator) still gets a part of the royalties paid because B is a joint author. "The Masked Infringer" would not exist without the contributions of B, and A would not have been able to license the character without B's input. Therefore, though B's original input is no longer being used, it is only fair to give him part of the royalties.

Perhaps Judge Posner wishes to promote collaborative efforts and grant joint author status to more people. Certainly there are many advantages. As one commentator notes, "the social cost of incorrectly stripping someone of authorship is higher than the cost of incorrectly classifying someone as a joint author."[161] Joint authorship maximizes dissemination because every author can exploit the work without permission from others.[162] Also, since every author owes a duty of accounting to the others, no one can "grab an unjust share of the rewards."[163] By rewarding all parties who make more than minimal contributions, the Nimmer approach helps Judge Posner achieve his goals of providing incentives for people to collaborate and granting joint copyright ownership to more people.

C. Implications

Those who favor the Goldstein approach fear increased litigation. Parties may be concerned that the *Gaiman* decision blurs the line between suggestions and contributions constituting joint authorship and that it may take the courts a long time to determine what constitutes more than a "de

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159. U.S. COPYRIGHT OFFICE, CIRCULAR 44, CARTOONS AND COMIC STRIPS (2002).

160. *Gaiman*, 360 F.3d at 661 (holding that once the character was "drawn and named and given speech he became sufficiently distinctive to be copyrightable" and therefore became the joint work of the parties).

161. Dreyfuss, *supra* note 118, at 1207.

162. 1 NIMMER & NIMMER, *supra* note 9, § 6.10; *see also* Dreyfuss, *supra* note 118, at 1207.

163. Dreyfuss, *supra* note 118, at 1207.

minimis" contribution. Parties may also believe they have to litigate the definition of "mixed media" in the Seventh Circuit; otherwise, *Erickson* (the Goldstein approach) is the rule of thumb.[164] However, as discussed above, Judge Posner has effectively adopted the Nimmer approach for all works. Also, experienced parties usually anticipate such problems beforehand, so the amount of litigation will not likely increase dramatically.

The Nimmer approach creates other problems when it grants rights to nonessential players. For example, if a percussionist (who is not covered by the work-made-for-hire doctrine) ad-libs a few phrases in the recording studio, he would be a joint author under the Nimmer approach. For that relatively small contribution, he can terminate transfers of the copyright in the song thirty-five years from now.[165] Record companies cannot force him to assign his termination rights because those rights are inalienable.[166] The termination of transfers coupled with joint authorship status under the Nimmer approach create an incentive for the other authors to destroy the value of the work by licensing the work indiscriminately because they have no duty to account if no profits are made on the licenses.

Nonetheless, the court's decision is not as fearsome as it first appears. Most parties anticipate some profits from collaborative efforts and therefore enter into arrangements under the work-made-for-hire doctrine to begin with (as DC Comics and Marvel Comics have done with Gaiman) or contract around the problem beforehand (have the contributors assign all copyright interests before the project begins).

Where the work-made-for-hire doctrine fails or the contracts are not signed, the Nimmer approach affords broader protection to creative inputs. For example, movie producers often hire others to write the script and translate the producers' ideas from storyboards to the final product. The Nimmer approach grants copyright protection to producers' ideas, once merged with the other contributions of expression. In *Thomson*, Thomson wrote a portion of the lyrics and the script, but the court held she was not a joint author because Larson did not intend for them to be joint authors.[167] Under the Nimmer approach, Thomson's contributions would be pro-

164. *Gaiman*, 360 F.3d 644, 659 (stating that the opinions that follow the Goldstein treatise do so "rightly in the generality of cases" but also stating that those opinions have failed to consider mixed media works where contributions cannot stand alone), *reh'g en banc denied*, 2004 U.S. App. LEXIS 6387 (7th Cir. Mar. 31, 2004).

165. 17 U.S.C. § 203 (2000); *see also* David Nimmer & Peter S. Menell, *Sound Recordings, Works for Hire, and the Termination-of-Transfers Time Bomb*, 49 J. COPYRIGHT SOC'Y U.S.A. 387, 397 (2001).

166. Nimmer & Menell, *supra* note 165, at 397.

167. Thomson v. Larson, 147 F.3d 195 (2d Cir. 1998).

tected. Finally, parties in working relationships, such as a client who works closely with an architect to tailor the designs to the client's needs, will not fear an infringement suit if the architect reuses the sketches or ideas later.[168]

The Nimmer approach will also not negatively impact creativity. Some people already share ideas without regard to idea protections.[169] It is more likely that the broader scope of coverage may encourage creativity. With greater protection, people will be more willing to share ideas. It may also encourage parties to contract before pursuing endeavors.[170] Anticipating and providing for problems before they arise leads to greater clarity of law and predictability. The smaller the risks, the greater the likelihood of investment becomes.

Granted, this approach may lead to decreased collaborations. Extended, complicated negotiations may deter some artists from pursuing the project, especially since artists tend to distrust lawyers.[171] Yet for all their dislike of attorneys and contracts, artists have signed contracts and made movies, records, and other highly collaborative projects in the past, and they will probably continue to do so in the future.

IV. CONCLUSION

It is an encouraging sign that a federal circuit court of appeals has finally adopted the Nimmer approach. The hypothetical applications suggest that this approach goes beyond Judge Posner's limitation to "mixed me-

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168. However, the Nimmer approach has been outright rejected in architectural cases. *See, e.g.*, MGB Homes, Inc. v. Ameron Homes, Inc., 903 F.2d 1486 (11th Cir. 1990) (finding a lack of intent that the sketch become a part of the finished plans). Whether the court's finding was correct is questionable. *See* Lape, *supra* note 100, at 54 (wondering why a client would produce a sketch if it was not going to be incorporated or why an architect would take the job if he was not going to meet his client's specifications).

169. Parodists or creators of fan fictions will often merge their ideas with pre-existing materials and then share their ideas with major studios or companies in the hopes of getting a big paycheck. However, most of their work product are considered unauthorized derivatives. *See, e.g.*, Sobhani v. @radical.media, Inc., 257 F. Supp. 2d 1234 (C.D. Cal. 2003) (finding that plaintiff's commercials, which spoofed the movie *Cast Away*, were unauthorized derivative works based on Jack-in-the-Box commercials); Anderson v. Stallone, No. 87-0592 WDK (Gx), 1989 U.S. Dist. LEXIS 11109, at *15-16 (C.D. Cal. Apr. 26, 1989) (finding that plaintiff's treatment for *Rocky IV* was not entitled to copyright protection because it was an unauthorized derivative work).

170. Dreyfuss, *supra* note 118, at 1217-18 ("So long as dominant authors know they cannot silently veto the expectations of others, they will be forced to lay their plans on the table and negotiate.").

171. *Id.* at 1172 (noting that many authors have "cultural aversions to lawyers and legal matters").

dia." While the Nimmer approach may result in decreased collaboration or an exponential increase in litigation, those outcomes have a very low probability. Furthermore, the Nimmer approach is better because it is fairer to the parties and grants broader protection in the absence of a contract. The Nimmer approach is also a more faithful interpretation of the Act, and it will promote and foster creativity and the arts. The advantages of the approach offset any costs to efficiency.

BUYER BEWARE: THE UNEXPECTED CONSEQUENCES OF THE VISUAL ARTISTS RIGHTS ACT

By Natalia Thurston

> "[I]n destroying my paintings, the Rockefellers have committed an act of cultural vandalism. There ought to be, there will be yet, a justice that prevents assassination of human creation as of human character."—Diego Rivera[1]

Artist Diego Rivera publicly accused John D. Rockefeller, Jr. of committing "art murder" after Rockefeller ordered the destruction of a mural his family commissioned Rivera to paint at their Manhattan headquarters in 1934.[2] The controversy hinged on Rivera's expression of political themes in the mural, including "May Day marchers in Moscow, gas masks and death rays, and venereal-disease germs hovering over dissolute society ladies," an antithetical adornment for the headquarters of one of the most powerful capitalist American families of the time.[3] The final death blow to the mural occurred when Rivera painted a portrait of Lenin in the mural, an image to which the Rockefellers strongly objected. Rivera refused to remove the image of Lenin, and as a result, without notice to Rivera, the Rockefellers had the mural completely destroyed in February of 1934.[4] At the time, Rivera had no cause of action against the Rockefellers for destruction of the mural because the Rockefellers had paid Rivera in full for the commission. Consequently, the mural was the Rockefellers' property and they were legally entitled to destroy it.

Today, under the Visual Artists Rights Act of 1990 ("VARA"),[5] Rivera could have sued the Rockefellers for violating his moral right of integrity. VARA grants visual artists two distinct moral rights: integrity and attribution. Under VARA, Rivera's right of integrity would prevent the Rockefellers from intentional distortion, mutilation or modification of his work.[6] Prior to the mural's destruction, Rivera could have filed suit

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1. JOSEPH L. SAX, PLAYING DARTS WITH A REMBRANDT: PUBLIC AND PRIVATE RIGHTS IN CULTURAL TREASURES 15 (1999), *quoted in* N.Y. TIMES, Feb. 13, 1934, at 21.
2. *Id.* at 15.
3. *Id.* at 14.
4. *Id.* at 14-15.
5. 17 U.S.C. § 106A (2000).
6. *Id.* § 106A(a)(3).

against the Rockefellers for injunctive relief and damages under VARA because destruction of the mural—a work of recognized stature—arguably caused harm to his reputation as an artist.[7]

On its face, VARA appears to benefit artists by providing protection for their works and reputations. However, the introduction of moral rights into American jurisprudence has had broader, unexpected implications. Two recent decisions under VARA, *Phillips v. Pembroke Real Estate*[8] and *Pollara v. Seymour*,[9] illustrate not only the limited scope of VARA, but also the divide between an artist's lifelong moral right in a work and the traditional rights of property owners to control their property. In addition, since the majority of cases litigated under VARA involve public works, the public also has a cultural interest in preserving or destroying the works. Finally, the economic impact of the assertion of rights under VARA may in effect dampen rather than promote the creation of arts, due to inefficiencies in the bargaining process and property holders' fear of impending litigation if they commission a work.[10]

Part I of this Note reviews the background behind the relatively recent recognition of artists' moral rights in the United States and the scope of the rights granted under VARA. Part II evaluates the decisions in *Phillips* and *Pollara* with regard to the courts' specific application of VARA. Part III examines the implications of the decisions in *Phillips* and *Pollara* from three perspectives: that of the artist, the property holder, and the public. An economic analysis of the impact of VARA indicates that the competing interests in a work of art create tension between the traditional rights of property holders, the artist's desire to protect her reputational interests, and the benefit the public gleans from art's contribution to the body of culture.

I. BACKGROUND

Congress enacted the Visual Artists Rights Act of 1990 to codify the protection of artists' moral rights, namely the rights of attribution and in-

7. *Id.* Even if Rivera's work fell under VARA's exception for works incorporated into a building, the Rockefellers still would have been required to provide notice to Rivera that they were going to destroy the mural in order to give him an opportunity to remove it. *Id.* § 113(d).

8. 288 F. Supp. 2d 89 (D. Mass. 2003).

9. 344 F.3d 265 (2d Cir. 2003).

10. It is unlikely the Rockefellers would have commissioned a work by the politically-charged Rivera if they had no control over their right to display or preserve the work.

tegrity.[11] The right of attribution grants an artist the right to claim authorship to a work and the right to forbid usage of her name in connection with a work she did not create.[12] The right of integrity grants an artist the right to prevent distortion, truncation, and/or mutilation of a work of visual art of recognized stature that would damage the honor or reputation of the artist.[13]

A. Origin of Moral Rights

Moral rights are concerned with the personal expression of the artist and therefore flow from the relationship between personhood and property.[14] Traditional property rights are fungible in nature; however, the personhood theory of property suggests that certain property is imbued with intangible meaning as well.[15] The viewer of a work of visual art instills the work with intangible meaning. For example, to the Rockefellers, Rivera's mural represented far more than paint applied decoratively to a wall—the mural's depiction of communist ideals directly attacked the character of the Rockefeller family. To Rivera, the mural represented the expression of his life-long commitment to social justice, a theme that influenced his entire body of work.

Consequently, art as property creates tension between an artist's right to control reputational externalities—or her artistic "voice"—and the art owner's right to exercise traditional property rights over the work. As Professor Burton Ong explains, "[t]he recognition of . . . [moral] . . . rights in a manner which favors the artistic sensibilities of the artist over the competing interests of those who own the objects . . . signals a measure of respect for the artist's position within the community."[16] Art as a physical object has meaning that extends beyond both the artist and the owner. An artist's work benefits the larger community. There is a public interest in preserving and protecting art works to enhance cultural development and promote the creation of new works.

Before the enactment of VARA, the range of claims filed by artists to protect their work, from First Amendment claims to copyright infringement, indicates that the only method for artists to protect their integrity

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11. 17 U.S.C. § 106A.

12. *Id.* § 106A(a)(1); 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8D.03 (2004).

13. 17 U.S.C. § 106A(a)(3); 3 NIMMER & NIMMER, *supra* note 12, § 8D.04.

14. *See* Margaret J. Radin, *Property and Personhood*, 34 STAN. L. REV. 957 (1982).

15. *See id.*

16. Burton Ong, *Why Moral Rights Matter: Recognizing the Intrinsic Value of Integrity Rights*, 26 COLUM. J.L. & ARTS 297, 303 (2003).

right was to either contract for protection or piece together an arguably valid claim from various bodies of law including copyright, constitutional, and trademark law.[17]

Several court opinions acknowledged moral rights prior to VARA, such as *Crimi v. Rutgers*[18] and *Gilliam v. ABC*.[19] In *Crimi*, the court declined to award damages to an artist whose mural had been painted over in a church, holding that the artist should have contracted for the display rights.[20] In *Gilliam*, the Second Circuit reached a different conclusion from *Crimi* and held that absent an agreement, the right to make changes to the *Monty Python* show resided in the authors of the show.[21] The court upheld the plaintiffs' copyright infringement and Lanham Act claims and held that the defendants, in broadcasting an edited version of the *Monty Python* show, misrepresented the plaintiffs' work, thereby causing injury to the plaintiffs' business and personal reputations.[22]

In order to comply with the Berne Convention's Article 6*bis* and compete internationally, the U.S. Congress finally codified moral rights under VARA, sixty years after the Berne Convention adopted moral rights in 1928.[23] The relatively late adoption of moral rights in the United States was due to the judiciary's reluctance to attach non-economic rights to property that do not belong to the traditional property owner.[24] Traditional property rights pass with physical possession of the property—when property is transferred, so are the accompanying rights and duties associated with the property. However, in the case of a work of visual art, moral rights are retained by the artist regardless of who owns the work of visual art, including the copyright.[25]

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17. *See generally* Serra v. U.S. Gen. Serv. Admin., 847 F.2d 1045 (2d Cir. 1988); Gilliam v. ABC, 538 F.2d 14 (2d Cir. 1976); Wojnarowicz v. Am. Family Ass'n, 745 F. Supp. 130 (S.D.N.Y. 1990); Crimi v. Rutgers Presbyterian Church, 89 N.Y.S.2d 813 (N.Y. Sup. Ct. 1949).

18. 89 N.Y.S.2d 813

19. 538 F.2d 14.

20. 89 N.Y.S.2d at 818-19.

21. 538 F.2d at 17.

22. *Id.*

23. Berne Convention for the Protection of Literary and Artistic Works, Sept. 9, 1896 (revised June 2, 1928), art. 6*bis*, *available at* http://www.wipo.int/treaties/en/ip/berne/trtdocs_wo001.html#P123_20726; *see* Russ VerSteeg, *Federal Moral Rights for Visual Artists: Contract Theory and Analysis*, 67 WASH. L. REV. 827 (1992). VerSteeg suggests that Congress's motivation in complying with Article 6*bis* was to protect American works of visual art in the world market as well as to have a role in shaping international copyright law.

24. Ong, *supra* note 16 at 304.

25. *Id.*

The slow adoption of moral rights reflected the judiciary's concern with fragmenting traditional property rights and recognizing non-pecuniary interests in property.[26] Congress' impetus in codifying the moral rights of attribution and integrity however stemmed from its desire to spur creation of new works as well as to preserve existing works for the public's cultural benefit.[27] Since American artists only gained international clout beginning with abstract expressionists such as Jackson Pollock in the 1940s,[28] the rise of the economic value of American art may have contributed to concern that destruction of such work would have a negative impact both culturally and economically.

B. Overview of VARA

Effective June 1, 1991, VARA grants authors of visual works of recognized stature the moral rights of attribution and integrity.[29] The right of attribution entitles an artist to claim authorship of a work, and to deny authorship if his work is altered or damaged in a way that would harm his honor or reputation.[30] This right is codified under 17 U.S.C. § 106A(a)(1) and (2) which state that:

> (a) . . . the author of a work of visual art—
>
> (1) shall have the right—
>
> (A) to claim authorship of that work, and
>
> (B) to prevent the use of his or her name as the author of any work of visual art which he or she did not create;
>
> (2) shall have the right to prevent the use of his or her name as the author of the work of visual art in the event of a distortion, mutilation, or other modification of the work which would be prejudicial to his or her honor or reputation . . . .[31]

The right of integrity grants the artist the right to prevent distortion, mutilation, or alteration of a work of recognized stature that would harm

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26. *See supra* note 17.

27. H.R. REP. NO. 101-514 (1990), *reprinted in* 1990 U.S.C.C.A.N. 6915, 6925 [hereinafter VARA House Report].

28. *See Abstract Expressionism: Artists and their Works*, ARTCYCLOPEDIA, *at* http://www.artcyclopedia.com/history/abstract-expressionism.html (last visited Mar. 14, 2005).

29. 17 U.S.C. § 106A(a)(3) (2000).

30. *Id.* § 106A(a)(1), (2); WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 270 (2003).

31. 17 U.S.C. § 106A.

the artist's honor or reputation.[32] The pertinent part of § 106A relating to the right of integrity is as follows:

> (a) . . . the author of a work of visual art—
>
> (3) subject to the limitations set forth in section 113(d), shall have the right—
>
> (A) to prevent any intentional distortion, mutilation, or other modification of that work which would be prejudicial to his or her honor or reputation, and any intentional distortion, mutilation, or modification of that work is a violation of that right, and
>
> (B) to prevent destruction of a work of recognized stature and any intentional or grossly negligent destruction of that work is a violation of that right.[33]

The Act defines a "work of visual art" as a "painting, drawing, print, or sculpture" that exists solely as a unique original or limited to prints of 200 or fewer that are signed and consecutively numbered by the author.[34] A photograph is protected if it was "produced for exhibition purposes."[35] Courts determine whether a work qualifies as a "work of recognized stature" by using "common sense and generally accepted standards of the artistic community."[36] The plaintiff bears the burden of proof on this issue, and this standard is generally established through expert witness testimony by art curators, critics, and other members of the artistic community.[37]

An artist's moral rights vest with the creation of an original work that meets the statutory requirements of a "work of visual art."[38] The protection of moral rights lasts for the life of the author, or in the case of joint authorship, for the life of the last surviving author.[39] Because moral rights flow from the artist's creative process and personality vested in the work, moral rights are inalienable and non-transferable. Moral rights are, however, waivable via written contract.[40]

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32. *See* LANDES & POSNER, *supra* note 30, at 270.

33. 17 U.S.C. § 106A.

34. *Id.* § 101.

35. *Id.*

36. 3 NIMMER & NIMMER, *supra* note 12, § 8D.06[A][1] (internal quotation marks omitted).

37. *See id.*

38. *See id.* § 8D.06[A][2].

39. *See* 17 U.S.C. § 106A(d)(1), (3); *see* 3 NIMMER & NIMMER, *supra* note 12, § 8D.06[E].

40. 17 U.S.C. § 106A(e)(1).

Only the artist may assert a claim under VARA, and may do so even if the artist has not retained ownership of the copyright in the original work.[41] The remedies for violation of the right of integrity include injunctive relief and/or damages.

VARA is limited in scope by several factors. First, a work-for-hire does not qualify for protection.[42] Second, works excluded from protection include:

> any poster, map, globe, chart, technical drawing, diagram, model, applied art, motion picture or other audiovisual work, book, magazine, newspaper, periodical, data base, electronic information service, electronic publication, or similar publication;
>
> any merchandising item or advertising, promotional, descriptive, covering or packaging material or container.[43]

For example, a print made by an employee of a graphic design studio would not be protected under VARA. Finally, VARA covers works created after June 1, 1991, and applies to works created before this date if title has not transferred from the author.[44] If violation of the integrity right occurred before the effective date of VARA, the work is not protected.[45]

The final issue with regard to the mechanics of VARA is whether or not an artist's claim under state law is preempted by VARA. Section 301(f) establishes that an artist cannot bring a claim under state law if that right is conferred under section 106 of VARA.[46] If a right is broader under state law as the court held in *Phillips*, then VARA will not preempt the state law as interpreted by the court.[47]

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41. *Id.* § 106A(e)(2).

42. *Id.* § 101 ¶ 48(B). Works-for-hire are exempted from protection under VARA because it is assumed that the employer retains significant control over the output in exchange for paying the artist's wage, and therefore the employer would necessarily seek a waiver of moral rights. *See* LANDES & POSNER, *supra* note 30, at 274. Whether a work constitutes a work-for-hire has been the subject of cases litigated under VARA. *See, e.g.*, Carter v. Helmsley-Spear, Inc., 861 F. Supp. 303 (S.D.N.Y. 1994) *rev'd in part, vacated in part, aff'd in part*, 71 F.3d 77 (2d Cir. 1995).

43. 17 U.S.C. § 101 ¶ 48(A)(i), (ii).

44. *Id.* § 106A(d).

45. *Id.*

46. *Id.* § 301(f).

47. *See* Phillips v. Pembroke Real Estate, 288 F. Supp. 2d 89, 92 (D. Mass. 2003); *see also* Pavia v. 1120 Ave. of the Ams., 901 F. Supp. 620 (S.D.N.Y. 1995) (holding that plaintiff's claim under state law was not preempted by VARA when the effective date of mutilated display occurred before VARA's enactment, and denying protection under state law for display thereafter).

II. APPLICATION OF VARA

To date, only two courts have awarded injunctive relief or damages to artists asserting their right of integrity under VARA, both involving publicly displayed sculptural works.[48] In more recent cases litigated under VARA—*Phillips v. Pembroke Real Estate*[49] and *Pollara v. Seymour*[50]—preservation of public art was once again at issue. In contrast to the prior two cases, the courts in *Phillips* and *Pollara* denied the artists protection under VARA, highlighting the narrow scope of types of works protected under VARA as well as the broader implication that VARA is perhaps more harmful than helpful to artists in promoting the creation of new works.

A. *Phillips v. Pembroke Real Estate*

Phillips was a case of first impression with regard to interpreting an artist's right to preserve site-specific art created for a public space under both VARA and Massachusetts state law. *Phillips* established a standard for types of works protected under VARA and the Massachusetts Art Preservation Act ("MAPA"), the test for works of a certain stature, and whether removal, alteration, or destruction of the work damages the artist's reputation and honor.[51]

In 1999, the well-known and established artist David Phillips was commissioned by Pembroke Real Estate to create sculptures for Eastport Park in conjunction with the development of the adjacent World Trade Center East office building.[52] Pembroke and Phillips executed two agreements setting forth the details of the commission.[53] Phillips did not waive any of his rights under VARA or MAPA in the agreement.[54] Pursuant to the agreements, Phillips created fifteen abstract sculptures and twelve realistic marine-themed bronze sculptures including crabs, shrimps, and

48. *See* Martin v. City of Indianapolis, 193 F.3d 608 (7th Cir. 1999) (awarding non-willful damages to artist Martin for the City's destruction of a large stainless steel sculpture commissioned by the City); Carter v. Helmsley-Spear, Inc., 861 F. Supp. 303 (S.D.N.Y. 1994) (enjoining property owner Helmsley-Spear, Inc. from removing a sculptural installation made from over fifty tons of recycled material because it would damage the reputation of the artists), *rev'd in part, vacated in part, aff'd in part*, 71 F.3d 77 92d Cir. 1995) (reversing and vacating district court's grant of permanent injunction because the sculptures were works made for hire and thus exempt from VARA).

49. 288 F. Supp. 2d 89 (D. Mass. 2003).

50. 344 F.3d 265 (2d Cir. 2003).

51. 288 F. Supp. 2d at 89.

52. *Id.* at 93.

53. *Id.* at 94.

54. *Id.*

frogs.[55] In addition, Phillips created paths connecting the sculptures using granite and worked with stone masons to create "Chords," the centerpiece of the park.[56] During creation of the sculptures and connecting paths, Phillips also worked closely with a renowned landscape architect, Craig Holvorson, to integrate the sculptures with the park's landscape and nautical theme.[57]

Phillips' moral rights claim under VARA arose after the project was completed in 2000, and in 2001, Pembroke hired another landscape artist to redesign the park because of what Pembroke believed where "conceptual" problems with the park.[58] The redesign included removal and relocation of some of Phillips' sculptures.[59] Phillips sought a temporary restraining order pursuant to VARA and MAPA to enjoin Pembroke from removing or altering any of the sculptures or stone work in Eastport Park. In seeking the order, Phillips asserted that his sculptures and stone work at Eastport Park were site specific, and that the individual works collectively formed one work of visual art protected under VARA and MAPA.[60] On October 2, 2003, the district court granted Phillips a temporary restraining order that enjoined Pembroke from modification, destruction or removal of Phillips' work at Eastport Park pursuant to VARA and MAPA.[61] The temporary restraining order was granted until the court could rule as to whether Phillips' work qualified for protection under VARA and/or MAPA.[62] Phillips then filed suit seeking a preliminary injunction to enjoin Pembroke from removing, destroying, or altering his work at Eastport Park.

To determine whether the work qualified for protection under VARA, the district court engaged in an analysis of the provisions of VARA, and denied Phillips protection under VARA because the work as a whole did not fall within one of the definitions of a work of visual art as set forth in § 101 ¶ 48.[63] The district court rejected Phillips' argument that the entire park was a work of visual art, holding instead that only the sculptures along the northwest and southeast axis of the park, including the centerpiece "Chords," were one integrated work of visual art.[64] The district court

55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.* at 93-94.
59. *Id.* at 95.
60. *Id.* at 95.
61. *Id.*
62. *Id.*
63. *Id.* at 100.
64. *Id.* at 99.

reasoned that the sculptures along the northwest to southeast axis constituted a single work because of the "integrated marine theme and recurring spirals, as well as the use of marine granite boulders and pavers."[65] However, the district court held that the remaining sculptures, including the "whimsical sea creatures," that were not part of this axis were individual free standing pieces.[66]

In its reasoning, the district court asserted that whether a work of art is protected under VARA is to be construed narrowly, and that because many of the elements of the park were not created specifically by Phillips, but rather under his artistic direction, the work could not be viewed as a unified whole.[67] Because the district court held that Phillips' work was not entirely site-specific, it accepted Pembroke's argument that the work fell under the "public presentation" exclusion in § 106A(c)(2), which permits Pembroke to move Phillips' sculptures from one location to another without altering or destroying the entire work.[68] Therefore, while the works along the northwest and southeast axis of the park were protected under VARA from alteration, mutilation, or destruction, Pembroke had a right to move the sculptures under VARA's public presentation exclusion.[69]

On the other hand, the district court held that under MAPA, the defendant could not alter, modify, destroy, or *move* sculptures from the unified work along the northwest and southeast axis of the park.[70] Here, VARA did not preempt MAPA because the definition of a work of visual art under MAPA is broader than it is under VARA.[71] Under MAPA, there is no exhaustive list of what constitutes a work of visual art protected under the statute; a work of visual art is broadly defined as any "original work of visual or graphic art of any media."[72] Based on expert testimony from an urban arts executive, the district court concluded that under MAPA, Phillips' work along the northwest and southeast axis of the park constituted a unified whole and was site specific to Eastport Park.[73] In addition, MAPA does not contain VARA's public presentation exclusion which would exempt modification from a change in placement of the sculptures.[74] Under MAPA, the district court held that changing the location of Phillips' inte-

65. *Id.* at 98.
66. *Id.* at 99.
67. *Id.*
68. *Id.* at 100.
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.*
73. *Id.* at 102.
74. *Id.*

grated sculptures would constitute an alteration under section 85S(b) and section 85S(c).[75]

After the definitional requirements of a work of visual art to be protected under MAPA were satisfied, the district court concluded, based on expert testimony, that Phillips' site-specific art was work of recognized quality.[76] Pembroke conceded that Phillips is an artist of international reputation.[77] Phillips was well-known for his site-specific visual works using sculpture and had won numerous commissions, exhibited in galleries, and had been featured in art magazines.[78] Therefore, the district court held that removal or destruction of Phillips' work would necessarily damage his reputation and integrity as an artist.[79] The *Phillips* decision is on appeal to the Supreme Judicial Court in Massachusetts on a certified question from the district court.[80]

B. *Pollara v. Seymour*

Pollara also addressed the narrow scope of works protected under VARA, yet has less far reaching implications than *Phillips* because the work in question more clearly falls within VARA's provision excluding protection for works of a promotional nature. *Pollara* involved interpretation of VARA with regard to destruction of an artist's banner commissioned by a nonprofit for purposes of drawing attention to an information desk at a promotional event.[81]

Plaintiff Joanne Pollara is a New York artist who is often commissioned to create large, hand-painted banners for private parties and corporate events.[82] In 1999, Gideon Coalition, a nonprofit legal service, commissioned Pollara to create a banner to hang above an information table in the Empire State Plaza as part of a "Lobbying Day."[83] The banner Pollara created was ten feet by thirty feet long and depicted a group of people of

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75. *Id.*
76. *Id.* at 103.
77. *Id.*
78. *Id.*
79. *Id.*
80. E-mail from Andrew D. Epstein, Attorney, Barker, Epstein & Loscocco, to Natalia Thurston, Law Student, University of California at Berkeley, School of Law (Boalt Hall) (Nov. 15, 2004) (on file with author) (e-mail from attorney for Phillips) [hereinafter E-mail from Phillips' Attorney].
81. Pollara v. Seymour, 344 F.3d 265, 265 92d Cir. 2003).
82. *Id.* at 266.
83. *Id.*

different ethnicities engaged in an effort to obtain legal services.[84] After completion, the banner was erected and left unattended in the plaza.[85]

Pollara's moral rights claim resulted from Gideon's failure to obtain a valid permit for Pollara to install the banner and leave it overnight.[86] Casey, the manager of the Empire State Plaza, had his workers remove the banner because of the absence of a permit.[87] In the process of removal, the banner was torn into three parts and left crumpled up in Casey's office.[88]

After learning of the banner's destruction, Pollara sued Casey and his supervisor, asserting claims under VARA and 42 U.S.C. § 1983 for violation of First Amendment rights. Pollara asserted that the defendants acted deliberately, willfully, wantonly, intentionally, and/or with gross negligence in destroying the banner.[89] Under 17 U.S.C. § 106A(a)(3)(B), a work of recognized stature is protected from "any intentional or grossly negligent destruction."[90] After a bench trial, the district court held that the banner was not a work of art as defined under VARA because it was promotional material, which is one of the types of works excluded from protection under VARA.[91] Pollara appealed this ruling.

In analyzing Pollara's claim under VARA, the Second Circuit denied the work protection because the work fell into one of the statutory exceptions to works of visual art.[92] The court reasoned that Pollara's work is not of the type to be protected under VARA because VARA only protects works of "recognized stature" or works of an artist whose "honor or reputation" would be damaged by removal, modification, or destruction of their works.[93] Furthermore, VARA does not protect works that advertise or promote.[94] The court turned to the work's objective and purpose to determine whether the work fell within a protected category.[95]

In its analysis, the Second Circuit concluded that the objective and purpose of the banner was to promote and draw attention to Gideon, the

84. *Id.*
85. *Id.*
86. *Id.* at 267.
87. *Id.*
88. *Id.*
89. *Id.*
90. 17 U.S.C. § 106A(a)(3)(B) (2000). The statute is not meant to protect works that are altered, modified or destroyed from acts of negligence, such as improper storage or handling. *See* 3 NIMMER & NIMMER, *supra* note 12, § 8D.06[C][1].
91. 344 F.3d at 268.
92. *Id.* at 271.
93. *Id.* at 269.
94. *Id.*
95. *Id.*

political advocacy group, and therefore constituted advertising material under 17 U.S.C. § 101.[96] Pollara argued that although her work was commissioned by a political group, she used traditional painting and drawing materials and that the text on the banner did not denigrate the artistic merit of her work.[97] In rejecting this argument, the Second Circuit pointed out that while the banner was "visually appealing and demonstrated a great deal of artistic viability and creativity," it was not within the purview of the court to judge artistic merit, but rather to determine whether the work fell within one of VARA's protected categories.[98] The Second Circuit therefore held that because the purpose of the work was to draw attention to the lobbying efforts of Gideon, the work was inherently promotional in nature and not protected under VARA.[99]

III. DISCUSSION

At first glance, the introduction of moral rights under VARA appears to grant protection for existing artistic works and promote the creation of new works. According to VARA's legislative history, moral rights "result in a climate of artistic worth and honor that encourages the author in the arduous act of creation . . . [and] . . . are consistent with the purpose behind copyright laws and the Constitutional provision they implement: 'To promote the Progress of Science and useful Arts.'"[100]

In theory, moral rights should protect valuable works and spur creation of new works. However, in practice, VARA may in fact inhibit creation of new works and provide minimal protection for existing works. As demonstrated in *Phillips* and *Pollara*, the narrow scope of protection provided under VARA indicates that many visual works will not receive protection because they fall outside the limited definitions of a work of visual art under VARA, or are not considered works of recognized stature.[101]

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96. *Id.* at 270.

97. *Id.* at 269.

98. *Id.* at 271.

99. *Id.* at 270. In a concurring opinion, Judge Gleeson asserted that Pollara's work was not protected because it was not work of recognized stature that had been displayed in a gallery or museum. *Id.* at 272 (Gleeson, J., concurring).

100. *See* VAWA House Report, *supra* note 27, *reprinted in* 1990 U.S.C.C.A.N. at 6915 (quoting *Hearings on H.R. 2690 Before the Subcommittee on Courts, Intellectual Property, and the Administration of Justice of the House Committee on the Judiciary*, 101st Cong. 3 (1989) (statement of the Honorable Ralph Oman, Register of Copyrights), and U.S. CONST. art. I, § 8, cl. 8) (internal quotation marks and footnote omitted).

101. *Pollara*, 344 F.3d at 265; Phillips v. Pembroke Real Estate, 288 F. Supp. 2d 89, 89 (D. Mass. 2003).

VARA's broader implications extend beyond its limited scope to issues that affect the artist, the property holder, and the public. Under VARA, art is protected if it is accepted by the public, as only works of recognized stature are protected. Often, art anticipates future intellectual discoveries, and therefore acceptance of a work may only occur years after the artist has passed away. Therefore, emerging artists and artists whose work falls outside the limited definition of a work of art may suffer from lack of protection under VARA. Great works could be destroyed that do not meet VARA's definition, and the general public will never benefit from art that could have contributed to our understanding of culture. On the other hand, VARA potentially curtails the public and property owner's right to control public spaces and could lead to the diminution of property values if an owner is forced to preserve a work for an artist's lifetime. An artist's assertion of moral rights may also impact purchasers of art, who may negotiate prices downward if artists seek to assert their moral rights. This could lead to artists automatically waiving their moral rights, thereby creating inefficient transactions. VARA's unexpected consequences and impact on the artist, the property holder, and the public are discussed in the following sections.

A. Lack of Protection for Emerging Artists

One major issue confronting an artist seeking protection under VARA is whether the work falls into one of the definitions provided for in VARA.[102] VARA limits protection of a work of visual art to include a "painting, drawing, print or sculpture."[103] Photographs, a popular medium of expression, are protected only if "produced for exhibition purposes."[104] A court's interpretation of what categories of work are to be protected under VARA is the first hurdle an artist must overcome in successfully litigating a case under VARA. This can be a difficult hurdle, as evidenced by the denial of protection under VARA for artists Phillips and Pollara based on the fact that their works did not meet all of VARA's definitional requirements.[105]

Once an artist has established that her work falls under a category to be protected under VARA, next she has the burden of establishing that her

102. *See Pollara*, 344 F.3d at 266; *Phillips*, 288 F. Supp 2d at 94; Bd. of Managers of Soho Int'l Arts Condo. v. City of New York, No. 01 Civ. 1226 (DAB), 2003 U.S. Dist. LEXIS 10221 (S.D.N.Y. June 17, 2003); Carter v. Helmsley-Spear, Inc., 861 F. Supp. 303 (S.D.N.Y. 1994), *rev'd in part, vacated in part, aff'd in part*, 71 F.3d 77 (2d Cir. 1995); Wojnarowicz v. Am. Family Ass'n, 745 F. Supp. 130 (S.D.N.Y. 1990).

103. 17 U.S.C. § 101 (2000).

104. *Id.*

105. *Pollara*, 344 F.3d at 266; *Phillips*, 288 F. Supp. at 100.

work is of recognized stature. Case law indicates that whether or not a work is protected is left to the discretion of the judge in determining whether to admit evidence supporting a plaintiff's claim that their work is of recognized stature.[106] The admission of evidence to support a finding that a work is of recognized stature is decided on a case-by-case basis.

Most courts require expert testimony from members of the art community. In *Martin v. City of Indianapolis*, however, letters and newspapers were enough to establish that the artist's work was of recognized stature.[107] Since no bright-line rule exists for establishing works of recognized stature, emerging artists may suffer from a lack of standing in the artistic community because their work's merit may only be recognized years later. Although Martin was successful in establishing that his work was of recognized stature, the dissenting judge in *Martin* declared the newspaper articles and letters as hearsay, and warned "those who are purchasers or donees of art had best beware. To avoid being the perpetual curator of a piece of visual art that has lost (or perhaps never had) its luster, the recipient must obtain at the outset a waiver of the artist's rights under VARA."[108]

B. Waivers and Associated Transaction Costs

In enacting VARA, the legislative history suggests that Congress was concerned that artists would necessarily seek waivers of their moral rights—obviating the purpose of the Act.[109] In practice, negotiating waivers for art is complicated because an original work of art is a unique commodity that is imbued not only with economic value, but also carries a deeper meaning for the artist, the owner, and the public. It is difficult to calculate the pecuniary value of a work of art without taking into account the artist's larger body of work and reputation in the art community. In essence, each work an artist creates serves as an advertisement for his other works, and damage to one work affects the value of the artist's other works.[110] Therefore, it is difficult to quantify the value artists and potential buyers will assign a waiver of moral rights since destruction or alteration of a work has associated external costs.

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106. *See Carter*, 861 F. Supp. at 325 (establishing a two-prong test for works of recognized stature).

107. 192 F.3d 608, 610 (7th Cir. 1999).

108. *Id.* at 616 (Manion, J., dissenting).

109. *See* VARA House Report, *supra* note 27, *reprinted in* 1990 U.S.C.C.A.N. at 6928-29.

110. *See* LANDES & POSNER, *supra* note 30, at 275.

The pecuniary impact of reputational externalities associated with the assertion of moral rights extend beyond the artist's pocketbook. Prior to the enactment of VARA, mutilation or destruction of a work imposed a cost on the artist. For example, the owners of a mobile in the Pittsburgh airport created by the renowned artist Calder repainted the black and white sculpture to match the colors of Allegheny County.[111] While this was an isolated incident, professors Hansmann and Santilli point out that "if all of Calder's work were altered and painted in such a fashion, that work—and hence the Calder name—would be less famous and the prices Calder could charge for subsequent work would fall."[112] Under VARA, this cost is now imposed on the owner who has not obtained a waiver.

Destruction or mutilation of a work has several implications for an owner. Because an original work of art is a scarce commodity, destruction of one work may actually increase the value of the other works, due to a decrease in the total number of the artist's original works. On the other hand, if damage or alteration of a work negatively affects the artist's reputation, this may in turn decrease the value of the other works.[113]

Professors Hansmann and Santilli posit that the transactional costs associated with obtaining waivers of moral rights decrease the value of an artist's work.[114] Moral rights create divided property interests. The right itself functions as a dominant tenement attached to property, such as an easement, that could potentially decrease the overall value of the work.[115] Additionally, there are inefficiencies associated with providing notice of waivers for works purchased by subsequent owners.[116]

While artists normally internalize the costs and benefits of their decision to retain or waive moral rights, Hansmann and Santilli assert that this decision affects "reputational externalities" which have associated costs and benefits.[117] If an artist waives his moral right of integrity and a work is damaged, because each piece is an advertisement for others, such damage may affect an artist's reputation and ability to sell future works.

Of further concern is the relatively weak bargaining position of artists in relation to those seeking to purchase or commission their works, de-

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111. *Id.* at 281, n.28.

112. Henry Hansmann & Marina Santilli, *Authors' and Artists' Moral Rights: A Comparative Legal and Economic Analysis*, 26 J. LEGAL STUD. 95, 104-05 (1997).

113. *Id.* at 104-05.

114. *Id.* at 125.

115. *Id.* at 100.

116. *Id.* at 125.

117. *Id.* at 104, 110.

pending on their status as an artist.[118] Because rights under VARA are waivable, an artist might gain some consideration for waiving these rights. On the other hand, moral rights may not provide an artist with significant leverage because VARA's scope of protection is so limited.[119] For example, in the *Phillips* case, the artist could benefit financially from waiving his moral rights in future contracts because his work is of recognized stature and he could use his stature as leverage in negotiating waivers. On the other hand, the threat of future litigation could deter business as well. In Pollara's case, because her work was not protected under VARA, she had no bargaining position with respect to a waiver of moral rights. The difficulty in predicting whether or not a work will qualify for protection under VARA creates risks and associated inefficiencies in the bargaining process because of the uncertainty associated with a court's evaluation of a work of art.

In their study of the economic impact of moral rights, Landes and Posner see little benefit to the artist in obtaining waivers. Instead, they argue that the cost of obtaining waivers for artists is greater than the associated benefits.[120] Landes and Posner hypothesize that the adoption of moral rights is economically inefficient and actually does more harm for the artist than good. In an attempt to buttress their assertion that moral rights are in fact harmful to artists, Landes and Posner conducted a statistical study of the effects of moral rights laws passed in nine states prior to the passage of VARA.[121] Although their findings for the most part produced no statistically significant results, they reached the interesting conclusion that artists value moral rights despite their finding that moral rights laws reduce demand for art and thereby decrease an artist's earnings.[122]

Why then do artists value moral rights? Landes and Posner found that "larger, richer states with more highly educated populations have relatively more artists and are more likely to enact moral rights laws."[123] A state's adoption of moral rights infers that "art is a highly valued social enterprise" within that community.[124] Regardless of whether moral rights increase or decrease an artist's income, the 7.3% increase in the number of artists moving to a state with moral rights reflects the importance of such

118. *See* VerSteeg, *supra* note 23, at 858.
119. *Id.*
120. *See* LANDES & POSNER, *supra* note 30, at 278.
121. *Id.* at 287.
122. *Id.* at 289.
123. *Id.* at 288.
124. *Id.* at 291.

an environment in supporting the honor and reputation of artists.[125] According to Landes and Posner, the socially desirable environment offsets any decrease in earnings an artist may experience in asserting their moral rights.[126]

Landes and Posner's findings go back to the premise that moral rights are a reflection of personhood and the value of moral rights lies in the protection of the artist's reputation, so a purely economic analysis falls short of appreciating the intrinsic value of art. This could explain why both Pollara and Phillips filed claims to protect their moral rights even though the prospect of obtaining pecuniary damages was limited and the benefits of securing moral rights to their future income questionable. Professor Ong asserts that economic analysis of moral rights ignores the non-pecuniary value of moral rights, that of "respect for, and recognition of, the artistic contributions of the artist."[127] Moral rights cannot be boiled down to the associated costs and benefits because moral rights extend beyond the scope of economic value and protect "the intrinsic worth of such artistic contributions to the cultural landscape."[128] Furthermore, art cannot be compared to other commodities because of its unique nature. A commodity such as a consumer product can usually be replaced if destroyed. An original work of art—imbued with the artist's "highly individualized expression of . . . aesthetic sensibilities"—if destroyed, can never be replaced.[129]

It is arguable whether an artist's assertion of moral rights actually increases transaction costs in negotiating waivers. Some scholars argue that moral rights actually increase an artist's bargaining power.[130] In fact, the attorney for Phillips suggested that moral rights do more to level the negotiating playing field, and both the artist and the buyer benefit if they know where they stand with regard to display and removal of the work.[131] Consequently, one solution to avoiding litigation under the limited scope of VARA is to ensure that the rights granted under VARA are fairly negotiated in the contract between the artist and the buyer. For example, notice provisions can be included in the contract to ensure that the artist has fair warning if the buyer intends to remove or alter the work. Additionally, the

125. *Id.* at 292.
126. *Id.* at 291.
127. *See* Ong, *supra* note 16, at 298.
128. *Id.* at 304.
129. *Id.* at 307.
130. *See, e.g.*, VerSteeg, *supra* note 23, at 844.
131. E-mail from Phillips' Attorney, *supra* note 80.

artist can negotiate the number of years the buyer must preserve the work, which would reduce the possibility of confusion over property rights.

C. Public versus Private Art

When a private art collector buys a work, artists have no right of display. In other words, the owner can put a sheet on the painting and put it in their closet without facing liability under VARA. However, when art is displayed publicly, an owner of such work may face increased liability.[132] Developers and building owners have been the primary defendants in the suits brought under VARA to date.[133] Public works, such as murals, outdoor sculptures, and site-specific works created for public display are often incorporated into the site and removing the work would necessarily result in its destruction or alteration. Additionally, removal or destruction of a work displayed publicly may affect the artist's reputation more than a private owner choosing not to display a work, since the public will have knowledge that the work has been destroyed or removed.

Landes and Posner suggest that an artist's assertion of moral rights will deter real estate developers from commissioning works for installation in lobbies, open spaces, and buildings.[134] A building owner might be deterred from investing in the commission of a public work if there is a risk he could become a perpetual curator of unwanted art, face monetary damages for removal of the work, or experience a decrease in the value of the property because of the work.

To illustrate, the district court judge in *Carter v. Helmsley-Spear, Inc.* insisted that the sculptural installation in the building should have no negative impact on the value of the property.[135] One wonders, however, whether a commercial property owner should have to maintain in perpetuity a sculpture made from recycled parts including "a giant hand fashioned from an old school bus, [and] a face made of automobile parts . . . ."[136] An informal survey of attorneys for real estate developers in Massachusetts surfaced little data about developers' desire to commission artworks in the

132. In the VARA litigation to date, the majority of cases have involved disputes over large-scale, public sculptural installations or site-specific works. *See* LANDES & POSNER, *supra* note 30, at 281.

133. *Id.* at 280-87.

134. *Id.* at 286.

135. 861 F. Supp. 303, 328 (S.D.N.Y. 1994), *rev'd in part, vacated in part, aff'd in part*, 71 F.3d 77 (2d Cir. 1995).

136. *See Carter*, 71 F.3d at 80.

aftermath of the *Phillips* decision.[137] Most of the attorneys had not dealt with the issue and therefore had no comment. In all likelihood this suggests that since few cases have been litigated successfully under VARA, moral rights pose no immediate threat to future commissions.

In enacting VARA, Congress intended the public, not just the artist and property holder, to benefit from preservation of art works.[138] The residual effects of destroying a work of art are two-fold. Not only is the public denied access to the work, but also future works created in response to the work may be thwarted.[139] On the other hand, certain works may be rejected by the public or members of the community who no longer wish to view the work.

In a pre-VARA case, *Serra v. United States*, artist Richard Serra, raised a First Amendment argument in pursuing a claim against the government for removal of the sculpture "Tilted Arc," commissioned from Serra and located in the Federal Plaza in Manhattan.[140] The Second Circuit rejected Serra's First Amendment claims. Interestingly, Serra's due process claim was also denied because the government held a hearing at which many of the employees who worked in the building where the sculpture was located objected to the presence of the sculpture because it blocked too much of the open space in front of the building.[141] As Professor Sax aptly points out:

> As for the rights of artists, they would have to be stretched pretty far to include a right to compel unwilling people to experience their work far into the indefinite future, which would be the practical result if a large sculpture (like Serra's *Titled Arc*) must remain in a public unavoidably frequented place.[142]

IV. CONCLUSION

Undoubtedly, in commissioning the work of Rivera, the Rockefellers failed to anticipate the message in the medium. Rivera's body of work reflected his mastery of the craft, and the Rockefeller's destruction of his work raised an outcry among artists. Rivera's public denouncement of the

137. E-mail from Sarah Hunt Broughel, Attorney, Choate, Hall & Stewart, to Natalia Thurston, Law Student, University of California at Berkeley, School of Law (Boalt Hall) (Nov. 15, 2004) (on file with author).

138. *See* VARA House Report, *supra* note 27, *reprinted in* 1990 U.S.C.C.A.N. at 6916-17.

139. *See* Hansmann & Santilli, *supra* note 112, at 106.

140. Serra v. U.S. Gen. Serv. Admin., 847 F.2d 1045 (2d Cir. 1988).

141. *Id.* at 1052.

142. *See* SAX, *supra* note 1, at 27.

Rockefellers surely impacted the desire of other financiers to commission his work; however, Rivera had no recourse under the law to pursue a claim against them. On the other hand, why should Rivera be able to force the Rockefellers to endorse a message at their headquarters that was the antithesis of their values as capitalists and that subjected them to public ridicule? The Rivera-Rockefeller dispute illustrates the competing interests of the artist, the property holder, and the public in deciding when art should live and when art should die.

VARA was enacted to protect the moral rights of artists—a right artists have proven to value. Although the exercise of moral rights may be inefficient, the value artists place on them is more than just pecuniary in nature, and reflects an artist's desire to protect work that is a product of personal expression. In creating a work, an artist develops a unique and intimate relationship to that work that survives beyond physical ownership of the work. Furthermore, an artist has a vested interest in protecting her works, as each work serves as an advertisement for future works and an artist's reputation is built upon her entire body of work.

While Congress intended VARA to protect existing work and promote the creation of new works, it remains to be seen whether VARA has actually dampened the artistic climate. Art collectors and real estate developers may be reluctant to invest in art because of the bargaining inefficiencies associated with waivers, the threat of litigation associated with VARA, and the fear of becoming perpetual curators of unwanted art. On the other hand, in the case of Rivera, perhaps the Rockefellers made a bad business decision in destroying the mural because had the mural survived, it would be worth much more than their original investment because of Rivera's standing as an artist. The future pecuniary value of art is difficult to predict precisely because art has more than monetary value. Art has the ability to shape and influence society—consequences reaching far beyond the limitations of traditional property values.

ADDITIONAL DEVELOPMENTS—COPYRIGHT, PART II

321 STUDIOS V. METRO-GOLDWYN-MAYER STUDIOS, INC.

307 F. Supp. 2d 1085 (N.D. Cal. 2004)

The district court held that decryption software that enabled users to copy digital versatile discs (DVDs) violated the Digital Millennium Copyright Act (DMCA) anti-circumvention provisions. The court also upheld the DMCA as constitutional against First Amendment and congressional powers challenges.

321 Studios marketed and sold software for copying DVDs. Many DVDs store digital data in an encoded format called the "Contents Scramble System" (CSS). An industry group called the Copyright Control Authority administers the CSS encoding scheme and licenses to player manufacturers the electronic keys used to play back DVDs. The keys and algorithm that can be used to decode a DVD are also, however, broadly available on the Internet. 321 Studios sold two software products for decoding the content of DVDs so they may be copied: DVD Copy Plus and DVD-X Copy. DVD Copy Plus enabled a user to copy only the video contents of a DVD onto a recordable CD, while DVD-X, a later version of the software, allowed a user to copy an entire DVD. DVD-X used a CSS player key and publicly known computer code to accomplish the decoding. 321 Studios filed suit seeking a declaratory judgment that the distribution of these products did not violate the DMCA or, in the alternative, that the provisions of the statute at issue are invalid in light of other provisions in the Copyright Act and/or constitutional limitations in the First Amendment and the Enumerated Powers and Due Process Clauses. The defendants, primarily members of the Motion Picture Association of America, moved for partial summary judgment opposing 321 Studios claims.

Among other actions, the district court granted the defendants' motion for partial summary judgment, held that the plaintiffs' products violated 17 U.S.C. §§ 1201(a)(2) and 1201(b)(1), and issued an injunction under 17 U.S.C. § 1203(b) prohibiting 321 Studios from distributing any type of DVD circumvention software. The court relied heavily on *Universal Studios, Inc. v. Corley*, 273 F.3d 429 (2d Cir. 2001), *United States v. Elcom Ltd.*, 203 F. Supp. 2d 1111 (N.D. Cal. 2002), and *Universal Studios, Inc. v. Reimerdes*, 111 F. Supp. 2d 346 (S.D.N.Y. 2000), in reaching its decision.

321 Studios argued that it did not violate 17 U.S.C. § 1201(a)(2) (access restrictions) because circumvention by definition is done without the authorization of the copyright holder. It believed it was free from liability because as purchaser of the DVD, the user has the authority to bypass CSS and indeed does so every time she views the DVD. The court rejected this argument and adopted the *Corley* distinction between authority to view and authority to decrypt. Thus, the court found 321 Studios liable because the DVD player rather than the end user was the entity granted license to decrypt the contents of lawfully purchased DVDs. The court reasoned that unlike 321 Studios, makers of licensed DVD players are not liable under this provision because they circumvent CSS with the authorization of the copyright owner.

The court also found that CSS is a copy control system and that downstream uses of the software by customers of 321 Studios are not relevant in determining whether 321 Studios itself violated the statute. Therefore, the court ruled that 321 Studios also

violated 17 U.S.C. § 1201(b)(1) (copying restrictions) even though CSS in itself only controls access, not copying. The court did not rule on "the commercially significant purpose" prong of the statute because neither side produced sufficient evidence on the issue.

The court upheld the constitutionality of the DMCA because it does not impermissibly seek to regulate the content of code—that is, speech—but rather only the functional elements of technology. The court also found that the DMCA does not impermissibly burden the fair use rights of users under *Eldred v. Ashcroft*, 537 U.S. 186 (2003), which the court interpreted as declining to mandate absolute First Amendment protection for the fair use of copyrighted works. Furthermore, the court found that the DMCA still allows fair uses even if users are not able to copy via the most optimum method or in the desired format. The court also stated that the DMCA does not impair the First Amendment right to access the non-copyrighted works simply because it allows publishers to control access to particular copies; it does not grant publishers any legally enforceable rights in public domain works. The court further held that the DMCA did not exceed the scope of congressional powers under the Commerce or Intellectual Property Clauses of the Constitution, and deemed the Necessary and Proper argument irrelevant because Congress explicitly invoked the Commerce Clause in enacting the DMCA.

BRIDGEPORT MUSIC, INC. V. DIMENSION FILMS

383 F.3d 390 (6th Cir. 2004)

The Sixth Circuit held that any unlicensed sampling, or using part of an existing sound recording in a new recording, is an infringement of the copyright in the original sound recording where the defendant does not dispute having sampled. With this holding, the court announced a new bright-line rule that no substantial similarity or *de minimis* inquiry should be undertaken in assessing infringement liability for sampling as it pertains to the sound recording, versus music composition copyright. That is, a sound recording copyright owner holds the exclusive right to sample her own recording.

Plaintiff Bridgeport Music owns the musical composition and sound recording copyright in "Get Off Your Ass and Jam" ("Get Off") by George Clinton and the Funkadelics. "Get Off" opens with a three-note guitar solo. This guitar solo was digitally sampled into a new song, "100 Miles and Runnin'" ("100 Miles"), which was used by defendant Dimension Films in the soundtrack for the film "I Got the Hook Up." The sample was used in "100 Miles" five times, for approximately seven seconds each time. Bridgeport brought suit for infringement of its copyright in the sound recording. The district court granted summary judgment in favor of the defendant, holding that under both the qualitative/quantitative *de minimis* analysis and the fragmented literal similarity tests, the sampling did not rise to the level of appropriation.

Plaintiff appealed, arguing that no substantial similarity or *de minimis* inquiry should apply when the defendant does not dispute that it digitally sampled a copyrighted sound recording. The Sixth Circuit agreed, and reversed the district court's grant of summary judgment. The appellate court found that the district court erred in applying an analysis for infringement of a copyrighted musical composition where the issue at hand was infringement of the copyrighted sound recording.

The Sixth Circuit used a "literal approach" to analysis under 17 U.S.C. § 114(a) and (b). These subsections give the owner of a copyright in a sound recording exclusive rights to prepare derivative works in which the actual sounds fixed in the sound recording are rearranged. Under its literal approach, the court read § 114(b) to mean that the owner of a sound recording has the exclusive right to sample its own recording. The court held that § 114(b) precludes the use of a substantial similarity test by rendering irrelevant both how much a digital sampler alters the actual sounds and whether the ordinary observer can or cannot recognize the artist's performance, because the exclusive rights of a sound recording owner encompass the alteration of the actual sounds in the recording. The court explained that the only question in determining infringement is whether the defendant re-recorded sounds from the original.

CARGILE V. VIACOM INTERNATIONAL, INC.

282 F. Supp. 2d 1316 (N.D. Fla. 2003)

The district court held that defendant Viacom International, Inc. ("Viacom") was entitled to summary judgment on claims that it misappropriated trade secrets and breached an implied-in-fact contract with plaintiff Cargile.

Cargile arranged to sell his "Go-Burns" cartoons through a third party agent in 1991 and 1992. The agent told Cargile that he had met with Nickelodeon, whose parent corporation was Viacom. Cargile heard nothing else from his agent and later discovered that his agent had died. Cargile brought suit in 2000 and claimed that Viacom misappropriated trade secrets to develop the "Rugrats" cartoon series when Viacom used Cargile's cartoon concepts, despite an expectation of confidentiality. Cargile further claimed that Viacom breached an implied-in-fact contract to pay Cargile for the use of his cartoon characters. Viacom argued that an independent production company developed "Rugrats" in 1989, no substantial similarity existed between the two cartoons, and Cargile was barred by the statute of limitations.

The court ruled in favor of Viacom. The court found that Cargile had no direct evidence of a meeting between his agent and Nickelodeon, and no evidence of an implied agreement with Viacom to pay Cargile for his cartoon or maintain confidentiality. The court held that hearsay statements of the agent and "slight" similarities between the cartoons were a "mere scintilla" of evidence. Since Viacom proved that "Rugrats" was created before "Go-Burns" and Cargile exceeded the four year statute of limitations for implied-in-fact contract claims, the district court granted Viacom's summary judgment motion.

CHICAGO BOARD OF EDUCATION V. SUBSTANCE, INC.

354 F.3d 624 (7th Cir. 2003)

The Seventh Circuit ruled on the applicability of the fair use defense to the use of quasi-secret standardized tests. The court held that the quasi-secret nature of the tests did not foreclose the possibility of the fair use defense, but that defendants did not have the right to eliminate all economic value of the tests by publishing them indiscriminately and in their entirety.

The Chicago Board of Education created and copyrighted a series of standardized tests entitled "Chicago Academic Standards Exams" ("CASE"). The tests were "secure tests" which were not marketed and were administered under tight supervision. After the tests were administered, all copies were accounted for and either destroyed or returned to restricted storage, where the tests were kept secret to enable reuse. Defendant, a teacher named Schmidt, edited a local teachers' newspaper called *Substance*, owned by co-defendant Substance, Inc. Schmidt published complete copies of six CASE tests in *Substance* to demonstrate alleged flaws within the tests. The Chicago Board of Education brought suit alleging copyright infringement. The district court held in favor of the school board, dismissing defendants' fair use defense and issuing a permanent injunction.

Defendants appealed. The Seventh Circuit affirmed in part, vacated in part, and remanded. The court first noted that although it might seem paradoxical, copyright can exist in so-called "secret documents." The court further held that the fair use defense was available to Schmidt notwithstanding the quasi-secret nature of the tests, but that defendants did not have the right to eliminate all value by publishing the tests in their entirety. The court found that although Schmidt had a right to criticize the tests, he did not have the right to cause such a high level of harm. In addition, the court pointed out the possibility of "floodgate" damages if Schmidt was not enjoined—if Schmidt was allowed to publish six tests, then other teachers could also publish small batches of tests, and soon none of the tests would be valuable or effective. Therefore, the court upheld the injunction.

DIRECTV, INC. V. TREWORGY

373 F.3d 1124 (11th Cir. 2004)

The Eleventh Circuit held that there is no private right of action for "mere possession" of technological devices that are capable of intercepting satellite transmissions in violation of the Wiretap Act, 18 U.S.C. § 2512(1)(b).

DirecTV (DTV) is a satellite television provider with millions of subscribers, who purchase access devices from DTV in order to decrypt the provider's encrypted satellite transmissions. Some individuals purchase decryption devices from other sources in order to gain access to DTV's satellite transmissions without paying subscription fees. Treworgy had purchased two such circumvention devices and DTV brought suit, alleging that 18 U.S.C. § 2520(a) creates a private right of action against an individual in possession of such devices in violation of § 2512(1)(b), a criminal provision. The district court held that the statute did not create a private right of action and granted Treworgy's partial motion to dismiss. The Eleventh Circuit granted an interlocutory appeal.

Although there have been several conflicting district court rulings on whether § 2520(a) creates a private right of action for possession of pirate access devices under § 2512(1)(b), this was the first time a circuit court addressed the issue. The Eleventh Circuit here held that a private right of action exists only for interception and use of electronic communications as described in § 2520(a). To extend this private right of action to "mere possession" of circumventing technologies, the court reasoned, would be to engage in a "tortured" reading of the statute and would contravene its plain meaning. Furthermore, reading the statute to create a private right of action for possession of circumventing technologies would raise constitutional issues, in that "[p]ossession of a pirate access device alone" would present no more than hypothetical harm to defendant DTV, and would thus not satisfy the case or controversy requirement set forth in Article III § 2 of the United States Constitution.

ELLISON V. ROBERTSON

357 F.3d 1072 (9th Cir. 2004)

The Ninth Circuit ruled that storage and grant of access to infringing copies by an Internet service provider (ISP) resulting from posts to a USENET newsgroup can constitute contributory and vicarious infringement. The court further found that there was a triable issue of fact regarding the ISP's eligibility for the safe harbor provided by § 512 of the Digital Millennium Copyright Act (DMCA), where the ISP had changed its e-mail address for copyright notices without appropriate forwarding measures and should have been on notice of the infringing activities.

Defendant Robertson posted unauthorized copies of well-known author Harlan Ellison's novels on a USENET newsgroup, which in accord with the newsgroup's protocols were then forwarded to all USENET servers worldwide, including those owned by America Online (AOL). Ellison sued Robertson as a direct copyright infringer and AOL under theories of vicarious contributory infringement. AOL moved for summary judgment. In addition to claiming that it was not liable, AOL asserted that it qualified for the safe harbor provided in 17 U.S.C. § 512. The district court concluded that AOL was not liable for vicarious infringement, but found that triable issues existed with regard to the contributory infringement claim. Nevertheless, the court granted summary judgment for AOL because it found that AOL qualified for a DMCA safe harbor. Ellison appealed.

The Ninth Circuit affirmed the district court's rulings on infringement, but reversed on its application of the safe harbor provisions. A triable issue of fact remained as to contributory infringement because a reasonable jury could find that AOL had knowledge of the infringement, based on the unreasonable change of AOL's e-mail address for copyright infringement notification and telephone notification of the alleged infringement by the plaintiff, and that AOL materially contributed to the infringement, based on AOL's storage of and grant of access to the infringing works. As for vicarious liability, the court stated that Ellison must demonstrate a causal connection between the infringing activity and a "direct financial benefit" to AOL, regardless of "*how substantial*" the benefit was in relation to the defendant's net profits. Since Ellison failed to offer evidence that AOL attracted or retained customers because of the infringing activity or that AOL lost customers when it eventually obstructed the infringement, the Ninth Circuit affirmed the district court's holding of no vicarious liability.

In reversing the district court's holding that AOL was eligible for the DMCA safe harbor, the Ninth Circuit ruled that "ample evidence" of problems with AOL's notification procedure precluded judgment as a matter of law that AOL implemented the measures against repeat infringers as the statute requires. The court noted, however, that if AOL established its eligibility on remand, then the district court would not need to revisit the qualification issue.

ELVIS PRESLEY ENTERPRISES, INC. V. PASSPORT VIDEO

349 F.3d 622 (9th Cir. 2003)

The Ninth Circuit upheld a preliminary injunction against producers of a biographical documentary about Elvis Presley containing unauthorized copyrighted material. The court found no fair use because the biography was not consistently transformational, was commercial in nature, and was likely to affect the market for the copyrighted works.

Passport Video created a sixteen-hour documentary on the life of Elvis Presley titled *The Definitive Elvis*. Retailing for $99 and offering an exhaustive biography covering all aspects of Presley's life, *The Definitive Elvis* was composed partly of unlicensed video footage, still photographs, and music owned by Elvis Presley Enterprises, Inc. and several other companies and individuals. At least 5-10% of *The Definitive Elvis* consisted of unauthorized copyrighted material.

Following unsuccessful license negotiations and the plaintiffs' motion, the district court granted a preliminary injunction to stop distribution of *The Definitive Elvis* because the copying in question was not likely to be found fair use. The Ninth Circuit upheld the injunction, finding that the lower court did not abuse its discretion in granting injunctive relief and was not clearly erroneous in finding each of the four fair use factors to weigh against fair use.

The Ninth Circuit affirmed the district court's assessment of the fair use factors codified in 17 U.S.C. § 107: purpose and character of the use, nature of the copyrighted work, amount and substantiality of the portion used, and effect of the use upon the potential market. Under the first factor, the court held that the purpose of the use of copyrighted materials was to make a profit. The fact that the biography's packaging advertised the inclusion of "every film and television appearance," including the copyrighted material, showed that Passport Video was attempting to profit directly from unauthorized material. The court also found that *The Definitive Elvis* was not consistently transformative. Although the overall balance of the first factor was a close issue, the court found that many of the clips were "simply rebroadcast for entertainment purposes" and the lower court's finding on this factor was not erroneous.

The court found the nature of the copyrighted work to be another close call but again upheld the decision of the lower court to count it against fair use. Noting that television footage could be categorized as a news event and thus enjoy less protection, the court nonetheless recognized creative elements that are at the core of copyright protection in such footage, and identified still photographs and songs, for example, as clearly creative.

The third factor weighed against fair use because although defendants often used less than the entire work at issue, the portion used was often the most important part of the work.

Finally, the Ninth Circuit agreed with the district court that Passport Video's use would affect the market for the copyrighted Elvis materials. The court pointed to the commercial nature of *The Definitive Elvis*, the advertisement expressly mentioning the copyrighted works, and the lack of transformativeness as reasons why the use was likely to have a negative effect on the market for the original copyrighted material.

MASTERCARD INTERNATIONAL, INC. V. NADER 2000 PRIMARY COMMITTEE, INC.

2004 U.S. Dist. LEXIS 3644 (S.D.N.Y. Mar. 8, 2004)

The Southern District of New York found that a political advertisement did not violate plaintiff MasterCard's copyright and trademark rights in its commercial advertisements because there was no likelihood of confusion between the advertisements and because political speech is exempted from certain liabilities.

MasterCard commissioned the production of a series of commercial advertisements featuring the names, images, and prices of goods and services, followed by a related intangible item which could not be purchased. The advertisements would conclude with the words or voiceover: "Priceless. There are some things money can't buy, for everything else there's MasterCard." In August 2000, Ralph Nader and his campaign committee broadcasted an advertisement promoting his candidacy for president. The advertisement featured a series of products and services, with their prices, followed by the words and voiceover of the priceless intangible "finding out the truth." The advertisement concluded with the words: ". . . priceless. There are some things that money can't buy." MasterCard alerted the Nader Campaign to its concern over the similarity of the advertisements and, following an inability to reach agreement, filed a complaint seeking a preliminary injunction. After the preliminary injunction was denied, defendants moved for summary judgment on all of MasterCard's claims.

As to the trademark infringement claim, the court applied the balancing test expressed in *Polaroid Corp. v. Polarad Electronics, Corp.*, 287 F.2d 492 (2d Cir. 1961), to determine whether the public would likely be confused as to the source of the goods and services. While the first two factors (strength of the protected marks and similarity between the goods) weighed in MasterCard's favor, the court found that upon balance, no likelihood of confusion existed. Due to the lack of the likelihood of confusion, the court also held that MasterCard's "palming off" claim failed.

The Federal Trademark Dilution Act ("FTDA") protects against the impairment of the goodwill and value of a plaintiff's mark as a result of an unauthorized use of the mark. However, the court stated that a plaintiff must show actual dilution rather than a mere likelihood of dilution. Moreover, the court stated that noncommercial uses of a mark are expressly exempted because Congress did not intend for the FTDA to "chill" political speech. The court found that because the advertisement constituted political speech it was not commercial and thus exempt from the FTDA. The finding that Nader's advertisement was political in nature also led the court to hold that the defendants did not engage in deceptive trade practices.

Additionally, the court held that the defendants were not liable for copyright infringement because their use of MasterCard's copyrighted material qualified as a fair use under 17 U.S.C. § 107. The court held that the Nader advertisement was a transformative, noncommercial parody. In considering the transformative value of a parody, a given work must be "reasonably perceived" to be commenting upon the original creation. However, the degree of parodic commentary of a given work is less critical where the parodic work is less likely to substitute for the original in the primary market. The court held that the Nader advertisement had no demonstrative capacity to divert sales from the original and

that the advertisement's commentary on the original MasterCard advertisement could be reasonably perceived.

Since the court found no genuine issue of material fact for any of the claims, the court granted defendants' motion for summary judgment on all claims.

MATTEL INC. V. WALKING MOUNTAIN PRODUCTIONS

353 F.3d 792 (9th Cir. 2003)

The Ninth Circuit held that the defendant's series of photographs featuring Mattel Barbie dolls in provocative settings were a fair use of copyrighted material and qualified as nominative fair use of trade dress.

Thomas Forsythe, an artist known for photographs with social and political overtones, created a series of photographs, "Food Chain Barbie," depicting Barbie in unusual and sometimes sexual poses. The pictures featured Barbie in dangerous situations involving kitchen appliances and food, and often included nude dolls. Following limited display of the work at two art festivals, on postcards and business cards, and on the web, Mattel filed suit, alleging that the series infringed its copyrights, trademarks, and trade dress.

The district court granted Forsythe summary judgment on the grounds that Forsythe's pictures were fair use. The Ninth Circuit affirmed, finding that the pictures were a fair use of copyrighted material, that the public interest in expression outweighed any consumer confusion from the use of the Barbie trademark, and that the use of trade dress was nominative fair use.

On the issue of copyright infringement, the court balanced the four fair use factors codified at 17 U.S.C. § 107—purpose and character of the use, nature of the copyrighted work, amount and substantiality of the portion used, and effect of the use upon the potential market—and for each factor found that the facts favored fair use. The purpose of the photographs could reasonably be perceived as parody, and this type of critique is protected by the First Amendment and supported by the Copyright Act. Forsythe's commercial interest in the photographs weighed only slightly against fair use. While Barbie's figure and face "can fairly be said to be a creative work," the nature of the copyrighted work is less important when the use is for parody. The amount copied was justifiable in light of the artist's parodic purpose and medium, and Mattel was unlikely to develop or license a market for similar "adult" uses of the Barbie image.

As to the trademark infringement claim, the court applied the *Rogers* test, which balances the public interest in free artistic expression with the potential for consumer confusion, and found that the use of the Barbie trademark had the requisite artistic relevance to Forsythe's work to trigger First Amendment protection. The court also found that Forsythe satisfied the three elements required for nominative fair use of trade dress: (1) The use of the Barbie figure and head were reasonably necessary to conjure up the idea of Barbie; (2) Forsythe only used as much trade dress as necessary; and (3) Forsythe did nothing by use of Barbie trade dress to suggest sponsorship or endorsement of the pictures by Mattel.

NEWTON V. DIAMOND

349 F.3d 591 (9th Cir. 2003)

The Ninth Circuit held that sampling, or use of a brief segment of a musical recording for incorporation into a new recording, was *de minimis* and therefore not infringing of the underlying musical composition, where the sample consisted of "three notes separated by half-step over a background C note" and the sampler had obtained a license to excerpt the sound recording.

Jazz flutist James Newton composed the song "Choir" in 1978. In 1981, he performed and recorded "Choir" and licensed all rights in the sound recording to ECM Records, but retained all rights to the composition. The rap band the Beastie Boys obtained a license from ECM Records in 1992 to sample portions of the sound recording of "Choir" in various renditions of their song "Pass the Mic." The band did not, however, obtain a license from Newton to use the underlying composition. Pursuant to their license from ECM Records, the Beastie Boys digitally sampled the opening six seconds of Newton's sound recording of "Choir," and repeated this six-second sample as a background element throughout their song. Newton brought suit, claiming that the Beastie Boys infringed his copyright in the underlying composition of "Choir."

The district court granted summary judgment in favor of the Beastie Boys, holding that no license of the underlying composition was required because the three-note segment of "Choir" lacked the requisite originality and was therefore not copyrightable. The court further held that even if the segment were copyrightable, the Beastie Boys' use of the work was *de minimis* and therefore not actionable.

The Ninth Circuit affirmed the district court's decision for the defendants on the ground that the use was *de minimis*. The court applied the "average listener" test articulated in *Fisher v. Dees*, 794 F.2d 432 (9th Cir. 1986), in determining whether the use was *de minimis*. Under this test, a taking is considered *de minimis* only if it is so meager and fragmentary that the average audience would not recognize the appropriation. Because the Beastie Boys had lawfully licensed the sound recording, the court confined its inquiry to whether the unauthorized use of the three-note sequence transcribed in the composition was substantial enough to sustain an infringement claim. The court found that there was a high degree but limited scope of similarity between Newton's and the Beastie Boys' work, and thus placed Newton's claim for infringement into the class of cases that allege "fragmented literal similarity."

In such cases, the question is whether the similarity goes to trivial or substantial elements of the original. This phenomenon is measured by considering the qualitative and quantitative significance of the copied portion in relation to the plaintiff's work as a whole. The court noted that when viewed in relation to Newton's composition as a whole, the sampled portion was not quantitatively significant as it appeared only once in Newton's composition and lasted only six seconds in the Beastie Boys recording. In addition, it was not qualitatively significant because the sampled section was a generic three-note sequence that lacked any distinctive elements. The court concluded that the average audience would not discern Newton's hand as a composer from the Beastie Boys' use of the sample and that the works in question were not substantially similar; therefore, the Beastie Boys' use of the "Choir" composition was *de minimis*.

NXIVM CORP. V. ROSS INSTITUTE

364 F.3d 471 (2d Cir. 2004)

The Second Circuit ruled on the impact of misappropriation of copyrighted material on the balancing of the four fair use factors. The court held that the district court did not adequately analyze the propriety of the defendants' conduct. Despite this error, the court still found that the defendants' work would likely be protected under fair use and affirmed the denial of a preliminary injunction.

NXIVM created a seminar training program for paid subscribers, known as "Executive Success." The program included exclusive access to a 265-page training manual. All seminar participants signed non-disclosure agreements barring the public release of the manual. Rick Ross published two nonprofit websites connected to his commercial work as a paid "cult de-programmer." The websites provided information about groups alleged to use mind control techniques. Ross received a NXIVM manual indirectly from Stephanie Franco, a defendant and former NXIVM client. Ross had the manual analyzed by defendants John Hochman and Paul Martin. Hochman and Marin each authored reports on NXIVM which included quotes from the manual. The reports were posted on Ross's websites. NXIVM sued Ross and the other defendants for copyright infringement and other claims. The district court denied a motion by NXIVM seeking a preliminary injunction against Ross's use of the reports, finding the reports likely to be protected by the fair use doctrine. NXIVM appealed.

The Second Circuit held that the district court should have included a more extensive analysis of the misappropriation of the original work under the first fair use factor. However, after an independent review of the four factors, the court held that the fair use defense was likely to succeed and affirmed the denial of the preliminary injunction. The court balanced the four § 107 fair use factors: purpose and character of the use; nature of the copyrighted work; amount and substantiality of the portion used; and effect of the use upon the potential market.

Under the first factor, the court found that the district court did not fully consider the propriety of defendants' conduct. The court held that to the extent that Ross, Martin, or Hochman should have known that access to the manuscript was unauthorized or illegal, this subfactor would weigh against a finding of fair use. A finding of bad faith impacts the first factor, but is neither conclusive for that factor nor dispositive of the entire fair use defense. Rejecting bright line rules, the court held that all the fair use factors must be analyzed, even when there is bad faith. Finally, the court found that even assuming the defendants' bad faith, the first factor still weighed in favor of fair use because of the transformative critical nature of the reports.

Because the copyrighted work was unpublished, the court found the second factor to weigh against fair use. The court found the third factor favored fair use because the secondary work did not take too much of the heart from the original work. The court held the fourth factor weighed heavily in favor of fair use because criticism of the NXIVM seminar could not substitute for participation in the seminar and market harm caused by criticism is not cognizable under the Copyright Act. Balancing all four factors, the court held the reports were likely to be fair use.

VIDEO PIPELINE, INC. V. BUENA VISTA HOME ENTERTAINMENT, INC.

342 F.3d 191 (3d Cir. 2003)

The Third Circuit held that the use of two minutes of copyrighted movie material in an online "clip preview" was not fair use. The court found the relevant factors balanced against fair use, rejected the defense that the copyright holder's license agreements interfered with copyright policy, and held that the copyright holder would likely suffer irreparable harm if the preview was not enjoined.

Video Pipeline, Inc. collects and sells movie trailers. "Trailers" are movie previews which include short scenes from the movie along with additional creative aspects such as narration, music, and editing. Video Pipeline collected trailers onto videocassettes and sold them to home video retailers for in-store display. In 1997, Video Pipeline expanded onto the web, where it operated databases of trailers for use by consumers and for sale to online retailers. Video Pipeline had a license agreement with Disney (owned by defendant Buena Vista) for the distribution of trailers on videocassettes. The license agreement did not permit online display, and Video Pipeline complied with Disney's request to remove Disney trailers from the online database. Video Pipeline replaced some of the Disney trailers with "clip previews," which generally included one or two scenes from the first half of each movie. The district court entered a preliminary injunction prohibiting Video Pipeline from displaying clip previews of Disney films because it likely infringed Disney's copyrights.

Video Pipeline appealed. The Third Circuit found Buena Vista likely to prevail on its copyright infringement claims and upheld the preliminary injunction, holding that three of the four fair use factors weighed against fair use. The court also rejected Video Pipeline's defense that Disney's license agreements interfered with copyright policy and found that Disney was likely to suffer irreparable harm if the clip previews were allowed to continue.

The court analyzed the four § 107 fair use factors: purpose and character of the use; nature of the copyrighted work; amount and substantiality of the portion used; and effect of the use upon the potential market. The court found the first factor weighed against fair use. The clip previews were not transformative so the commercial nature weighed more heavily, making the first factor balance strongly against fair use. Under the second factor, the copyrighted material was creative expression and not factual information, so this factor also weighed against fair use, even though the copyrighted material was widely available to the public. Contrary to the finding of the district court, the Third Circuit found that the clip previews did not copy the "heart of the original," therefore the third factor weighed in favor of fair use. The appellate court also disagreed with the district court on the fourth factor, finding that the correct context for market harm was the loss of value the clip previews caused to Disney *trailers*, not Disney *movies*. In this context the court found the fourth factor to balance against fair use because the Disney trailers did lose value, even if they were not directly for sale.

The court held that although Disney's licensing agreements did limit where trailers could be displayed, the agreements did not interfere with creative expression at a level that significantly impacted copyright policy, and so Video Pipeline was not likely to succeed on its copyright misuse defense.

WINTER V. DC COMICS

69 P.3d 473 (Cal. 2003)

The California Supreme Court held that a comic book containing characters that parodied prominent blues rock musicians Johnny and Edgar Winter was entitled to First Amendment protection that outweighed the plaintiff's right of publicity.

During the 1990s, DC Comics published "Jonah Hex," a five-volume comic book series of which two volumes contained villainous characters named Johnny and Edgar Autumn. The Autumns were depicted as half-worm, half-human brothers with long hair and albino features. One Autumn brother also wore red sunglasses and a stovepipe hat. Plaintiffs Johnny and Edgar Winter are well-known recording artists from Texas. In addition to the similarity in name, the Winters are albino and Johnny Winter often wears a top hat.

Plaintiffs sued under California's right of publicity statute, CAL. CIV. CODE § 3344, which states in part, "[a]ny person who knowingly uses another's name, voice, signature, photograph, or likeness, in any manner, on or in products, merchandise, or goods, or for purposes of advertising or selling, or soliciting purchases of, products, merchandise, goods or services, without such person's prior consent . . . shall be liable for any damages sustained by the person or persons injured as a result thereof." The trial court granted summary judgment for defendants, and the court of appeal initially affirmed. The California Supreme Court granted review and stayed pending resolution of another § 3344 case, *Comedy III Productions, Inc. v. Gary Saderup, Inc.*, 25 Cal. 4th 387 (2001). The California Supreme Court then remanded for reconsideration in line with *Comedy III*, and the court of appeal reversed *Winter* and remanded for trial. The California Supreme Court again granted review.

Noting that the right of publicity generally protects a celebrity's interest in the commercial value of his or her identity, the court explained that *Comedy III* borrowed part of the fair use doctrine from copyright law in identifying the relevant question for assessing the interaction between the right of publicity and the First Amendment as "whether the work in question adds significant creative elements so as to be transformed into something more than a mere celebrity likeness or imitation." In *Winter*, the court further elaborated this test: "[A] work is protected by the First Amendment inasmuch as it contains significant transformative elements or that the value of the work does not derive primarily from the celebrity's fame." Finding the depiction of plaintiffs to be "distorted for purposes of lampoon, parody, or caricature," and the comic books' marketability to be derived from their creative elements rather than appropriation of the Winters' identities, the court held that the First Amendment defense precluded the plaintiffs' right of publicity claim.

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ENTERTAINMENT TRADEMARK

ADDITIONAL DEVELOPMENTS—ENTERTAINMENT TRADEMARK

PRO-FOOTBALL, INC. V. HARJO

284 F. Supp. 2d 96 (D.D.C. 2003)

The district court for the District of Columbia reversed a decision by the Trademark Trial and Appeal Board ("TTAB") that the trademarks for the football team the Washington Redskins were disparaging to Native Americans.

Harjo brought an action to cancel six of a professional football team's trademark registrations under § 2(a) of the Lanham Act, which prohibits registration of marks "which may disparage . . . persons, living or dead, institutions, beliefs, or national symbols." The TTAB found for Harjo and cancelled the trademark registrations. Defendant Pro-Football sought judicial review of the decision.

On cross-motions for summary judgment, the district court reversed. First, the court found that Harjo had not presented substantial evidence that the term was disparaging to Native Americans. Specifically, there was little or no evidence that during the relevant time period, namely when the marks were registered, that a "substantial composite" of the Native American population found the term "redskins" to be disparaging.

Second, the court found that the suit was barred by laches. Laches is an available defense in an action to cancel a trademark as potentially disparaging upon satisfaction of three conditions: (1) substantial delay by plaintiff prior to filing suit; (2) plaintiff's awareness of the mark during the delay; and (3) reliance interest resulting from defendant's continued development of good-will during this period of delay. In this case, the court found that the substantial and unexcused delay of twenty-five years in bringing suit brought prejudice to the mark holder.

SCHOLASTIC INC. V. STOUFFER

81 Fed. Appx. 396 (2d Cir. 2003)

The Second Circuit affirmed the dismissal of trademark and copyright claims and the imposition of sanctions on a party who submitted falsified evidence to the court.

Stouffer filed a counterclaim against Scholastic for trademark and copyright violations alleging similarities between her work and Scholastic's *Harry Potter* book. Since the two works were not substantially similar, the court dismissed the copyright infringement claims. After the Federal District Court for the Southern District of New York applied the eight-factor test for trademark confusion as stated in *Polaroid Corp. v. Polarad Electronics Corp.*, 287 F.2d 492, 495 (2d Cir. 1961), and found that no reasonable juror would be confused as to the source of the two works, the court dismissed Stouffer's trademark infringement claims. Furthermore, the district court imposed sanctions on Stouffer for falsified evidence she submitted in support of her claims.

Upon *de novo* review of the district court's decision, the Second Circuit stated that the district court correctly dismissed the claims. While the district court did not analyze each *Polaroid* factor, the Second Circuit affirmed the decision because the district court correctly stated the law and thoroughly compared the works at issue. The Second Circuit also affirmed the district court's dismissal of the copyright claims because it found no substantial similarities between the works at issue.

Reviewing the district court's decision to impose sanctions under an abuse of discretion standard, the court affirmed the sanctions on Stouffer of $50,000 along with attorneys fees. The court also awarded Scholastic all attorneys fees and costs incurred on appeal.

SHERWOOD 48 ASSOCS. V. SONY CORP. OF AMERICA

76 Fed. Appx. 389 (2d Cir. 2003)

The Second Circuit held that the owners of three Times Square buildings who brought suit against the producers of the motion picture *Spider-Man*, for depicting digitally altered billboard advertisements upon the owners' buildings in the movie, failed to identify with enough precision their protectable trade dress under the Lanham Act, 15 U.S.C. § 1125(a).

Spider-Man includes a scene set in New York City's Times Square during a fictional "World Unity Festival." Producer Sony made agreements with various companies to superimpose their advertising on the buildings as they appear in the recreated version of Times Square. The building owners alleged violation of § 43(a) of the Lanham Act, which provides a private cause of action against any person who, "in connection with any goods . . . or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, which . . . is likely to cause confusion, or to cause mistake, or to deceive . . . as to the origin, sponsorship, or approval of his or her goods . . . by another person . . . ." 15 U.S.C. § 1125(a).

The Second Circuit held that the building owners did not identify their purportedly protectable trade dress with the requisite precision in their complaint. The court stated that by seeking protection of both "the configuration" of the three buildings and the advertising and signage display on the faces of the buildings, the plaintiffs plainly sought to protect the "overall look" of each of the buildings, and yet they failed to identify the specific elements that comprise each building's identifiable dress. Concluding that this "basic defect" in the pleading could not be cured, the court affirmed the district court's dismissal of the claim.

The plaintiffs also alleged four tort claims under New York law: unfair competition, deceptive trade practices, dilution, and trespass. The Second Circuit held that the district court erred in asserting supplemental jurisdiction over these claims because they involved unsettled questions of state law—specifically, whether a trespass is committed under New York law when a party's physical contact with another party's personal property diminishes the value of that property even if it does no damage. Noting that the California Supreme Court had recently concluded that "the tort [of trespass to chattels] does not encompass, and should not be extended to encompass, an electronic communication that neither damages the recipient computer system nor impairs its functioning," *Intel Corp. v. Hamidi*, 71 P.3d 296 (Cal. 2003), the Second Circuit concluded that a New York court should determine in this case whether physical damage to the buildings is a prerequisite to a trespass claim. The court also determined that a New York court should likewise decide upon the plaintiffs' other state claims, and accordingly vacated their dismissal by the district court.

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ANTITRUST

PROMETHEUS RADIO PROJECT V. FCC: THE PERSISTENCE OF SCARCITY

By Aaron Perzanowski

A well-informed citizenry forms the very basis of a functioning democracy.[1] Newspapers, radio, television, and, more recently, the Internet serve as essential wellsprings of information for the American public. Media concentration, because it results in an ever-decreasing number of sources of publicly available information, poses a serious threat to the development of an informed public.

Not surprisingly, the recent efforts by the Federal Communications Commission (FCC) to allow further consolidation among already concentrated sources of news and information have met with harsh and sustained criticism.[2] In 2003, the FCC called for significant deregulation of its limits on media concentration. This Note examines these rule changes, their historical context, the litigation they sparked, and their underlying justification.

Part I traces the history of broadcast regulation, emphasizing the development of the scarcity doctrine and the subsequent deregulatory trend. Part II examines the FCC's 2003 rule changes and the Third Circuit's analysis of those modifications in *Prometheus Radio Project v. FCC*.[3] Part III analyzes the assumptions underlying the FCC's proffered explanation for its rule changes, ultimately concluding that they lack justification, and offers suggestions for responsible ownership deregulation. Part IV calls on Congress to reassert itself as the final arbiter of media policy.

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1. *See* Minneapolis Star & Tribune Co. v. Minn. Comm'r of Revenue, 460 U.S. 575, 585 (1983) (stating "an informed public is the essence of working democracy").

2. *See* Gregory M. Prindle, *No Competition: How Radio Consolidation Has Diminished Diversity and Sacrificed Localism*, Note, 14 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 279, 306-20 (2003); Brian Lowry, *Viewers, It's Time to Wake Up and Smell the Mergers,* L.A. TIMES, Feb. 27, 2002, at 6-1; *Media Conglomeration*, N.Y. TIMES, Aug. 23, 2003, at A4.

3. 373 F.3d 372 (3d Cir. 2004).

I. A BRIEF HISTORY OF BROADCAST REGULATION

Two trends mark the history of the FCC's efforts to regulate broadcasters. The first tracked a steady increase in regulatory power. Initial structural regulations gave way to content-based rules, both of which found their justification in spectrum scarcity. The second trend, beginning in the 1980s and continuing today, reversed the course charted by the FCC in its first fifty years.[4] Deregulation emerged as a primary goal of the FCC, and the scarcity rationale, the basis for the regulations of the past, came under fire.

A. The Development of the Scarcity Rationale

Since the early development of radio, the government has imposed regulatory limits on use of the broadcast spectrum.[5] As the incipient medium's popularity grew, the inherent limitations of the broadcast spectrum both motivated and justified increased federal oversight.[6] Broadcasting provided a means of mass communication with a finite carrying capacity. The widespread adoption of radio coupled with the scarcity of broadcast frequencies created an environment that jeopardized the very functionality of the technology. "The number of stations increased . . . rapidly, . . . and the situation became . . . chaotic."[7] Without regulation, the crowded radio spectrum risked incoherence.

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4. The FCC's enforcement of broadcast decency standards, rather than decreasing as part of the general deregulatory trend, has grown more aggressive. *See* Mathew C. Holohan, Note, *Politics, Technology, and Indecency: Rethinking Broadcast Regulation in the 21st Century*, 20 BERKELEY TECH. L.J. 341 (2005) (reviewing recent FCC enforcement of decency standards and concluding that such enforcement is politically motivated); Emily Fredrix, *Viacom to Pay $3.5m in FCC Decency Cases*, BOSTON GLOBE, Nov. 24, 2004, *available at* http://www.boston.com/news/nation/washington/articles/2004/11/24/viacom_to_pay_35m_in_fcc_decency_cases; Marilyn Geewax, *FCC Chairman Raises Profile; Powell Hardens Stance on Broadcast Decency*, ATLANTA J. CONST., Sept. 24, 2004, at 1F.

5. *See* Radio Act of 1912, Pub. L. No. 62-264, 37 Stat. 302 (1912) (requiring sea-based radio operators to obtain a license from the Secretary of Commerce and Labor).

6. Some have argued that broadcast regulations need not rely on the scarcity rationale. One commentator has suggested that regulations imposed on broadcasters could find "firmer First Amendment footing" in the public forum doctrine. *See* Charles W. Logan, Jr., *Getting Beyond Scarcity: A New Paradigm for Assessing the Constitutionality of Broadcast Regulation*, 85 CALIF. L. REV. 1687 (1997). This result is justified by viewing the First Amendment to allow active governmental promotion of robust debate on issues of public concern, or alternatively, by emphasizing the quid pro quo of broadcast licensing, whereby the access to a valuable and limited public resource granted to broadcasters is conditioned upon their agreement to serve the public interest. *See id.*

7. NBC v. United States, 319 U.S. 190, 211 (1943).

The Communications Act of 1934 created the Federal Communications Commission, granting it the authority to regulate broadcasters.[8] The FCC's initial rules, required under the Act to further the "public interest, convenience, or necessity," found their justification in the need to maintain radio's usability.[9] In addition to awarding licenses, the FCC limited signal power, antenna height, and frequency.[10] These structural regulations guarded against interference resulting from overcrowded spectrum.

The FCC's rulemaking soon expanded to include limits on media ownership. When the FCC denied a broadcast license in 1938 on the basis of the applicant's control of another station, it established its first ownership rule.[11] The duopoly rule prohibited the owner of a broadcast station from controlling two stations in the same broadcast area.[12] While the duopoly rule imposed limits on local concentration of broadcast facilities, the first national ownership limits emerged in the 1940s. Under these regulations, the FCC denied licenses to any entity controlling six radio stations or three television stations nationwide.[13]

As the Supreme Court's decision in *NBC v. United States* demonstrated, even the FCC's power to deny broadcast licenses found its justification in spectrum scarcity.[14] Disposing of NBC's First Amendment challenge to the denial of its license application under the Chain Broadcasting Regulations,[15] the Court explained, "Unlike other modes of expression, radio inherently is not available to all. That is its unique characteristic, and that is why, unlike other modes of expression, it is subject to governmental regulation. Because it cannot be used by all, some who wish to use it must be denied."[16] Employing an inherently limited medium of expression, broadcasters enjoy lessened First Amendment protections and can be encumbered with greater regulatory burdens.

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8. *See* Communications Act of 1934, 47 U.S.C. § 151 (2000).

9. *Id.*

10. *See* FCC Broadcast Radio Services, 47 C.F.R. § 73.603 to .614 (2004).

11. *See* C. Edwin Baker, *Media Concentration: Giving Up on Democracy*, 54 FLA. L. REV. 839, 863 (2002).

12. High Frequency Broadcast Stations, 5 Fed. Reg. 2382, 2384 (June 26, 1940).

13. *In re* Amendment of Section 73.3555, [formerly 73.35, 73.240, and 73.636] of the Commission's Rules Relating to Multiple Ownership of AM, FM, and Television Broadcast Stations, 100 F.C.C.2d 17 (1984).

14. 319 U.S. 190, 226 (1943).

15. The Chain Broadcasting Regulations were meant to limit the influence of networks on individual broadcast stations. The rules barred licensing of stations that agreed, *inter alia,* to the following: exclusive network affiliation, territorial exclusivity, terms of affiliation longer than two years, and network penalization for alterations of broadcast airtime rates. *See id.* at 198-209.

16. *Id.* at 226.

In the 1970s, these regulatory burdens reached their peak. The FCC instituted a number of cross-ownership bans that prevented entities from owning various media combinations. It established the first such rule in 1970, prohibiting television station owners from controlling cable systems in the same broadcast area.[17] Shortly thereafter, it barred common ownership of television and radio stations in local communities.[18] Finally, a prohibition against newspaper and broadcast cross-ownership took effect in 1975.[19]

The FCC's regulatory efforts included not only structural requirements, but content-based rules as well. In 1969, the Supreme Court examined the Fairness Doctrine, a long-standing FCC policy requiring broadcasters to allocate equal time to both sides of issues of public concern.[20] Red Lion, a radio broadcaster, brought suit after the FCC demanded it provide free airtime to an individual disparaged by Reverend Billy James Hargis' "Christian Crusade" series broadcast by Red Lion.[21] In upholding the Fairness Doctrine, the Court offered its most perspicuous statement of the scarcity rationale. Given the demand for access to limited spectrum, the Court explained:

> [I]f there is to be any effective communication by radio, only a few can be licensed and the rest must be barred from the airwaves. It would be strange if the First Amendment, aimed at protecting and furthering communications, prevented the Government from making radio communication possible by requiring licenses to broadcast and by limiting the number of licenses so as not to overcrowd the spectrum.[22]

Permitting unregulated use of spectrum would result in "chaos."[23] The FCC was therefore justified, according to the Court, in imposing content-based duties on those granted broadcast licenses.[24]

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17. *See In re* Amendment of Part 74, Subpart K, of the Commission's Rules and Regulations Relative to Community Antenna Television Systems, 23 F.C.C.2d 816, 820 (1970).

18. *See In re* Amendment of Sections 73.35, 73.240 and 73.636 of the Commission's Rules Relating to Multiple Ownership of Standard, FM and Television Broadcast Stations, 28 F.C.C.2d 662, 662 (1971).

19. *See In re* Amendment of Sections 73.34, 73.240, and 73.636 of the Commission's Rules Relating to Multiple Ownership of Standard, FM, and Television Broadcast Stations, 50 F.C.C.2d 1046, 1089 (1975).

20. Red Lion Broad. Co. v. FCC, 395 U.S. 367, 369 (1969).

21. *Id.* at 371.

22. *Id.* at 389.

23. *Id.* at 375.

24. *Id.* at 401.

B. The Deregulatory Trend

The 1980s marked a turning point in broadcast regulation. While its first five decades were characterized by a steady expansion of its regulatory powers, the FCC initiated a march towards the deregulation of broadcast media during the Reagan era. Among the first targets were the content-based requirements of the Fairness Doctrine. In 1985, the FCC released its Fairness Report, repudiating the doctrine and claiming that it no longer served any purpose and that it chilled expression.[25] When Congress passed legislation reinstituting the Fairness Doctrine in 1987, President Reagan vetoed it.[26]

By the mid-1990s the deregulatory fervor had reached Congress. The Telecommunications Act of 1996 codified the congressional preference for broadcast deregulation. It eliminated the National Radio Cap,[27] which limited the total number of radio stations an entity can control.[28] Further, the Act required the FCC to conduct biennial reviews of its regulations in order to eliminate any rules no longer necessary to the public interest.[29]

The FCC's biennial review process sparked litigation from its inception. In 1998, in its first such review, the FCC determined that the national television ownership rule and the cable/broadcast cross-ownership rule furthered the public interest and announced their retention.[30] The Fox network brought suit in the D.C. Circuit challenging this decision. The court in *Fox Television Stations v. FCC* held that the FCC had failed to provide

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25. *See In re* Inquiry into Section 73.1910 of the Commission's Rules and Regulations Concerning the General Fairness Doctrine Obligations of Broadcast Licensees, 102 F.C.C.2d 145, 147 (1985).

26. *See* S. 742, 100th Cong. (1987).

27. Telecommunications Act of 1996 § 202(a), Pub L. No. 104-104, 110 Stat. 56 ("The [FCC] shall modify section 73.3555 of its regulations (47 C.F.R. 73.3555) by eliminating any provisions limiting the number of AM or FM broadcast stations which may be owned or controlled by one entity nationally.").

28. Since the elimination of the National Radio Cap, concentration of the radio market has increased markedly. Clear Channel Communications, the nation's largest radio broadcaster, owns over 1200 radio stations, and according to many accounts is largely responsible for the homogenization of radio programming throughout the United States. *See* Loren Steffy, *KLOL Just Wasn't Music to Ears of Radio Marketers*, HOUSTON CHRON., Nov. 19, 2004, Business, at 1.

29. *See* 47 U.S.C. 161 (2000); Telecommunications Act of 1996 § 202(h), Pub L. No. 104-104, 110 Stat. 56.

30. *In re* 1998 Biennial Regulatory Review - Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, 15 F.C.C.R. 11,058, 11,061 (2000).

adequate justification for its decision.[31] The court vacated the cross-ownership rule but remanded the national television ownership rule to the FCC for further justification or revision.[32]

Shortly after its decision in *Fox*, the D.C. Circuit evaluated the FCC's retention of the local television ownership rule in *Sinclair Broadcast Group v. FCC*.[33] The court upheld the FCC's retention of the rule despite Sinclair Broadcasting's contention that the "eight independent voices" rule, which barred any merger that would result in fewer than eight station owners in a given market, lacked sufficient justification.[34] It did, however, remand on the issue of excluding non-broadcast media from the eight voices rule.[35]

The FCC addressed the rules remanded in *Fox* and *Sinclair*, among others, in its 2002 biennial review. This review culminated with the most sweeping deregulatory changes yet introduced by the FCC: the 2003 Order[36] scrutinized by the Third Circuit in *Prometheus*.

II. THE ORDER AND *PROMETHEUS*

The Report and Order and Notice of Proposed Rulemaking ("The Order") issued by the FCC on July 2, 2003 marked a new zenith in the FCC's push towards the deregulation of broadcast media. While it did not call for an end to ownership regulation, The Order marked a significant step towards total deregulation, a position advocated by some commentators, among them, former FCC Chairman Mark Fowler.[37] It called for significant loosening of the FCC's restrictions on media ownership and allowed previously prohibited levels of concentration both within and between media.[38] The Order significantly increased the national television owner-

31. 280 F.3d 1027, 1053 (D.C. Cir.), *amended en banc by* 293 F.3d 537 (D.C. Cir. 2002).

32. *Id.*

33. *See* 284 F.3d 148 (D.C. Cir. 2002).

34. *Id.* at 169.

35. *Id.*

36. *In re* 2002 Biennial Regulatory Review—Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, 18 F.C.C.R. 13,620 (2003) [hereinafter The Order].

37. *See* Mark S. Fowler & Daniel L. Brenner, *A Marketplace Approach to Broadcast Regulation*, 60 TEX. L. REV. 207 (1981-82); Note, *Paying Attention to Justice: The FCC and the Failure to Deregulate*, 11 MEDIA L. & POL'Y 62 (2002); James Gattuso, *The Myth of Media Concentration: Why the FCC's Media Ownership Rules Are Unnecessary* (May 29, 2003), *available at* http://www.heritage.org/Research/InternetandTechnology/wm284.cfm.

38. *See* The Order, *supra* note 36, at 13,953 (Commissioner Copps, dissenting).

ship cap[39] and eliminated the remaining cross-ownership rules, replacing them with a new rule that allowed greater control and concentration across media.[40] The Order relaxed the local television ownership rule, allowing owners to control up to three stations in the same market and created a new method of calculating market size for the purpose of controlling local radio concentration.[41]

The proposed rulemaking met with immediate and vocal opposition. The public spoke out,[42] Congress legislated,[43] and litigants filed suit. Dozens of petitioners filed to challenge the FCC's Order, and those challenging the rules fell into two distinct categories. The citizen petitioners, among them the Prometheus Radio Project, argued, *inter alia*, that The Order violated the FCC's public interest obligation and sacrificed diversity of media sources and viewpoints by allowing increased concentration of ownership. The deregulatory petitioners, composed of networks, broadcasters, and industry associations, insisted that The Order failed to go far enough in removing regulatory impediments. Pursuant to the random lottery selection process for challenges to administrative rulemakings,[44] the suits of these petitioners were consolidated and heard by the Third Circuit.

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39. *Id.* at 13,815.

40. *Id.* at 13,790.

41. *Id.* at 13,668.

42. The public reaction to the FCC's efforts to reform its media ownership regulations was swift and unambiguous. Prior to the official publication of The Order, the FCC received comments from nearly two million citizens in response to its review of ownership regulations. *Id.* at 13,977-78. Over 99.9% of those comments voiced objections to increased consolidation. Membership-driven organizations ranging from the American Civil Liberties Union to the National Rifle Ass'n opposed further concentration among media owners, as did city councils in cities such as Chicago, Philadelphia, and San Francisco. *Id.*

43. In the months following The Order, a bipartisan effort to reverse the FCC's new rules took shape in Congress. Although the vast majority of Democrats and a significant Republican minority sought a rollback of The Order, ultimately the "aggressive political tactics" of the pro-FCC minority in Congress blocked such attempts. Ben Scott, *The Politics and Policy of Media Ownership*, 53 AM. U. L. REV. 645, 655 (2004). The Senate passed a bill stripping The Order's rules of any force or effect that languished in the House and was never put to a vote. *See* 108 S.J. Res. 17, 108th Congress (2003). In the end, the Congressional concern over media concentration resulted in only minor alterations of the FCC's rules. In 2004, Congress set the national television ownership cap at 39%, choosing a limit between the FCC's prior 35% cap and the proposed 45% limit. *See* Consolidated Appropriations Act, Pub. L. No. 108-199, § 629, 118 Stat. 3, 99-100 (2004). Additionally, Congress exempted the national television cap and related rules, including the UHF discount, from further review under § 202(h). *Id.*

44. *See* 28 U.S.C. § 2112(a) (2000).

A. The Third Circuit's Analysis

The *Prometheus* court examined The Order's revisions of the cross-ownership, local television, and local radio regulations, ultimately finding significant deficiencies in the rationale underlying each of the FCC's rule changes.[45] In evaluating the rules, the court was bound by both the Administrative Procedure Act and § 202(h) of the 1996 Telecommunications Act. The Administrative Procedure Act requires courts to set aside administrative actions that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law."[46] The Telecommunications Act in § 202(h) calls for periodic review of FCC rules to determine their continued importance to achieving the public interest, defined primarily in reference to the FCC's three core values: diversity, competition, and localism.[47] Any rule failing to advance the public interest must be repealed or modified.

The court's inquiry focused on each of the Order's rule changes in turn, outlining both the prior regulations and their modification, and analyzing the propriety of the rule changes under the relevant standards.

1. Cross Ownership

The FCC's previous rules governing cross-ownership applied two distinct regulations to owners depending on the forms of media at issue.[48] The newspaper/broadcast rule prohibited the owner of a daily newspaper from owning any broadcast station in the same market.[49] The radio/television rule provided market-relative limits to the number of radio stations, if any, the owner of a television station could possess.[50]

The new rule promulgated by the FCC eliminated both of these cross-ownership restrictions, replacing them with a new comprehensive market-relative cross-ownership regulation.[51] In markets of three or fewer television stations, the new standard permitted no cross ownership of television,

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45. The court deemed moot the changes made to the national television ownership rule in light of the intervening legislation readjusting the numeric limit and exempting the rule from further biennial review. *See supra* note 43.

46. 5 U.S.C. § 706(2)(A) (2000).

47. Telecommunications Act of 1996, § 202(h), Pub L. No. 104-104, 110 Stat. 56.

48. The *Fox* court previously eliminated the cable/broadcast rule, which prevented common ownership of cable and broadcast stations in the same community. *See* Fox Television Stations v. FCC, 280 F.3d 1027, 1053 (D.C. Cir.), *amended en banc by* 293 F.3d 537 (D.C. Cir. 2002).

49. 47 C.F.R. § 73.3555(d) (2004).

50. *Id.* § 73.3555(c).

51. *See* The Order, *supra* note 36, at 13,790.

radio, or newspapers.[52] In markets with four to eight television stations, the rule permitted a single entity to own a newspaper and either (1) a television station and 50% of the radio stations permitted under the local radio ownership rules, or (2) 100% of the radio stations allowable under the local radio rule.[53] In the largest markets, those with more than eight TV stations, cross-ownership was left entirely unregulated.[54]

In examining the new cross-ownership rule, the *Prometheus* court found that because the merger of local broadcast and newspaper ventures can potentially increase local news coverage by increasing efficiency and does not necessarily create significant harms to diversity, the FCC offered sufficient justification for its elimination of the newspaper/broadcast rule.[55] In addition, according to the court, the FCC's retention of some regulations over media ownership violated neither the First nor the Fifth Amendment, despite the contention of the deregulatory petitioners.[56] While the language of the regulation is couched in terms of restrictions placed on newspaper owners, the court held that the regulations applied equally to all media owners, and therefore, did not violate the Fifth Amendment's equal protection clause.[57] Although the rule may hamper the ability of potential media cross-owners to speak to a larger audience, the court, relying on the Supreme Court's decision in *National Citizens Committee for Broadcasting*,[58] justified such restrictions on First Amendment protections on the basis of spectrum scarcity.[59]

Despite sanctioning the general approach of the FCC's new rule, the court remanded on the issue of the specific numeric limits created by the cross-ownership rule.[60] The court objected to the assumptions made by the FCC in creating the Diversity Index, a metric used to determine speaker diversity within communities for the purpose of establishing the appropriate cross-ownership regulations.[61] Specifically, the court found that the weight given to Internet news sources in calculating the Diversity Index lacked justification.[62] Further, the court objected to the unrealistic assumption made by the FCC of equal market share between stations within a

52. *Id.* at 13,799.
53. *Id.* at 13,803.
54. *Id.* at 13,804.
55. Prometheus Radio Project v. FCC, 373 F.3d 372, 397 (3d Cir. 2004).
56. *Id.* at 400.
57. *Id.* at 401.
58. FCC v. Nat'l Citizens Comm. for Broad., 436 U.S. 775, 799 (1978).
59. *Prometheus*, 373 F.3d at 401.
60. *Id.* at 403.
61. *Id.*
62. *Id.* at 405.

given medium.[63] Finally, the court found that the FCC applied the results of the Index in an inconsistent manner, allowing increases of Diversity Index scores in some instances that were larger than increases prohibited under other circumstances.[64]

2. *Local Television Ownership*

Prior to its 2003 rulemaking, the FCC allowed duopolies, ownership of two television stations by the same firm within a given market, if two stipulations were satisfied: (1) no owner can control two of the top four most-viewed stations in a market and (2) at least eight "independent voices" must remain after the proposed merger.[65] In constrast, the FCC's new rule allowed much greater consolidation by permitting triopolies in markets of eighteen or more stations and duopolies in markets of seventeen or fewer stations.[66] The "top four" rule remained applicable, effectively precluding duopolies in markets with fewer than five television stations.[67]

The court upheld the retention of the "top four" rule despite the deregulatory petitioners' claim that it unfairly prevented stations in small markets from achieving the efficiencies of consolidation.[68] The court agreed with the FCC's determination that the likely harm to viewpoint diversity resulting from consolidation in such markets outweighed the likely benefits of increased efficiency.[69]

However, the court found the specific numerical limits created by the rule arbitrary.[70] In formulating its rule, the FCC failed to account for the actual market share of the stations at issue, considering mergers of the seventeenth, eighteenth, and nineteenth most watched stations as equivalent to common ownership of the fourth, fifth, and sixth rated stations in a given market. Further, the court insisted the FCC provide justification for allowing market concentration that exceeds the FCC's own target Diversity Index score.[71]

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63. *Id.* at 409.
64. *Id.* at 411.
65. *See* 47 C.F.R. § 73.3555(b) (2000); *In re* Review of the Commission's Regulations Governing Television Broadcasting, 14 F.C.C.R. 12,903, 12,907-08 (1999).
66. The Order, *supra* note 36, at 13,668.
67. *Id.*
68. *Prometheus*, 373 F.3d at 417.
69. *Id.*
70. *Id.* at 420.
71. *Id.*

3. *Local Radio Ownership*

Finally, the court considered the local radio rule. The Telecommunications Act of 1996 stipulated that in markets of forty-five or more stations, a single entity may own up to eight stations, with up to five in any one service (AM or FM).[72] The rule permitted firms to own seven stations (up to four in one service) in markets with 30-44 stations, six stations (four in a service) in markets of 15-29 stations, and five stations (three in a service) in markets of less than fifteen stations provided no company controls more than 50% of the local market.[73]

The new rule made no changes to the numerical restrictions, but it did significantly alter the method used to calculate the total number of stations in a market, the "denominator." While the previous method considered only commercial stations in calculating the denominator, the new approach included both commercial and noncommercial stations.[74] Secondly, the new method abandoned the transaction-specific "contour overlap" method for counting stations in a market, instead employing an objective geographic standard employed by Arbitron.[75]

The court upheld the FCC's decision to make use of the Arbitron system because of demonstrated flaws in the contour overlap method that created a "perverse incentive" to merge the largest, most powerful stations in a market.[76] Despite the objections of the citizen petitioners, the court also held that the inclusion of noncommercial stations in the denominator calculation posed no threat to diversity because the net effect of the new approach was a decrease in denominators in most markets.[77]

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72. Telecommunications Act of 1996 § 202(b), Pub L. No. 104-104, 110 Stat. 56.

73. *Id.*

74. *See* The Order, *supra* note 36, at 13,713.

75. Arbitron is the nation's leading provider of radio ratings. It has established geographic radio markets for most U.S. urban areas. *See id.* at 13,712.

76. *Id.* at 13,719. The contour overlap method involved first calculating the "numerator," the number of commonly owned stations within a market, by adding all commonly owned stations with overlapping principal community signal contours. Next the "demoninator," the total number of stations in the relevant market, was calculated by adding to the numerator any stations whose contours overlap with at least one of the stations in the numerator. A party was "deemed to own only those stations . . . that have mutually overlapping principal community contours." *Id.* at 13,718. The denominator calculation, however, included all stations "whose principal community contour overlaps the principal community contour of at least one of the radio stations in the numerator . . . regardless of who owns that station." *Id.* The denominator, therefore, could include radio stations owned by the same party that owns the radio stations represented in the numerator but were not counted against the party's ownership limit. *See id.*

77. Prometheus Radio Project v. FCC, 373 F.3d 372, 426 (3d Cir. 2004).

Although the numerical limits were not revised, the court remanded them for further justification by the FCC. The court expressed doubt as to the effectiveness of the regulations in promoting the FCC's goal of creating five equal-sized competitors in each market and, further, questioned the propriety of that particular goal in achieving the public interest.[78]

B. Arbitrary Rule or Unwise Policy?

At first glance, the Third Circuit's ruling in *Prometheus* appears to be an unremarkable application of the standards of administrative review. Upon closer inspection, while the court couched its decision in the language of administrative law, it remanded each of the FCC's numeric limits on the basis of policy concerns rather than any failure to meet the relevant administrative standards. The court's decision reflects its disapproval of the FCC's policy choices rather than a determination that the rules were "arbitrary and capricious" or violated the FCC's public interest obligation.

In *NBC*, the Supreme Court addressed the application of both the "arbitrary and capricious" and "public interest" standards in regard to a challenged FCC regulation, clearly outlining the appropriate role of the courts in such determinations.[79] Denying NBC's challenge to the Chain Broadcasting Regulations, the court explained:

> The Regulations are assailed as "arbitrary and capricious." If this contention means that the Regulations are unwise, that they are not likely to succeed in accomplishing what the Commission intended, we can say only that the appellants have selected the wrong forum for such a plea. What was said in *Board of Trade v. United States*, 319 U.S. 534, 548 [1942], is relevant here: "We certainly have neither technical competence nor legal authority to pronounce upon the wisdom of the course taken by the Commission." Our duty is at an end when we find that the action of the Commission was based upon findings supported by evidence, and was made pursuant to authority granted by Congress. It is not for us to say that the "public interest" will be furthered or retarded by the Chain Broadcasting Regulations.[80]

The *Prometheus* court disregarded the narrow test formulated in *NBC* and applied its own contradictory standard of review. The Supreme Court warned against questioning the wisdom of the FCC's rules, their likelihood of success, or the quality of their evidentiary support. The *Prome-*

78. *See id.* at 432-34.
79. NBC v. United States, 319 U.S. 190, 224 (1943).
80. *Id.*

theus court, however, challenged the FCC's rulemaking on each of these proscribed grounds.

The FCC justified its local radio rule, in part, by contending that the rule furthered its goal of achieving five equal-sized competitors in each radio market. The Third Circuit, in conflict with the Supreme Court's directive in *NBC*, doubted the effectiveness of the local radio limits in achieving the FCC's five equal-sized competitor goal[81] and questioned that goal's importance to the public interest.[82] The FCC relied on game theory justifications to support the five equal-sized competitor goal.[83] The court, citing an apparent discrepancy between the scholarly research upon which the FCC's goal relied and recent Merger Guidelines introduced by the Federal Trade Commission, questioned the expedience of the five equal-sized competitor goal.[84] In doing so, the court doubted both the wisdom of the FCC's objective and the sufficiency of the evidence supporting it.

Further, the court disapproved of the methodology used to calculate the Diversity Index, a metric central to both the cross-ownership and local television ownership rules, citing empirically flawed assumptions employed in calculating the index.[85] In calculating the Diversity Index, the FCC considered the impact of the Internet on viewpoint diversity. The court contended that the FCC was incorrect in its assumption that the Internet significantly increased the availability of diverse viewpoints on local issues. It questioned the accuracy of the FCC's survey that indicated Internet sites as a source of news programming because that survey failed to distinguish between independent news sources, which increase source and viewpoint diversity, and those that merely republish information available from more traditional sources, which do not.[86] The court then attempted to distinguish between the quality of the content created by traditional media sources and individual online contributors, ultimately concluding that such independent voices cannot be considered "media outlets."[87] In attempting to define what sources of news and information are

81. The court found that the numerical limits could not "rationally be derived" from a five equal-sized competitor goal. This determination comports more closely with the Supreme Court's directive in *NBC*. The limits failed to result in such equally divided markets in the past. Further, the FCC ignored actual market share, a statistic essential to its goal, in formulating the numerical limits. *Prometheus*, 373 F.3d at 433-34.

82. *Id.* at 432-34.

83. The Order, *supra* note 36, at 13,731.

84. *Prometheus*, 373 F.3d at 433.

85. *Id.* at 405.

86. *Id.*

87. *Id.* at 407.

appropriately considered media outlets and criticizing the studies conducted by the FCC, the court presumed a "technical competence" explicitly denied by the Supreme Court.[88]

The *Prometheus* court, by providing a policy-driven determination in a case requiring application of administrative standards and deference to administrative expertise, ignored its proper role and "substituted its own policy judgment for that of the Federal Communications Commission."[89] The court's overreaching decision points to deep misgivings regarding the FCC's rule changes and the policy goals that prompted them. In the discussion below, this Note suggests a likely source of the concern that motivated the *Prometheus* court to remand the rule changes. The Note also endeavors to show that while the court failed to apply the appropriate standard of review, its decision was far from misguided as a matter of media policy.

III. SCARCITY IN THE NEW MEDIA MARKETPLACE

The scarcity rationale has long faced criticism.[90] Technological developments in recent decades have increased the calls for its abandonment. Notwithstanding these criticisms, the FCC's attempt to deny the relevance of scarcity rests on untenable assumptions. Impartial reflection on the current media marketplace reveals that the scarcity doctrine remains both applicable and essential despite recent changes in the distribution of content.

A. The Denial of Scarcity

Although the FCC offered numerous justifications for its rule changes, one assumption underpins the sweeping deregulations called for in The Order: the diminished relevance of scarcity in establishing ownership limits. While the dearth of available spectrum continues to limit speech opportunities for would-be broadcasters, according to the FCC scarcity no longer justifies the ownership restrictions of the past because changes in the media marketplace have diminished its importance. As The Order explained:

> Today's media marketplace is characterized by abundance. . . . [N]ew modes of media have transformed the landscape, providing more choice, greater flexibility, and more control than at any other time in history. Today we can access news, information,

88. NBC v. United States, 319 U.S. 190, 224 (1943)

89. *Prometheus*, 373 F.3d at 435 (Scircia, J., dissenting).

90. *See e.g.*, R.H. Coase, *The Federal Communications Commission*, 2 J.L. & ECON. 1 (1959).

> and entertainment in many enhanced and non-traditional ways via: cable and satellite television, digital transmission, personal and portable recording and playback devices, handheld wireless devices, and perhaps the most extraordinary communications development, the Internet. In short the number of outlets for national and local news, information, and entertainment is large and growing.[91]

Today, information consumers enjoy access to an unprecedented volume of media content. The local newspaper and broadcast stations no longer form the limits of our media exposure. Cable and satellite television offer hundreds of channels, satellite radio supplies new content, and the Internet provides access to a seemingly infinite number of information sources. Since these new distribution channels provide greater access to more information, the FCC contends, the need for diversity in broadcast media is lessened and relaxed regulations are justified. Two propositions underlie the FCC's denial of the continued importance of scarcity: the abundance of new outlets and the substitutability of media. Under inspection, both of these assumptions fail.

B. The Continued Relevance of Scarcity

Despite the FCC's quixotic belief in the power of new technology to radically restructure the media marketplace, scarcity remains a vital consideration in crafting thoughtful regulatory policies. The availability of new distribution channels alone fails to justify the FCC's de-emphasis on scarcity because such an increase cannot guarantee concomitant increases in media outlets or, by extension, diverse viewpoints. Even where new methods of content distribution do give rise to new outlets, implicit in the FCC's reasoning is an unsupported belief in the substitutability of media.[92] In order to reduce the importance of spectrum scarcity, consumers must treat these newly available outlets as equivalents of the traditional broadcast media. Only by serving as market substitutes can these new outlets decrease the burden on the limited electromagnetic spectrum, justifying relaxed regulation. The failure of the FCC's assumptions, coupled with the continued demand for access to the limited broadcast spectrum, requires recommitment to the scarcity rationale and the regulatory obligations it demands.

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91. The Order, *supra* note 36, at 13,647.

92. *See* Enrique Armijo, *Public Airwaves, Private Mergers: Analyzing the FCC's Faulty Justifications for the 2003 Media Ownership Rule Changes*, 82 N.C. L. REV. 1482, 1494 (2004).

1. *Outlets, Sources, Distribution, and Diversity*

While the FCC is undoubtedly correct that more media outlets exist today than at any point in our past, its conclusion that viewpoint diversity is adequately served in the new media environment lacks justification. The FCC recognizes several types of diversity. Viewpoint diversity, chief among the FCC's diversity goals, ensures that the public is exposed to competing and differing perspectives on important issues.[93] Both outlet diversity (the presence of multiple independent media owners in a market) and source diversity (the availability of content from a variety of producers) serve the greater goal of achieving a multiplicity of viewpoints.[94] While increases in outlet and source diversity tend to yield greater viewpoint diversity, the abundance of non-broadcast media content offers no guarantee of viewpoint diversity.

The ownership of non-broadcast media receives far less scrutiny than that of broadcast stations. As a result, the same corporations that dominate broadcasting control many non-broadcast media providers. While cable and satellite provide hundreds of unique channels to viewers, 90% of the most watched non-broadcast television channels are owned by the same corporations that control the broadcast networks and cable systems.[95] In fact, just six owners control 80% of the top ninety-one cable channels.[96] Because nearly all of the top twenty news sites are owned by large media conglomerates, the Internet fares no better.[97]

Technology provoked a rapid increase in availability of news and information. This technology, however, provides merely a means of distribution. It offers both new and existing media owners an additional method by which they can disseminate the content they license, purchase, or create. Technology alone cannot ensure diversity of outlet ownership nor can it guarantee the independent production necessary for source diversity. Consequently, the technology of the new media marketplace fails to secure greater viewpoint diversity, and cannot justify the loosening of broadcast regulations meant to safeguard such a variety of viewpoints.

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93. *See* The Order, *supra* note 36, at 13,627.

94. *See id.* at 13,632-33.

95. See *id.* at 13,953 (Commissioner Copps, dissenting).

96. *See id.* at 13,981 (Commissioner Adelstein, dissenting).

97. *See Newspapers Run 8 of Top 20 News Sites*, EDITOR & PUBLISHER MAG., Feb. 20, 2003, LEXIS, Nexis Library, Editor & Publisher Magazine File; American Press Institute, *Top 20 Current Events & Global News Sites Nielsen//NetRatings, November 2002*, *at* http://www.cyberjournalist.net/features/netratings/1102netratings.htm (last visited Mar. 10, 2005) (citing Nielsen//NetRatings).

A daily newspaper with an Internet presence provides the same information via two vehicles for delivery. Although the ready accessibility of information offers a public benefit, the two distribution channels offered by the *New York Times* and www.nytimes.com, for example, represent neither two independent media sources nor two distinct outlets. Instead, they offer only two centrally controlled distribution channels for nearly identical content and, therefore, cannot materially contribute to increased viewpoint diversity. On a larger scale, the fifteen national cable channels and thirty-nine broadcast television channels owned by Viacom present a similar concern.[98] As the number of channels offered by local cable systems increases, the number of media conglomerates controlling their content does not.

The FCC's understanding of the media marketplace is tainted by a crucial conflation. The FCC misconstrues newly created means of distributing content as newly developed and independent outlets for information providing diverse viewpoints. The media marketplace is characterized not by an abundance of viewpoints, but by an abundance of distribution channels through which media owners can pump a single point of view. This mischaracterization of the media marketplace undermines the central justification for the FCC's relaxation of the ownership rules.

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98. Viacom's cable holdings include: BET (Black Entertainment Television), CMT (Country Music Television), Comedy Central, Flix, MTV (Music Television), MTV2 (Music Televesion 2), Nick at Nite, Nickelodeon, NOGGIN, Showtime, Spike TV, TMC (The Movie Channel), The Sundance Channel , TV Land, VH1. Its broadcast television holdings include: KAUT-TV (Oklahoma City, Okla.), KBHK-TV (San Francisco, Cal.), KCAL (Los Angeles, Cal.), KCBS-TV (Los Angeles, Cal.), KCCO (Alexandria, Minn.), KCCW (Walker, Minn.), KCNC-TV (Denver, Colo.), KDKA-TV (Pittsburgh, Pa.), KEYE-TV (Austin, Tex.), KMAX-TV (Sacramento, Cal.), KPIX-TV (San Francisco, Cal.), KSTW-TV (Seattle, Wash.), KTVT-TV (Dallas-Fort Worth, Tex.), KTXA-TV (Dallas, Tex.), KUSG (Washington, Utah), KUTV-TV (Salt Lake City, Utah), KYW-TV (Philadelphia, Pa.), WBBM-TV (Chicago, Ill.), WBFS-TV (Miami, Fla.), WBZ-TV (Boston, Mass.), WCBS-TV (New York, N.Y.), WCCO-TV (Minneapolis, Minn.), WFOR-TV (Miami-Ft. Lauderdale, Fla.), WFRV-TV (Green Bay, Wis.), WGNT-TV (Norfolk-Portsmouth, Va.), WJMN (Escanaba, Wis.), WJZ-TV (Baltimore, Md.), WKBD-TV (Detroit, Mich.), WLWC-TV (Providence, R.I.), WNDY-TV (Indianapolis, Ind.), WNPA-TV (Pittsburgh, Pa.), WPSG-TV (Philadelphia, Pa.), WSBK-TV (Boston, Mass.), WTOG-TV (Tampa, Fla.), WTVX-TV (West Palm Beach, Fla.), WUPA-TV (Atlanta, Ga.), WUPL-TV (New Orleans, La.), WWHO-TV (Columbus, Ohio), and WWJ-TV (Detroit, Mich.). Viacom's other holdings include Paramount Pictures, Paramount Home Entertainment, publisher Simon & Schuster, television producer and distributor King World Productions, and over 150 radio stations nationwide. *See* Who Owns What: Viacom, *at* http://www.cjr.org/tools/owners/viacom.asp (last visited Jan. 26, 2005).

2. *The Non-Fungibility of Media*

The FCC's assumption that non-broadcast media can serve as equal substitutes for traditional broadcast channels faces significant difficulty. Broadcasters occupy a unique place in our culture. Broadcast content is pervasive, popular, responsive, and valuable. For these reasons, non-broadcast media are unlikely to fulfill the same needs for the viewing public.

As the Court noted in *Red Lion*, "[L]ong experience in broadcasting [and] confirmed habits of listeners and viewers . . . give existing broadcasters a substantial advantage over new entrants, even where new entry is technologically possible."[99] Few American homes lack a television.[100] Nearly every home and automobile in America has a radio.[101] The freely available content broadcast over the air presents few barriers to viewing and listening. As a result of the pervasive character of broadcasting, 90% of American adults watch television on a daily basis,[102] and more than 75% of Americans listen to the radio every day.[103] Not only do Americans regularly tune in to broadcast programming, they rely on it as their primary source of news and information. A recent study conducted by the Pew Internet and American Life Project showed that 89% of Americans received most of their news about the war in Iraq from television programming, while only 17% of Internet users cited Internet sites as their primary source of information.[104] Although television viewing among Internet users continues to decline, television remains the dominant source of news and information.[105]

While the statistics above fail to differentiate between broadcast and non-broadcast television, two key characteristics differentiate these media. Broadcast television provides free over-the-air access to news and information. Cable and satellite providers, on the other hand, charge fees for access to the channels they deliver. Continued emphasis on maintaining diversity of broadcast viewpoints serves a crucial role in assuring quality

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99. Red Lion Broad. Co. v. FCC, 395 U.S. 367, 400 (1969).

100. *See* Media Info Center, *at* http://mediainfocenter.org/compare/penetration (last visited on Mar. 9, 2005).

101. *Id.*

102. *Id.*

103. *Id.*

104. LEE RAINIE ET AL., PEW INTERNET & AMERICAN LIFE PROJECT, THE INTERNET AND THE IRAQ WAR: HOW ONLINE AMERICAN HAVE USED THE INTERNET TO LEARN WAR NEWS, UNDERSTAND EVENTS, AND PROMOTE THEIR VIEWS 2 (2004), *available at* http://www.pewinternet.org/pdfs/PIP_Iraq_War_Report.pdf.

105. Online Publishers Ass'n, *Generational Media Study* (Sept. 21, 2004), *at* http://www.online-publishers.org/pdf/opa_generational_study_sep04.pdf.

programming for all. Secondly, broadcast stations, along with daily newspapers, provide essential coverage of local issues. Cable networks, because of their national audience and centralized facilities, are unmotivated and ill equipped to cover issues of local concern. Similarly, widely read Internet news sources focus on national and international news and fail to serve as a substitute for the local coverage offered by broadcasters.

The continued value of broadcast stations provides perhaps the clearest evidence of the non-substitutability of broadcast and non-broadcast media. If Internet sites, for example, served as equal substitutes for broadcast stations, we should expect to see station owners abandoning their expensive broadcast enterprises and adopting a low cost Internet-only media strategy. Instead, the value of broadcast stations continues to soar. Stations in major markets have sold at prices approaching $1 billion.[106] The continued demand for broadcast stations, even in the face of low cost online dissemination, demonstrates the unique value of broadcasting.

The *Prometheus* court's decision finds ample support in an examination of the FCC's underlying justification for The Order's rule changes. Although new technology has provoked rapid and widespread changes in the media marketplace, those developments fail to undermine the importance of spectrum scarcity. Because new distribution methods can neither promise viewpoint diversity nor offer substitutability with broadcast media, the inherent limitations of broadcast media continue to justify the regulation of media owners who enjoy access to a limited and valuable public resource.

C. The Future of Deregulation

The FCC's attempts at deregulation, while premature, may not be fundamentally misguided. Under the appropriate circumstances, the deregulation of broadcast ownership may prove a responsible policy.

The emergence of independent, widely available, and popular non-broadcast media provide the most likely justification for ownership deregulation. In a media environment truly characterized by abundant, independent, and pervasive non-broadcast media outlets, the criticisms leveled against the FCC's rule changes hold less sway. This is particularly so if those outlets offer local content, because each of the FCC's overarching policy goals—diversity, localism, and competition—would be satisfied. While such a shift appears likely in time, it is not guaranteed. Nor would it remove all justification for regulating the use of broadcast spectrum.[107]

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106. *See* The Order, *supra* note 36, at 13,983 (Commissioner Adelstein, dissenting).
107. *See* Logan, *supra* note 6, at 1687.

Secondly, the development and adoption of efficiency enhancing spectrum technology, coupled with a democratization of spectrum allocation, could reduce the need for broadcast media ownership rules. Developing technologies offer more economical use of available spectrum. Spread spectrum[108] and cognitive radio[109] both hold the promise of allowing more individuals to communicate over the air and reducing the impact of spectrum scarcity. While these technologies are not designed to operate with existing radio and television broadcasting, the principles underlying them could form the basis of efficient next generation media distribution technologies. In the short term, the transition from analog to digital transmission offers the promise of freeing "vast quantities of additional . . . spectrum" that could greatly increase viewpoint diversity.[110]

Lessening the need for regulation requires greater access to spectrum by new entrants through not only technology but also through the FCC's spectrum allocation policies. The approval of Low Power FM (LPFM) technology provides the most apt example of this approach. In 2000, the FCC created the LPFM service, which allows community broadcasters to operate stations powered with 100 watts or fewer.[111] By limiting these stations to noncommercial educational broadcasters and explicitly excluding current broadcast license holders and newspaper owners, the FCC helped to ensure viewpoint diversity.[112] Unfortunately, by requiring a separation of three channels between new LPFM stations and existing broadcasters, Congress and the FCC prevented the creation of LPFM stations in most major markets, where the station's small broadcasting range could reach the largest audiences.[113]

Finally, the FCC could reduce the need to regulate ownership of broadcast stations by reinstituting the division between the creation and distribution of content. The Financial Interest and Syndication Rules

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108. *See generally* Raymond L. Pickholtz et. al., *Theory of Spread-Spectrum Communications—A Tutorial*, [COM-30 NO.5] IEEE TRANSACTIONS ON COMMUNICATIONS (May 1982).

109. *See generally* Joseph Mitola III, *Cognitive Radio: An Integrated Agent Architecture for Software Defined Radio*, Royal Institute of Technology, May 8, 2000, *available at* http://www.it.kth.se/~jmitola/Mitola_Dissertation8_Integrated.pdf.

110. Media Access Project, *Digital TV and the Spectrum Grab of 1997*, *at* http://www.mediaaccess.org/programs/digitaltv (last modified Aug. 24, 2000).

111. *See In re* Creation of Low Power Radio Service, 15 F.C.C.R. 2205, 2206 (2000).

112. *See id.* at 2206, 2217.

113. *See* 47 C.F.R. § 73.807 (2004) (modified by the 2001 Appropriations Act to require third adjacent channel separation). In 2004, Sen. John McCain introduced legislation to eliminate the third-adjacent minimum distance separation requirements. *See* S. 2505, 108th Cong. (2004).

("Fin-Syn Rules"), created by the FCC in 1970 and eliminated in the 1990s, precluded networks from obtaining a financial interest in the programs they broadcast beyond their initial airing and prohibited the development of network controlled syndication enterprises.[114] The FCC in creating the Fin-Syn Rules hoped to encourage production of content independent from the control of the networks that aired it. In the wake of the elimination of the rules, the feared consolidation of production and distribution has occurred. After the establishment of the Fin-Syn Rules, of the top three television networks, only CBS was among the twenty leading suppliers of prime time network content, accounting for just 2% of programming.[115] In 2002, years after the end of Fin-Syn, the CBS, ABC, and NBC networks served as the top three prime time content suppliers, accounting for over 63% of programming hours.[116] Re-imposition of rules that limit the control networks can exert over the production of the programming they air could contribute to program and viewpoint diversity, lessening the need for media ownership regulation.

While none of the above suggestions could likely suffice to justify complete deregulation of broadcast ownership, without these or similar changes the need for continued stringent limits on media concentration will remain pressing.

IV. THE NEED FOR CONGRESSIONAL INTERVENTION

The FCC's authority, as a federal administrative agency, derives from Congress. The FCC serves as an agent of the legislature and its regulations must comport with congressional goals. The FCC, however, has faced ambivalence and inaction from Congress. After passing the Telecommunications Act of 1996, which eliminated the national radio cap and paved the way for further deregulation by demanding biennial reviews, Congress has offered the FCC little guidance despite the continual litigation facing FCC rulemakings.

While the deregulations of the early 1980s faced congressional opposition, those of the late 1990s were encouraged, if not demanded, by Congress.[117] The FCC, in calling for further deregulation, is simply following

114. 47 C.F.R. § 73.659 (1994).

115. Mara Einstein, *Program Diversity and the Program Selection Process on Broadcast Network Television*, Federal Communications Commission, Media Ownership Work Group, Sept. 2002, *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC226838A10.pdf.

116. *Id.*

117. *See supra* Part I.B.

Congress's most recent mandate. Congress has yet to provide the FCC with a clear signal that it no longer favors aggressive deregulation of broadcasting. The initial Congressional outcry over The Order resulted in only minor concessions to the apparent majority favoring a wholesale rejection of the new rules. Such congressional waffling sends a mixed message to the FCC.[118]

The need for clear and decisive legislation is compounded by the courts' difficulty in resolving the disputes arising out of the FCC's rule changes. As *Prometheus* makes clear, courts lack both the expertise and authority necessary to adequately and effectively address the FCC's failure to craft appropriate media ownership policy. Courts are limited by both the standard of administrative review as well as the binary decision-making required in judicial proceedings. Courts may only accept or reject the rules devised by the FCC, and, even then, only as demanded by the "public interest" and "arbitrary and capricious" standards. Only Congress is free to craft context-sensitive and creative solutions to issues of ownership regulation that escape perpetual reviews by both the FCC under § 202(h) and the courts in suits such as *Sinclair* and *Prometheus*. Congress must base its legislation on a careful consideration of the public good and a sober evaluation of the existing media marketplace, one that accounts for, but does not overestimate, the opportunities for diversity created by new and developing technologies.

V. CONCLUSION

The decision in *Prometheus Radio Project v. FCC*, though it resulted from the misapplication of the standards of administrative review, finds justification as a matter of policy. The faulty reasoning underlying the FCC's rule changes explains the court's skepticism of the overzealous deregulatory efforts embodied in The Order. Ultimately, Congress must reassert itself as the ultimate authority responsible for the regulation of broadcasters and provide the FCC with legislative guidance. While deregulation may prove an appropriate policy in the future, Congress must recognize that until the media marketplace can secure widespread "dissemination of information from diverse and antagonistic sources" to the American public in the absence of broadcast media ownership rules, the regulations must remain.[119]

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118. *See supra* note 43.

119. Associated Press v. United States, 326 U.S. 1, 20 (1945).

CLEVELAND V. VIACOM, INC.: IMPLICATIONS FOR THE DISSEMINATION OF MOVIES IN A DIGITALLY NETWORKED WORLD

By Daniel Castro

The motion picture industry has a history of anticompetitive practices.[1] Since the early days of the motion picture industry, movie producers and distributors have sought absolute control of the industry by dominating the production, distribution, and exhibition of movies.[2] In 1948, the United States Supreme Court held that such control of the industry was anticompetitive and forced major movie studios to separate the exhibition aspect of the industry from its production and distribution aspects.[3] The emergence of home videos introduced an entirely new market, where video retailers became key players in the distribution of movies to the public.

In *Cleveland v. Viacom, Inc.*, the Fifth Circuit analyzed output revenue-sharing agreements between movie studios and large chain video retailers, addressing the antitrust issues that emerge when a movie studio oligopoly uniformly refuses to deal with small independent retailers on similar terms as large chain video retailers.[4] According to the court, because the small independent retailers were unable to offer the studios a deal similar to that of the large chain video retailers, the studios' uniform refusal to deal was not illegal.

The implications of *Cleveland*, however, become increasingly significant as the movie industry moves further along its digital evolution. Namely, as technology for disseminating movies over digital networks becomes more secure and affordable, the online movie distribution market will grow, and an increasing number of potential online movie distributors will emerge. In addition, as the technology becomes more secure and affordable, the competitive gap between small and large online movie distributors will likely shrink. The popularity of online movie distribution, coupled with lower prices stemming from competition, may then be seen

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1. *See generally* Barak Y. Orbach, *Antitrust and Pricing in the Motion Picture Industry*, 21 YALE J. ON REG. 317 (2004).

2. *See generally* Ralph Cassady, Jr., *Monopoly in Motion Picture Production and Distribution: 1908-1915*, 32 S. CAL. L. REV. 325 (1959).

3. Unites States v. Paramount Pictures, Inc., 334 U.S. 131 (1948).

4. Cleveland v. Viacom, Inc., 73 Fed. Appx. 736 (5th Cir. Aug. 25, 2003), *cert. denied*, 520 U.S. 1219 (2004).

as a viable threat to the existing video retail industry. Indeed, renting physical copies of movies may soon be obsolete in light of technology that instead allows users to obtain digital copies at home.

This Note examines the implications of *Cleveland* on the movie industry within a digital marketplace. In particular, the Note examines the likelihood of digital technology sufficiently evolving to the point where small retailers may offer studios a deal legally similar to that of large retailers such as Blockbuster Inc. Part I begins by giving a background of the in-home movie market. Part II then provides a legal background of section 1 of the Sherman Act, the Robinson-Patman Act, and the First Sale Doctrine. Next, Part III provides a summary of *Cleveland.* Part IV discusses the online movie distribution market, the impediments potential online distributors will face in the future, and possible solutions to these impediments. Finally, this Note concludes in Part V that the reduced costs involved in digitally distributing movies will enable small retailers to enter this marketplace and that studios will ultimately have to distribute their movies via these retailers.

I. BACKGROUND OF THE IN-HOME MOVIE MARKET

The rental home video market emerged in the 1980s and was largely influenced by consumers' desire to rent a video for temporary viewing, as opposed to purchasing ownership at a much higher price. According to this business model, video retailers would purchase videos and rent them to the public by invoking their first sale rights.[5] Currently, home videos comprise the largest category of copyrighted works widely disseminated by rental.[6]

Despite the popularity of rental videos, the market has experienced difficulties. For example, during the mid-1990s, many video retailers had insufficient copies of "new release" titles available to accommodate customer demand. As a result, customers were often unable to rent popular movies which were in most demand, which translated to a loss in potential profits to video retailers.

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5. The first sale doctrine is the right to resell, rent, or lend copies of copyrighted works to individual purchasers. *See* 17 U.S.C. § 109(a) (2000) ("[T]he owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.").

6. R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C. L. REV. 577, 587-88 (2003).

In 1997, Blockbuster responded to this problem by entering into long-term output revenue sharing contracts with various major movie studios. By dealing directly with the studios and bypassing the distributors, Blockbuster was able to obtain videos for lower upfront payments in exchange for a percentage of their revenues. It agreed to purchase all titles a studio released, regardless of performance or perceived popularity. As a result, it significantly increased its volume of new releases and subsequently distanced itself from the independent retailers in the video rental market.

In August 2001, five of the seven largest movie studios[7] announced their joint plan to offer Internet users digitized movies through a service called Moviefly.[8] This service, which has been renamed Movielink, allows customers to download movies from the Internet.[9] These movies may be downloaded approximately two months after they are released on video, and must be viewed within a 24-hour period.[10]

Approximately two months after the movies are released on video, customers may also order them on a pay-per-view basis from the customers' local cable service or satellite provider.[11] Similar to the Movielink business model, movies ordered via pay-per-view must be viewed during a 24-hour viewing period. And similar to renting movies from a video store, customers may rewind and fast-forward these movies as they desire.[12]

II. LEGAL BACKGROUND

This Note primarily focuses on three legal issues. The first two issues involve interpreting the two laws under which the plaintiffs' antitrust claims were brought in *Cleveland*: section 1 of the Sherman Act and price discrimination under the Robinson-Patman Act. The third issue involves the first sale doctrine, which is the copyright law that enables video retailers to rent copyrighted movies.

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7. Metro-Goldwyn-Mayer ("MGM"), Paramount Pictures, Sony Pictures Entertainment, Universal Studios, and Warner Brothers.

8. *See* Gary Gentile, *Studios in Video on Demand Venture*, AP ONLINE, Aug. 16, 2001, *available at* 2001 WL 26180234.

9. *See* Movielink, http://www.movielink.com (last visited Mar. 4, 2005).

10. Ron Grover, *Video-on-Demand, Hollywood Style*, BUS. WK. ONLINE, Aug. 21, 2001, *at* http://www.businessweek.com/bwdaily/dnflash/aug2001/nf20010821_006.htm.

11. *Id.*

12. *See* Comcast, http://www.comcast.com/Benefits/CableDetails/Slot6PageOne.asp (last visited Mar. 4, 2005).

A. Concerted Action Under Section 1 of the Sherman Act

Under section 1 of the Sherman Act, it is illegal to enter into a contract or conspiracy in restraint of trade or commerce.[13] Despite the statute's admonition that every concerted trade restraint is illegal, judicial interpretation of the statute has limited its scope by implementing a "standard of reason."[14] Nevertheless, the statutory requirement of concerted action remains a fundamental threshold burden for any antitrust plaintiff. Concerted action requires an antitrust plaintiff to prove the defendant conspired either horizontally with a competitor, or vertically with a firm involved in a different stage of production than the defendant. In fact, courts have held that unilateral conduct simply cannot be deemed a violation of section 1 of the Sherman Act, no matter how anticompetitive.[15] Courts have further held that unless the competitive process is harmed by a single buyer's particular purchasing agreement, no conspiracy to monopolize may be inferred.[16]

B. Price Discrimination Under the Robinson-Patman Act

Under the Robinson-Patman Act, it is unlawful for a seller to either directly or indirectly discriminate in price between different purchasers of similar commodities.[17] The application of this statute may occur in either of two situations. First, it may apply where the discrimination substantially lessens competition or tends to create a monopoly.[18] Second, it may apply where the effect may be substantially "to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either."[19]

According to the Supreme Court, "price discrimination" under the Robinson-Patman Act is defined as being merely a difference in price.[20] This difference in price, however, also includes discount prices that are theoretically available to all, but functionally not.[21] Indeed, according to

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13. 15 U.S.C. § 1 (2000).

14. *See* United States v. Am. Tobacco Co., 221 U.S. 106, 179 (1911); Standard Oil Co. v. United States, 221 U.S. 1, 60 (1911).

15. *See, e.g.*, Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 768 (1984); Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 (1984).

16. NYNEX Corp. v. Discon, Inc., 525 U.S. 128 (1998).

17. 15 U.S.C. § 13(a) ("It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality.").

18. *Id.*

19. *Id.*

20. FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 549 (1960).

21. FTC v. Morton Salt Co., 334 U.S. 37, 42 (1948).

the Supreme Court, the legislative history of the Robinson-Patman Act clearly shows Congress's intent to prevent large buyers from securing a competitive advantage over small buyers simply based on the large buyers' superior purchasing power.[22] A price discrimination claim under the Robinson-Patman Act, therefore, could be described as focusing primarily on the rivals of both the discriminating seller and the buyer receiving lower prices, rather than the ultimate consumer of the product.

C. First Sale Doctrine

Under the first sale doctrine, a copyright owner ceases to have control of a particular copyrighted work after the owner's first transfer of that copy.[23] As a result, anyone who *legally* purchases copies of a copyrighted work is free to resell, rent, or lend those copies. For the video rental industry, this doctrine thus provides a legal shelter under which renters can operate.

The emergence of digital networks, however, created a new landscape for interpreting the first sale doctrine in which users can readily forward copyrighted works they may have legally obtained from the copyright owner. In 1995, a presidential task force formed to research this issue determined that such conduct was not permitted under the first sale doctrine. And although Congress has considered creating a "digital first sale doctrine," nothing has actually passed.[24] Instead, Congress has adopted a "wait and see" approach because of the inherent uncertainties involved with rapid technological advances in e-commerce and encryption.[25] This policy remains in effect today.

III. CASE SUMMARY

A. Facts and Procedural History

Several independent video retailers sued home video affiliates of the seven major Hollywood movie studies, including Blockbuster Inc. ("Blockbuster") and its parent company Viacom Inc. ("Viacom").[26] The

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22. *Id.* at 43.

23. 2 MELVILLE NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12 (2004).

24. *Id.*; Reese, *supra* note 6, at 581-83.

25. Congress adopted this policy in 2001 under the recommendation of the United States Copyright Office. Reese, *supra* note 6, at 581-83.

26. The defendants are Buena Vista Home Entertainment, Inc.; Columbia Tri-Star Home Video, Inc.; Metro-Goldwyn-Mayer Home Entertainment, Inc.; Paramount Home Video, Inc.; Time Warner Entertainment Company, L.P.; and Twentieth Century Fox Home Entertainment, Inc. (collectively "studios").

plaintiffs alleged that Blockbuster conspired with the studios to deny independent retailers long-term output revenue-sharing agreements equivalent to its own.[27] As a result, the plaintiffs alleged that the defendants violated antitrust and price discrimination statutes.[28] The issues presented by the *Cleveland* decision include whether disparate pricing agreements between media producers and retailers are violations of antitrust laws where 1) small independent retailers lack the resources to enter into agreements similar to those negotiated by large chain retailers, and 2) there is little evidence of any bad faith intent to exclude small independent retailers from entering into agreements similar to those negotiated by large chain retailers.

Defendants moved for judgment as a matter of law at the close of plaintiffs' case-in-chief. This motion was granted by the district court in 2001,[29] and later affirmed by the appellate court in an unpublished opinion in 2003.[30] Plaintiffs' petition for certiorari to the United States Supreme Court was subsequently denied in 2004.[31]

B. The Fifth Circuit's Analysis

The statutory basis of plaintiffs' antitrust violation claim was section 1 of the Sherman Act.[32] In its review, the Fifth Circuit conceded that it should consider all evidence in the light most favorable to the nonmovant, which were the plaintiffs.[33] The court also, however, insisted that antitrust cases such as this one require "the range of permissible inferences [to be] limited by particular principles of antitrust law."[34] In particular, the court held that inferences of a conspiracy cannot be supported by evidence of conduct that is equally consistent with both permissible competition and an illegal conspiracy.[35] Accordingly, since direct evidence of a conspiracy was lacking, the court required plaintiffs to present sufficient circumstantial evidence which would exclude the possibility of independent action.[36]

The court rejected plaintiffs' argument that Blockbuster's plan to increase its market share was proof of a conspiracy. According to the court,

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27. 73 Fed. Appx. 736, 739 (5th Cir. Aug. 25, 2003).
28. *Id.*
29. Cleveland v. Viacom, 166 F. Supp. 2d 535 (W.D. Tex. 2001).
30. Cleveland v. Viacom, 73 Fed. Appx. 736 (5th Cir. Aug. 25, 2003).
31. Cleveland v. Viacom, 520 U.S. 1219 (2004).
32. 15 U.S.C. § 1 (2000).
33. *Cleveland*, 73 Fed. Appx. at 739.
34. *Id.* (citing Viazis v. Am. Ass'n of Orthodontists, 314 F.3d 758, 762 (5th Cir. 2002)).
35. *Id.*
36. *Id.*

a company's ambitious desire to significantly increase its market share cannot support an inference of conspiracy without proof that it intends to achieve these goals via illegal means.[37] The court further held that, despite plaintiffs' evidence of Blockbuster requesting a "special deal" from Fox's vice-president, an exclusive deal was never made and an inference of conspiracy would be premature.[38]

The court also rejected plaintiffs' argument that a conspiracy may be inferred from the studios' parallel conduct. In particular, the court held that plaintiffs cannot establish an inference of conspiracy by simply showing that the studios followed similar courses of action, without providing evidence that these acts stemmed from an agreement as opposed to each studios' independent business judgment.[39] According to plaintiffs' expert testimony, the studios' conduct was contrary to their economic self-interest. Plaintiffs argued that "because the studios received greater revenues under the terms of their deals with Blockbuster, they likewise would have received greater revenues under similar deals with distributors serving independents."[40] The court subsequently rejected this testimony, holding that it ignored key differences between independent retailers and large video chains such as Blockbuster.[41]

Plaintiffs' price discrimination claim was brought under the Robinson-Patman Act.[42] According to the court, however, this statute only applies where customers are otherwise purchasing on like terms and conditions.[43] Here, the court found the studios' transactions with Blockbuster and plaintiffs to be dissimilar. Namely, the court found Blockbuster's purchasing agreement with the studios readily distinguishable from agreements entered into by plaintiffs because Blockbuster's agreement required Blockbuster to 1) commit to long-term contracts and 2) purchase a studio's entire output.[44] According to the court, this distinction is so significant that the disparity in price cannot support a claim of price discrimination.[45]

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37. *Id.* at 740-41.
38. *Id.* at 740.
39. *Id.*
40. *Id.* at 741.
41. *Id.*
42. *See* 15 U.S.C. § 13 (2000). The plaintiffs also claimed the price discrimination was in violation of the California Unfair Trade Practices Act. CAL. BUS. & PROF. CODE §§ 16750(a), 17078-17080 (West 1997), 17203 (West Supp. 2005).
43. *Cleveland*, 73 Fed. Appx. at 741 (citing FTC v. Borden, 383 U.S. 637, 643 (1966)).
44. *Id.*
45. *Id.*

IV. DISCUSSION

This Note attempts to foreshadow the significance of *Cleveland* in a future era of digital networks. In so doing, it examines how the court's original analysis fits within the framework of a digital marketplace where small website operators can offer movie studios the same deal as the Blockbusters of the world. Furthermore, this Note examines the likely options for the movie studios and the new antitrust considerations with which they will inevitably have to deal. Section A provides some background with respect to the studios' attempts to vertically integrate the online movie distribution market. Section B discusses the impediments potential online distributors will face in the future. Section C offers possible solutions to these impediments.

A. Studios Seek to Vertically Integrate the Online Movie Distribution Market

The studios have historically been reluctant to distribute their movies over the Internet because of the threat posed by illegal piracy.[46] The emergence of Movielink, however, reveals a desire of the studios to cautiously embrace this new market through vertical integration. In particular, the studios hope this venture will enable them to set the technical and security standards necessary for the online movie market to safely flourish.[47] Having learned from their music industry counterparts, the studios hope Movielink deters consumers from engaging in illegal piracy by providing them with a legitimate way to obtain movies over the Internet.[48]

The threat posed by legal file-sharing ventures has also expedited the emergence of Movielink.[49] CenterSpan Communications, for example, plans to provide a legal version of a Napster-like software service that enables users to share movies online.[50] Fortunately for the studios, third par-

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46. *See* Gentile, *supra* note 8.

47. *See* Grover, *supra* note 10.

48. Laura Rich, *Analysis: Hollywood Braces for "Napsterization"*, CNN.COM TECH. PAGE, Jan. 10, 2001, *at* http://asia.cnn.com/2001/TECH/computing/01/10/hollywood.napsterization.idg/index.html.

49. *See id.*

50. CenterSpan acquired this software from Scour, Inc. in a court-supervised bankruptcy auction following Scour's copyright infringement litigation against members of the Motion Picture Association of America (MPAA), the Recording Industry of America (RIAA), and the National Music Publishers' Association (NMPA). Carey D. Ramos, *The Security of Music and Motion Pictures Distributed on the Internet: Legal Background and Developments*, *in* MUSIC ON THE INTERNET: UNDERSTANDING THE NEW RIGHTS AND SOLVING NEW PROBLEMS 402 (PLI Patents, Copyrights, Trademarks, and Literary Property Course, Handbook Series No. G0-00PP, 2001).

ties such as CenterSpan currently lack the technology necessary to make such ventures profitable. By launching Movielink, however, the studios clearly want to get a head start.

1. *Prospects of Movies Being Widely Disseminated over the Internet*

Despite having the legality of its revenue sharing agreements challenged in *Cleveland*, Blockbuster ultimately prevailed because it negotiated deals with the various studios that the independent retailers could not match. Today, however, the possibility of disseminating movies via the Internet is a significant threat to Blockbuster's current business model. Such technology may eventually eliminate demand for large retail chains that rent tangible copies of movies. Indeed, the convenience of either downloading a movie from a studio website or ordering it via pay-per-view may soon supersede the convenience of going to a local Blockbuster.

Although Blockbuster has already taken steps towards ascertaining its share of this new technology's market share, it is struggling to obtain a firm foothold in it. Blockbuster executives, for example, have openly expressed their commitment to "delivering movies to people at home however they want to receive them" and have already begun negotiating deals with studios.[51] Some of these negotiations have failed, however, including a failed negotiation with its corporate cousin Paramount Studios in which an insider is quoted as saying, "Hollywood isn't about to give Blockbuster another blank check."[52] Although Blockbuster did secure limited video-on-demand rights from Universal Pictures, it failed in its efforts to start an Internet venture with Enron.[53] Even if Blockbuster were to negotiate a deal with a particular movie studio to distribute movies online, it would still have to compete with independent websites that may offer studios the same deal.

Current technological conditions also make it difficult for the online movie distribution market to emerge. In particular, the number of homes currently equipped with high-speed Internet connections has not yet reached a level where sustaining a movie distribution site would be profitable. Nevertheless, the studios are optimistic that the popularity of broadband Internet access will continue to rapidly grow and eventually make their Movielink joint venture profitable.

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51. Konrad Gatien, *Internet Killed the Video Star: How In-House Internet Distribution of Home Video Will Affect Profit Participants*, 13 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 909, 923-24 (2003).

52. *Id.*

53. *Id.*

Experts agree that these conditions may occur relatively soon. According to some analysts, the number of homes with high-speed Internet connections is expected to grow from two million in 2000, to approximately 47 million in 2005.[54] By the year 2009, experts predict that approximately 107 million Internet users will have broadband connections (approximately 90% of all Internet users).[55] Furthermore, according to reports from the Federal Communications Commission (FCC), the number of Internet users watching Internet videos has been steadily increasing over the past few years.[56]

The need to establish a secure technological standard is also critical to making online movie distribution a reality.[57] Indeed, without a common technological standard, the industry may never emerge because of compatibility issues. The irony of developing such a standard, however, is that it would require the cooperation and agreement of all the major studios. In fact, according to some studio executives who were involved in launching Movielink, the opportunity to set the technical and security standards of the industry partially motivated them to take part in the joint venture.[58]

2. *Movielink Business Model Inconsistent with* Paramount*?*

As mentioned previously, the Supreme Court in *Paramount* forced the major movie studios to separate the exhibition aspect of the industry from its production and distribution aspects. One of the concerns alleged by the government in *Paramount* was the apparent favoritism exhibited by the major studios of each other over smaller independent studios.[59] Namely, the government alleged that the major studios were exhibiting only movies produced by the major studios and licensing first run movies only amongst themselves, rather than to independent theatres.[60]

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54. Mary Rasenberger & M. Lorrane Ford, *Untangling the Web of Rights to Film and Video: Before Putting Such Content On-Line, Clear It for Use on the Internet*, N.Y.L.J., Sept. 18, 2000, at S3.

55. *Id.*

56. *In re* Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Seventh Annual Report, CS Docket No. 00-132, at 49, ¶ 107 (Fed. Communications Comm'n 2001), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-01-1A1.pdf.

57. Mark A. Lemley, *Antitrust and the Internet Standardization Problem*, 28 CONN. L. REV. 1041, 1042-43 (1996).

58. Grover, *supra* note 10.

59. United States v. Paramount Pictures, Inc., 334 U.S. 131, 161-62 (1948).

60. *Id.*

The Movielink business model will inevitably be scrutinized by antitrust regulators as being inconsistent with *Paramount*. By allowing the studios to control not only the production of movies, but also all aspects of distribution and pricing, consumers are left vulnerable to monopolistic prices stemming from a lack of competition. Indeed, other than the post-*Paramount* distribution channels of the movie industry, true competition is noticeably lacking.

With these antitrust concerns in mind, the studios have taken affirmative steps towards circumventing these problems. Most importantly, they have agreed to offer a nonexclusive license to any potential distributor with a service that complies with the Movielink partners' security and anti-piracy provisions.[61] Therefore, the door is theoretically open for third-party vendors to launch their own distribution sites, so long as they obtain a license from the studios. Regardless of whether Movielink is ever found to violate antitrust law though, it is clear that third-party distributors will always play *some* role in the online movie market, either competing against the studios, or against each other.

B. Future Impediments for Small Online Movie Distributors

According to the holding in *Cleveland*, a plaintiff's claim under section 1 of the Sherman Act requires direct evidence of a conspiracy. Namely, these claims require evidence of explicit collusion amongst the studios. Tacit collusion, however, provides a legal loophole in which studios may achieve the same objective without violating any antitrust laws. Indeed, while legal scholars have identified the act of communication as the distinguishing feature between explicit and tacit collusion, economists view the two as being essentially the same.[62] Therefore, so long as each member of the studio cartel has an "understanding" of how other members will react, no formal communication is ever needed.[63]

Technological barriers to entry may also be significant for potential online distributors. As discussed previously, the threat of piracy gives studios added leverage to develop a highly sophisticated technological standard. But the more sophisticated a standard becomes, the more expensive it is to abide by it. Therefore, in order to limit the number of potential competitors, the studios may simply tacitly agree to an overly sophisticated standard.

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61. *Id.*

62. Ian Ayers, *How Cartels Punish: A Structural Theory of Self-Enforcing Collusion*, 87 COLUM. L. REV. 295, 296-97 (1987).

63. *Id.* at 297.

Such a strategy would parallel the facts in *Cleveland* in that the independent retailers in *Cleveland* lacked the financial resources to offer the same deal as Blockbuster. In the future, small potential online distributors may lack the technological resources to offer the same deal as larger ones.

The lack of a first sale doctrine will be another significant hurdle for potential online distributors to overcome. Unlike before, where retailers would purchase tangible copies of movies, retailers would now only be purchasing a license to access the servers of each studio. Therefore, because an actual purchase is never made, the first sale doctrine does not apply. As a result, the studios are able to control all copies of their copyrighted works.

The same technology that enables small distributors to potentially offer the studios the same deal as large distributors may also, in the end, be the reason why small distributors fail. For example, if we assume that technology will evolve to where a significant number of individuals can comply with the standards set forth by the industry, the market may become so saturated with competitors that most will fail. This ironic fate would stem from the *perfect competition* scenario towards which antitrust law is designed to gravitate.[64]

C. Possible Solutions

The *Cleveland* court's rejection of plaintiffs' vertical and horizontal theories of concerted action in violation of section 1 of the Sherman Act,[65]

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64. PHILLIP AREEDA ET AL., ANTITRUST ANALYSIS: PROBLEMS, TEXT, AND CASES 5 (6th ed. 2004).

> A market economy will be perfectly competitive if the following conditions hold:
>
> 1) Sellers and buyers are so numerous that no one's actions can have a perceptible impact on the market's price, and there is no collusion among buyers and sellers.
>
> 2) Consumers register their subjective preferences among various goods and services through market transactions at fully known market prices.
>
> 3) All relevant prices are known to each producer, who also knows of all input combinations technically capable of producing any specific combination of outputs and who makes input-output decisions solely to maximize profits.
>
> 4) Every producer has equal access to all input markets and there are no artificial barriers to the production of any product.

Id. (footnotes omitted).

65. 15 U.S.C. § 1 (2000).

as well as its rejection of plaintiffs' allegation of price discrimination under the Robinson-Patman Act,[66] reveal a general reluctance of the judiciary to resolve the problem of tacit collusion in oligopolies. In *Rebel Oil*,[67] for example, the Ninth Circuit refused to rule on this issue despite explicitly recognizing that oligopolies may use this jurisprudential gap to engage in acts that would otherwise be prohibited by the Sherman Act. In particular, the court in *Rebel Oil* felt that Congress, and not the judiciary, was authorized to fill this gap.[68]

This reasoning is flawed, however, because antitrust law in the United States is primarily driven by judicial interpretation of broadly written legislative statutes.[69] In fact, some scholars suggest that the legislative intent of drafting the Sherman Act with extremely broad and vague sentences may have been "little more than a legislative command that the judiciary develop a common law of antitrust."[70] With this in mind, the judiciary should feel authorized to equate tacit collusion with explicit collusion without having to wait for a cue from Congress.

In addition, judicial bodies outside the United States have recognized the threat posed by shared monopolies and have taken affirmative steps towards enforcing their anticompetition laws when appropriate.[71] For example, in a case known as *Magill*, the European Commission (EC) inferred that individuals were refusing to license their intellectual property in an attempt to prevent the creation of a comprehensive product.[72] *Magill* involved television listings of various programs that were exclusively published by networks in the United Kingdom and Ireland.[73] Each of these networks individually refused to license their proprietary listings to Magill, who was seeking to publish all program listings in one guide.[74]

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66. *Id.* § 13.

67. Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1443 (9th Cir. 1995).

68. *Id.*

69. *See* PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, ch. 1, ¶ 103d (2d ed. 2002) ("[M]ore than a century of judicial interpretation has now largely preempted contrary indications in the legislative history. Congress can amend the Sherman Act any time it wishes, but in more than a century has rarely done so, and then largely to correct technical deficiencies.").

70. AREEDA ET AL., *supra* note 64, at 3; *see also* AREEDA & HOVENKAMP, *supra* note 69, ch. 1, ¶ 103d.

71. Brian A. Facey & Dany H. Assaf, *Monopolization and Abuse of Dominance in Canada, the United States, and the European Union: A Survey*, 70 ANTITRUST L.J. 513, 539-43 (2002).

72. Case 241/91 P, Radio Telefis Eireann v. Commission, 1995 E.C.R., I-743, ¶¶ 47, 58, 104, [1995] 4 C.M.L.R. 718, 730-33 (1995).

73. *Id.* ¶ 24-30, [1995] 4 C.M.L.R. at 726-28.

74. *Id.*

The Court of Justice held each network liable for jointly monopolizing "television guides by excluding all competition . . . [and] den[ying] access to the basic information which is the raw material indispensable for the compilation of such a guide."[75]

Some scholars suggest that antitrust agencies such as the Department of Justice (DOJ) and the Federal Trade Commission (FTC) are actually better equipped than either Congress or the judiciary to regulate the dissemination of copyrighted work over the Internet.[76] In particular, it is suggested that because these agencies have both the authority and experience to initiate programs that monitor fair competition and protect fair use, their involvement is ideal.[77] The DOJ, for example, may play an active role in scrutinizing the studios' efforts to further expand their market power, much as they did with Microsoft under the Clinton and Bush administrations.[78] Similarly, the FTC's inquiries into Intel and CD price-fixing[79] may foreshadow the agency's future role in monitoring licensing agreements between the studios and potential online movie distributors.

By working together, the DOJ and FTC may also take advantage of their respective institutional competences. For example, because the FTC can sue under the Federal Trade Commission Act,[80] the FTC has much more discretion to protect consumers from the unfair and deceptive conduct of the studios. In fact, an FTC investigation may be initiated by letters from consumers or businesses and followed by either an "attempt to obtain voluntary compliance by entering into a consent order with the company . . . [or] an administrative complaint."[81] The DOJ, on the other hand, is more familiar with traditional antitrust analysis and may more readily investigate the market structure of the movie industry.[82]

Ideally, this DOJ investigation would be coupled with a public FTC investigation focused on consumer protection to create leverage against the studios.[83] The agencies may then use this leverage to induce the stu-

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75. *Id.* ¶ 56, [1995] 4 C.M.L.R. at 791.

76. *See* Matthew Fagin et al., *Beyond Napster: Using Antitrust Law to Advance and Enhance Online Music Distribution*, 8 B.U. J. SCI. & TECH. L. 451, 549 (2002).

77. *Id.*

78. *See id.*

79. *See* Robert Pitofsky, *Antitrust and Intellectual Property: Unresolved Issues at the Heart of the New Economy*, 16 BERKELEY TECH L.J. 535 (2001).

80. 15 U.S.C. § 45 (2000).

81. FTC, *How the FTC Brings an Action*, *at* http://www.ftc.gov/ftc/action.htm (last visited Dec. 16, 2004).

82. *See generally* United States Department of Justice, *at* http://www.usdoj.gov (last visited Jan. 16, 2005).

83. *See* Fagin et al., *supra* note 76.

dios to offer more favorable licensing agreements to prospective online movie distributors. This leverage may also be used to give prospective online movie distributors a voice in the standard-setting process, as well as to force the studios to disclose and limit their digital rights management techniques.

V. CONCLUSION

The adjudication following the *Cleveland* decision will have a significant effect on the mass commercial distribution of motion pictures. Other large video movie retailers will inevitably try to emulate the Blockbuster business model to take advantage of their smaller competitors' inability to offer the studios similar deals. Rumors regarding the industry, however, suggest that the number of these large video retailers may be shrinking.[84] Higher prices resulting from this reduction in competition, coupled with advances in digital network technology, may lead to the eventual demise of the video retail industry. If so, we will likely revisit *Cleveland* within the context of a digital marketplace, where small retailers offer the studios a deal similar to that of large retailers. Moreover, because the economic results associated with particular antitrust policies are generally unpredictable, only time will tell whether the *Cleveland* decision will truly be in the best interest of the individual consumer and, more importantly, society as a whole.

84. *See* Associated Press, *Hollywood Video Seeks Merger to Challenge Rival Blockbuster*, ABCLOCAL.COM MONEYSCOPE, Jan. 13, 2005 (discussing Hollywood Video's announcement of a proposed merger with Movie Gallery, Inc., as well as Blockbuster's continued efforts to acquire Hollywood Video), *at* http://abclocal.go.com/ktrk/business/011305_APbusiness_hollywood.html.

JOINT VENTURES AND THE ONLINE DISTRIBUTION OF DIGITAL CONTENT

By Jonathan A. Mukai

The proliferation of digital media and the widespread adoption of broadband technology have created new opportunities, and new challenges, for the online exchange of entertainment content.[1] Digital technology has afforded consumers "unprecedented power to access, store, manipulate, reproduce and distribute entertainment content."[2] This increased capacity, however, is accompanied by serious issues of digital piracy derived from the sharing of unauthorized digital reproductions among end-users.[3]

In response, the entertainment industry has adopted numerous conventional strategies to preserve its interests, ranging from lobbying and litigation to copy-protection technologies and licensing.[4] Yet, in a bolder effort, providers of both music and film content have steadily engaged in the formation of joint ventures in order to exert greater control over the online distribution of content.[5] Content owners have pursued, and continue to pursue, horizontal collaborations that seek to vertically integrate their ownership of content with delivery via the Internet.[6] These collective ac-

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1. *See, e.g.*, Peter S. Menell, *Envisioning Copyright Law's Digital Future*, 46 N.Y.L. SCH. L. REV. 63, 118-19 (2002-2003) (discussing the implications of digital content for the entertainment industry).

2. *Id.* at 118.

3. *See* Anthony Maul, Note, *Are the Major Labels Sandbagging Online Music? An Antitrust Analysis of Strategic Licensing Practices*, 7 N.Y.U. J. LEGIS. & PUB. POL'Y 365, 366 (2003-2004).

4. *See* Peter K. Yu, *The Escalating Copyright Wars*, 32 HOFSTRA L. REV. 907, 909 (2004) (exploring five strategies used by the entertainment industry to combat the copyright concerns raised by digital technology).

5. *See* HARRY FIRST, ONLINE MUSIC JOINT VENTURES: TAKEN FOR A SONG 10-12 (N.Y. Univ. Law & Econ. Research Paper Series, Working Paper No. 04-006, 2004), *available at* http://ssrn.com/abstract=508685.

6. *See* Press Release, Department of Justice, Justice Department Closes Antitrust Investigation into the Movielink Movies-On-Demand Joint Venture (June 3, 2004), [here-

tions, however, have been subject to varying degrees of antitrust scrutiny by both the antitrust division of the U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC).[7] This Note briefly considers the impetus driving the use of joint ventures by content owners in their attempts to guide the development of online distribution, and explores what characteristics are relevant in enabling a given joint venture to withstand antitrust scrutiny.

Part I provides a brief overview of the development of digital media and the changes in technology that gave rise to the online distribution of content. Part II examines the utilization of joint ventures by content owners and the stated advantages of such organizations as perceived by the entertainment industry. Part III briefly explores the regulatory framework guiding antitrust analysis. Finally, Part IV examines the structure of joint ventures organized for online distribution and the characteristics that enable them to withstand antitrust challenges.

I. THE DIGITAL REVOLUTION

The development of digital technology and the Internet has led to a revolution in the ability of individuals to process and manipulate information.[8] Analog technology requires that information be "fixed" through "some human or mechanical process of deforming a physical object."[9] Thus, it utilizes an "analogy" to represent the information to be stored and transmitted.[10] These analogies, however, are subject to multiple variables; for example, the etching in vinyl records or the color intensity on film affecting their quality.[11]

For decades the entertainment industry organized around analog technology platforms.[12] This was, to a large extent, due to the fact that the deterioration in quality upon subsequent reproductions of analog works acted

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inafter *Movielink Press Release*], *available at* www.usdoj.gov/opa/pr/2004/June/04_at_388.htm; Press Release, Department of Justice, Statement by Assistant Attorney General R. Hewitt Pate Regarding the Closing of the Digital Music Investigation (Dec. 23, 2003) [hereinafter *Digital Music Press Release*], *available at* www.usdoj.gov/atr/public/press_releases/2003/201946.pdf.

7. *Id.*

8. *See* Paul Romer, *In the Beginning was the Transistor*, FORBES MAG., Dec. 2, 1996, at S43.

9. Menell, *supra* note 1, at 104 (explaining that digitization is the encoding of information using an array of binary switches).

10. *Id.* at 104-05.

11. *See id.* at 105; *Analogue*, FREE ON-LINE DICTIONARY OF COMPUTING, Nov. 14, 1998, *at* http://foldoc.doc.ic.ac.uk/foldoc/foldoc.cgi?analogue.

12. Menell, *supra* note 1, at 105.

as a natural impediment to content piracy.[13] An analog reproduction could not compete with the quality of an original work held by the content owners.[14] Even with the development of the photocopier, the audio cassette, and the video cassette recorder, content owners maintained a distinct advantage because of the inherent degradation in the quality of analog media.[15]

The development of digital technology, however, removed the natural advantages afforded to content owners by allowing perfect reproductions across unlimited generations and providing alternative channels of distribution which could not easily be controlled or monitored.[16] Whereas, in the past, the distribution of content was limited to tightly controlled broadcasts or the sale of analog media, the digital revolution fostered the Internet as a new, efficient, distribution channel.[17]

The speed with which the adoption of digital technology has wrought change is largely driven by the continuous, exponential growth in computing power.[18] While digital technology, in some form, has existed for over fifty years, the recent expansion in processing speed and memory storage capacity coupled with developments in data compression has allowed computer technology to serve as a viable platform for digital content.[19] In turn, this capacity to manipulate copyrighted content threatens the ability of content owners to control and monitor unauthorized reproductions and distributions of their works, in the enforcement of their intellectual property rights.[20]

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13. *See id.*

14. *See id.* at 105-06.

15. *See id.*

16. *See id.* at 108-09. Digitization allows for the storage and transfer of data as a "sequence of discrete symbols from a finite set," likely in the form of binary (i.e., ones and zeros). Thus, as each datum is composed of a discrete set of symbols, perfect reproductions are possible as any digital copy may be replicated symbol by symbol. *Digital*, FREE ON-LINE DICTIONARY OF COMPUTING, Oct. 28, 1998, *at* http://foldoc.doc.ic.ac.uk/foldoc/foldoc.cgi?digital.

17. *See* FIRST, *supra* note 5, at 1; Menell, *supra* note 1, at 108-09.

18. *See* Menell, *supra* note 1, at 110-11.

19. *See id.* With the increase in computing power and the expanded capacity to store large files, personal computers now maintain the capability to store and reproduce complex entertainment works. Moreover, the development of data compression formats, like MP3 and DivX, reduce the amount of memory to store and bandwidth required to transfer digital content. These technologies thus facilitate the use of digital content by ordinary consumers through the maintenance of high quality through subsequent reproductions and increased portability and manipulability. *Id.*

20. *See id.* at 118-19 ("Enforcement of copyrights throughout the Internet and beyond becomes increasingly difficult as information flows ever more freely, decentralized

Peer-to-Peer (P2P) technology is one such threat because of its ability to make "public distribution of music to the world as easy as sharing music with a friend."[21] The rise of P2P has been facilitated by the digitization of music and film and by the development of compression technologies, like MP3, that allow content to be compressed into small, high-quality, readily transferable files free of any copy-protection technology.[22] Through a network of ad hoc relationships between personal computers, unauthorized digital copies of entertainment content are uploaded and shared through an ever-expanding network resulting in an expansive, and highly efficient, piracy of copyrighted material.[23]

II. INDUSTRY RESPONSE: JOINT VENTURES AMONG CONTENT OWNERS

A. Legal, Political, and Technological Strategies

Faced with the substantial uncertainties associated with the increasing reproduction and distribution of digital media, content owners have considered and implemented numerous strategies to secure their interests.[24] The entertainment industry has routinely lobbied for protective legislation when presented with the development of any technology affecting the storage, use or transfer of entertainment content.[25] With the rise of the Internet, content owners sought special protection for digitized works distributed online.[26] Congress subsequently enacted the Digital Millennium Copyright Act (DMCA) in 1998, prohibiting circumvention of copy protection technologies and protecting the integrity of copy management systems.[27]

In addition to legislation, the entertainment industry has sought to initiate litigation against alleged infringers under existing copyright law.[28] In

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networks take root, and the cost of memory devices and faster processors continue to fall.").

21. Matthew Fagin et al., *Beyond Napster: Using Antitrust Law to Advance and Enhance Online Music Distribution*, 8 B.U. J. SCI. & TECH. L. 451, 457 (2002).

22. *Id.* at 458.

23. *See* FIRST, *supra* note 5, at 7-8; Yu, *supra* note 4, at 907. *See generally* Margaret Jane Radin, *Humans, Computers, and Binding Commitment*, 75 IND. L.J. 1125, 1132 (2000) (discussing the issues posed by digital networks and online transactions).

24. *See* Yu, *supra* note 4, at 909.

25. *See* Jessica Litman, *Revising Copyright Law for the Information Age*, 75 OR. L. REV. 19, 22 (1996).

26. Yu, *supra* note 4, at 910.

27. *Id.* at 911.

28. *Id.* at 913.

1999, Napster, one of the earliest successful P2P networks, was the target of a suit filed by several record labels alleging contributory and vicarious copyright infringement in its facilitation of the sharing of unauthorized digital reproductions of copyrighted songs.[29] After implementing a modified preliminary injunction, the district court found that Napster was not in "satisfactory compliance" with the terms of the injunction and ordered Napster to shut down its file-sharing service until certain conditions were met.[30] Napster never relaunched its free file-sharing service and was subsequently acquired.[31]

Successor file-sharing services, like KaZaa, altered the structure of their P2P networks to better comply with the mandates of copyright law.[32] As a consequence, subsequent litigation targeting these new networks has met with limited success.[33] In response, the entertainment industry has shifted to the direct pursuit of infringement actions against individual file-sharers.[34] The deterrent effect of these individualized suits, as of late, remains unclear.[35]

In an effort to supplement the effects of litigation, content owners have also adopted educational measures to deter consumers from file-sharing. Entertainment interest groups have sent letters to universities alerting them of possible infringement activity on their networks while celebrities have sought public outlets to express their concerns.[36] In a more institutionalized effort, the National Academy of Recording Arts & Sciences recently

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29. A&M Records, Inc. v. Napster, Inc., 114 F. Supp. 2d 896, 900 (N.D. Cal. 2000).

30. A&M Records, Inc. v. Napster, Inc., 284 F.3d 1091, 1096 (9th Cir. 2002); Fagin et al., *supra* note 21, at 459-60.

31. *See* Matt Richtel, *Napster Says It Is Likely to be Liquidated*, N.Y. TIMES, Sept. 4, 2002, at C2.

32. *See* Metro-Goldwyn-Mayer Studios, Inc. v. Grokster Ltd., 259 F. Supp. 2d 1029, 1045 (C.D. Cal. 2003) (differentiating Napster's "integrated service," from Defendant's services, which "provide[d] software that communicate[d] across networks that [were] entirely outside Defendants control") *aff'd*, 380 F.3d 1154 (9th Cir.), *cert. granted*, 125 S. Ct. 686 (2004).

33. *See id.*

34. *See* A.J. Bedel, *Lights, Camera, Lawsuit*, 2003 DUKE L. & TECH. REV. 31 (exploring litigation against different parties as a means of combating digital piracy); Jefferson Graham, *Music Industry Weighs its Option; Lawmakers Want to Hear Proposals for Fighting Piracy Without Lawsuits*, USA TODAY, Sept. 29, 2003, at D6.

35. FIRST, *supra* note 5, at 10. It should also be noted that the film industry has elected to pursue similar lawsuits against individual infringers. Sarah McBride, *Film Industry Vows Crackdown on Online Movie Thieves*, WALL ST. J., Nov. 5, 2004, at B1. *See generally* Kristina Groennings, Note, *Costs and Benefits of the Recording Industry's Litigation Against Individuals*, 20 BERKELEY TECH. L.J. 571 (2005).

36. *Entertainment Industry Widens War*, USA TODAY, Feb. 13, 2003, at D9.

unveiled a major "public education campaign" utilizing a new website, print and radio public service announcements and retail activities.[37]

In conjunction with these efforts, the entertainment industry has also pursued the development and implementation of copy-protection technology, including encryption, digital watermarking, and the use of trusted systems.[38] In broader terms, the industry has sought to utilize a system of "digital rights management" (DRM) and "access protection" in developing software and hardware controls to facilitate the monitoring, regulation and pricing of digital content.[39]

In practice, however, these technologies often result in imperfect solutions. First, the utility of any given technology is subject to decryption by hackers.[40] Once the technology is defeated, the general public can piggyback on the hacker's breakthrough. Second, there are substantial consumer rights concerns related to the continued utility of existing hardware, like stereos and computers, and the ability of individuals to exploit previously available functions, like reproductions for personal use, supported by the "fair use" privilege.[41] Consumer groups are, thus, wary of the potential for copy-protected media preventing consumers from making fair use reproductions of their purchases or limiting the ability of consumers to use the new media with their existing hardware.

Altogether, the practical success of these strategies has been limited. Despite the victory in the *Napster* litigation, the industry has struggled in its attempts to target less centralized file-sharing services.[42] The individual lawsuits remain controversial and the effects of the industry's educational efforts are unclear.[43] Copy-Protection technologies and DRM remain viable options but are vulnerable to decryption and consumer rights concerns. As a consequence, the industry has turned to business solutions as an alternative means of addressing these issues.

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37. Yu, *supra* note 4, at 921.

38. *Id.* at 918.

39. Michael A. Einhorn, *Digitization and Its Discontents: Digital Rights Management, Access Protection, and Free Markets*, 51 J. COPYRIGHT SOC'Y U.S.A. 279 (2004).

40. Yu, *supra* note 4, at 919.

41. *Id.* at 920.

42. *See* Metro-Goldwyn-Mayer Studios, Inc. v. Grokster Ltd., 259 F. Supp. 2d 1029, 1045 (C.D. Cal. 2003) (holding that the lack of control, by defendants, in the operation of their P2P networks undermined claims of vicarious copyright infringement) *aff'd*, 380 F.3d 1154 (9th Cir.), *cert. granted*, 125 S. Ct. 686 (2004).

43. FIRST, *supra* note 5, at 10; Yu, *supra* note 4, at 921.

B. Licensing

While the entertainment industry has been reluctant to relax its control over content, in some instances the market has introduced licensing as a possible solution to the digital problem.[44] By the end of 2002, Rhapsody, an independent online music service, announced that it had signed agreements with all five major record labels to distribute music online, with four of the five agreeing to allow Rhapsody to offer the burning of songs on to CDs.[45] Subsequently, four new independent ventures entered the market, spearheaded by Apple Computer and its iTunes Music Store.[46] iTunes offers individual songs and albums for download from all five major labels.[47] Most recently, Yahoo Inc. concluded a $160 million deal to buy Musicmatch Inc., a song management software maker, providing Yahoo the capacity to offer "online music downloading and subscription services."[48] In addition, a group of music retailers, including Best Buy Co. and Tower Records, recently announced the formation of Echo, Inc., a consortium aimed at developing an "online music subscription service that will let each of the retailers distribute music on the Internet under their respective brand names."[49]

Despite the apparent success of these services and the popularity of legitimate downloads among consumers, numerous concerns persist relating to the legal nature of online content and the implications of their possible resale.[50] Questions also remain as to the security of the delivery format.[51] Moreover, from an economic perspective, it may not be in the industry's interest to see legitimate online distribution prevail.[52] Notwithstanding the

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44. *See* Yu, *supra* note 4, at 922. *See generally* Cydney A. Tune, *Licensing Music on the Internet*, ENT. & SPORTS LAW., Summer 2004, at 1 (discussing the licensing of music on the Internet), *available at* http://pillsbury.admin.hubbardone.com/files/tbl_s17PDFRepository/PDFUpload121/167/Ent%20%20Sports%20Lawyer%20(Summer-2004)%20Tune.pdf.

45. John Borland, *Listen.com Lands Last Big Five Label*, CNET NEWS.COM, July 1, 2002, *at* http://news.com.com/2100-1023-940841.html?tag=bplst.

46. FIRST, *supra* note 5, at 12.

47. Pui-Wing Tam & Anna Wilde Mathews, *Apple Polishes Its Music Service*, WALL ST. J., Apr. 14, 2003, at B1.

48. Benny Evangelista, *Yahoo to Enter Music Fray / Web Giant to Buy Musicmatch for $160 Million*, S.F. CHRON., Sept. 15, 2004, at C1. Yahoo joined RealNetworks, Roxio's Napster, Wal-Mart, Sony, MusicNow, Microsoft's MSN Music Store, and eBay. John Schwartz & John Markoff, *Power Players*, N.Y. TIMES, Jan. 12, 2004, at C1.

49. FIRST, *supra* note 5, at 14.

50. *See* Yu, *supra* note 4, at 922.

51. John Borland, *Program Points Way to iTunes DRM Hack*, CNET NEWS.COM, Nov. 24, 2003, *at* http://news.com.com/2100-1027-5111426.html.

52. *See* Maul, *supra* note 3, at 370.

wide consumer interest in authorized third-party online services, it is widely understood that such services "must be inexpensive as well as comprehensive" to remain attractive to consumers.[53] According to the music industry's own research, such "inexpensive" pricing would likely result in a price point of twenty-five cents per download.[54] This would result in a substantial drop from the thirty to forty percent profit margins currently reaped from the sale of CDs.[55] Indeed, some industry insiders suspect that the industry would ultimately rather see online ventures fail, thereby securing their interests in the distribution of physical media.[56]

C. Joint Ventures

Given the deficiencies in these approaches, many content owners have proceeded to form joint ventures as a means of securing their interests. In light of the substantial demand for a legal alternative to P2P file-sharing, these collaborations have sought to personally oversee and control the development of online distribution.[57]

1. Generally Accepted Advantages

Joint ventures are collaborations where disparate parties combine resources and efforts to undertake a given enterprise for profit.[58] The perceived value of such collaborations lies in the expectation that by pooling resources the "resulting whole will be greater than the sum of the constituent parts."[59] The combination, thus, is intended to create significant efficiencies and provide competitive and synergistic advantages over alternative arrangements.[60]

There are numerous concerns that typically underlie any joint venture. Some of these concerns relate to the sharing of risks, whether between companies in an emerging market or with a local partner in a new geographic area.[61] Other joint ventures seek to leverage the existing strengths or resources of partner firms to create new opportunities in serving global

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53. *Id.*

54. *See id.*; Amy Harmon, *Grudgingly, Music Labels Sell Their Songs Online*, N.Y. TIMES, July 1, 2002, at C1.

55. Maul, *supra* note 3, at 369.

56. Fagin et al., *supra* note 21, at 464; Maul, *supra* note 3, at 370 (quoting Neil Strauss, *Online Fans Start to Pay the Piper*, N.Y. TIMES, Sept. 25, 2002, at E1);

57. Fagin et al., *supra* note 21, at 464.

58. Stephen Fraidin & Radu Lelutiu, *Strategic Alliances and Corporate Control*, 53 CASE W. RES. L. REV. 865, 867 (2003).

59. *Id.*

60. *Id.*

61. *Id.* at 869-70.

clients, in initiating joint marketing, distribution or product development efforts, or in generating enough critical mass with a new technology to realize the benefits of network effects.[62]

2. *Pooling of Rights*

Specific to the entertainment industry, and the diversity of content owners, joint ventures have been used as a means of pooling rights. These collective efforts have sought out efficiencies that "stem from combinations of different capabilities or resources."[63] They thus allow for the "pooling" of intellectual property rights to avoid the licensing entanglements caused by the fragmentation of rights among countless different owners.[64] In some instances, where there are overlapping or conflicting rights, as in the case of blocking patents, pooling serves to consolidate potentially conflicting interests to enable a given product or products to be produced.[65] From an entertainment perspective, this is particularly relevant in relation to the "splintering of rights" in the music industry.[66]

The specific advantages of joint ventures, with regard to pooling, are most readily perceived in the operation of the American Society of Composers, Authors & Publishers (ASCAP) and Broadcast Music, Inc. (BMI). ASCAP and BMI are performing rights organizations which serve as intermediaries charged with the monitoring of music licensees and the collection of royalties.[67] The Supreme Court noted that the ultimate development of blanket licenses, and organizations like ASCAP, grew out of the "practical situation in the marketplace: thousands of users, thousands of copyright owners, and millions of compositions."[68] The advantage of pooling rights, in the words of the Court, existed in the avoidance of "thousands of individual negotiations," which the court deemed to be a "virtual impossibility," and the balancing of "unplanned, rapid and indemnified access to any and all of the repertory of compositions" sought by users against a "reliable method of collect[ion] for the use of . . . copyrights" sought by owners.[69] Thus, pooling ensures that the desired media is

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62. *Id.* at 871.

63. FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS § 3.36 (2000) [hereinafter COLLABORATION GUIDELINES].

64. FIRST, *supra* note 5, at 18.

65. *Id.*

66. *Id.*; *see* Amy Harmon, *Copyright Hurdles Confront Selling of Music on the Internet*, N.Y. TIMES, Sept. 23, 2002, at C1.

67. FIRST, *supra* note 5, at 20.

68. Broad. Music, Inc. v. Columbia Broad. Sys., 441 U.S. 1, 20 (1979).

69. *Id.*

delivered in a "sure and speedy way," reassures licensees that they have obtained proper permission to use the media, and bolsters the ability of licensors to enforce their rights.[70]

3. *One-Stop Shopping and Uniform Standards*

The delivery of "one-stop-shopping" is another impetus for collaborations among licensors in their efforts to satisfy consumer wants.[71] Because of the claimed "infinite economies of scale" associated with online distribution, content suppliers have looked to create "celestial jukeboxes" to provide in one place all the music, or any other form of content for that matter, that exists worldwide.[72] This addresses the consumer desire to minimize "search costs" by providing "access to any and all of the repertory of compositions" available, as discussed by the Supreme Court.[73]

Related to this conception of one-stop shopping is the importance of obtaining uniformity in the digital media standards used for online distribution. While there is great perceived value in the simple combination of the libraries of the major content providers, there is a secondary advantage in the standardization of digital formats.[74] Consumers might be put off from shopping for content online if studio or label libraries were only available from each content owner, individually, in a different proprietary format. The existence of a single distribution format for online content coupled with the consolidation of a comprehensive content library streamlines the online purchase of content and addresses the needs of consumers.[75]

The entertainment industry is justifiably wary of the distribution of their content in "digital form," given the ease with which pirates might reproduce and distribute illegal copies.[76] As with the development of technical standards, joint ventures enable content owners to control anti-piracy measures which they hope will stem the rise of *Napster*-like distribution networks for other forms of content.[77]

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70. FIRST, *supra* note 5, at 20.

71. *Id.* at 23.

72. *Id.*

73. *Id.*; *Broadcast Music, Inc.*, 441 U.S. at 20.

74. *See* Karen Kaplan & Corie Brown, *Five Studios Plan Joint Venture to Offer Movie Downloads*, L.A. TIMES, Aug. 17, 2001, at A1.

75. Katherine L. Race, *The Future of Digital Movie Distribution on the Internet: Antitrust Concerns with the Movielink and Movies.com Proposals*, 29 RUTGERS COMPUTER & TECH. L.J. 89, 99-100 (2003).

76. *See id.* at 97.

77. *Id.* That is not to say, however, that there are no services which currently facilitate the online trading of music. *See* McBride, *supra* note 35, at B1.

4. *Control over the Internet as a Means of Distribution*

Lastly, given the relatively recent rise of digital technology, there is an additional incentive to form joint ventures in order to control the development of the Internet as a new medium of distribution. This rationale has been utilized to support past collaborations among content owners, notably upon the development of pay television. With the development of the Home Box Office (HBO) pay television network, the movie studios found themselves somewhat dissatisfied with the seemingly disproportionate amount of revenue being diverted to cable operators and programming companies.[78] As a consequence, four major studios formed a joint venture (Premiere) to collectively manage the distribution of their films via pay television.[79] The studios believed that by controlling the distribution they could increase revenues, mitigate "potential problems on the theatrical distribution side," and create an "outlet for 'marginal productions' that would not otherwise be accepted on pay television."[80] Thus, rather than defer to the wilds of the market and the existing third-party pay television operators, the studios sought to utilize a joint venture to leverage their content ownership and thereby control the development of a new medium of distribution to suit their interests.

It must be noted that the district court held the Premiere joint venture to be potentially in violation of antitrust laws and subsequently granted a preliminary injunction.[81] That is not to say, however, that the role of content owners in guiding the development of a new technology cannot be procompetitive. Certainly the need for standardization, the need for the implementation of protective measures, and the support of content providers are crucial to the successful adoption of a new technology. Thus, to the extent that the legitimate interests of a content industry in guiding the advancement of a new means of distribution prevails, there can be significant strategic value, and procompetitive benefits, in exerting some control over the development of the new technology.

Content owner collaborations thus provide significant strategic advantages in: (1) the consolidation of fragmented rights; (2) the provision of a single comprehensive source of content; (3) the formulation of security and technical standards; and (4) the general development of a new technology.

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78. United States v. Columbia Pictures Indus., Inc., 507 F. Supp. 412, 419 (S.D.N.Y. 1980).

79. *Id.*

80. *Id.* (internal citations omitted).

81. *Id.* at 434.

III. ANTITRUST CONSIDERATIONS

A. Regulatory Framework

The threat posed by the concentration of economic power in the hands of a few corporations and individuals prompted the promulgation of antitrust legislation.[82] In the interests of the public, these laws serve to promote and preserve competition, eliminate price controls, foster innovation, and, altogether, facilitate the proper functioning of the market.[83] Thus, section 1 of the Sherman Act declares illegal "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations."[84]

To assist economic actors in abiding by the principles espoused by U.S. antitrust laws, the DOJ and the FTC have implemented guidelines to "articulate the analytical framework" applied in determining whether a given action or transaction is anticompetitive.[85] These guidelines focus on preventing the creation, enhancement or use of market power, defined as the ability of a given seller to profitably maintain prices above the level ordinarily achieved by competition for an extended period of time.[86] This enhanced profitability, brought about by the ability of a firm or a group of firms to control the market, is coupled by reduced output and an overall "misallocation of resources" through the "transfer of wealth from buyers to sellers."[87]

This concern, relating to the concentration of market power, extends to the organization of joint ventures. Horizontally, concerns exist as to the cooperation between competitors in an effort to collectively restrict output and raise prices. Yet, in cases where horizontal competitors join together to exploit an opportunity on another level of the marketing chain, the issue of vertical integration arises. With the music industry as an example, the concern as to the collaboration of music labels in forming a joint venture to spearhead the online distribution of music lies not in the prospect of a reduction in the creation of content, a horizontal integration. Rather the issue lies in the impact on competition by integrating two segments of the marketing channel, content and delivery, which would then allow the content providers to also control a means of distribution. Thus, the issue of

82. 54 AM. JUR. 2D *Monopolies and Restraints of Trade* § 1 (2004).

83. *Id.*

84. 15 U.S.C. § 1 (2000).

85. *See* FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, HORIZONTAL MERGER GUIDELINES § 0.1 (2d ed. 1997).

86. *Id.*

87. *Id.*

horizontal collaboration raises antitrust concerns insofar as the potential economic power of the collaborating music labels is exercised vertically in the control of online distribution.

As a general principle, the courts have long been wary of vertical integration in the entertainment industry.[88] In *United States v. Paramount Pictures, Inc.*, the Supreme Court held that a collaboration between movie studios and movie theaters constituted a vertical integration of production, distribution, and exhibition and led to an unlawful restraint on trade.[89]

However, since the *Paramount* decision, courts have become more accepting of vertical integration, consistently declining to find antitrust violations.[90] This shift reflects, to some extent, the Chicago school analysis of vertical integration which holds that "vertical integration should be per se legal because vertical integration is either competitively neutral or procompetitive."[91] Many content providers argue that vertical integration is justified due to the rise of multiple competing methods of distribution.[92] Nevertheless, notwithstanding the existence of procompetitive benefits or competition-neutral circumstances, in any case of vertical integration there remains the potential for anticompetitive consequences.[93] Thus, the FTC and the DOJ have implemented guidelines to regulate the use of joint ventures among competitors.[94]

B. Federal Guidelines

Two types of analysis, per se and rule of reason, are utilized in evaluating the antitrust implications of a given collaboration.[95] The rule of reason analysis evaluates the overall competitive effect of a given agreement.[96] It considers whether the agreement is anticompetitive in encourag-

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88. Race, *supra* note 75, at 121-22.

89. 334 U.S. 131, 173-74 (1948); Konrad Gatien, *Internet Killed the Video Star: How In-House Internet Distribution of Home Video Will Affect Profit Participants*, 13 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 909, 936 (2003).

90. Gatien, *supra* note 89, at 937.

91. *Id.* at 941.

92. *Id.* For example, with the motion picture industry, movies may distributed via theatres, video-rental outlets, pay-per-view, pay television, DVDs, broadcast or cable television, or online.

93. *Id.* at 942.

94. The FTC and DOJ share responsibilities in enforcing antitrust law. *Id.* at 943; *see* COLLABORATION GUIDELINES, *supra* note 63, § 1.1. With matters involving media and entertainment, the FTC has ceded oversight to the Department of Justice. Gatien, *supra* note 89, at 943.

95. COLLABORATION GUIDELINES, *supra* note 63, § 1.2.

96. *Id.* § 3.3.

ing higher prices or reduced output, quality, service or innovation.[97] Such an analysis "entails a flexible inquiry," colored by the nature of the agreement and the market circumstances.[98] Initially, the FTC and DOJ will consider the "nature of the agreement," exploring the "business purpose" of the agreement and determining whether the agreement has caused actual anticompetitive harm.[99] This analysis serves to explore whether the relevant agreement might "limit[] independent decision making," "combine[] control or financial interests," or facilitate explicit or tacit collusion, thereby resulting in a decrease in competition.[100] These considerations relate to reductions in the ability to compete, decreases in the incentive to compete, and facilitation of collusion through the sharing of information.[101]

If the resulting analysis indicates the absence of anticompetitive harm there generally is no antitrust challenge. However, where there is a likelihood of, or demonstrated, anticompetitive harm, the regulatory authorities initiate a more detailed market analysis.[102] They define the affected markets, determine the ease of market entry, and calculate market shares, concentration, and market power.[103] In addition, they seek to evaluate the ability and incentives for the collaborators to compete independently by considering exclusivity, control over assets, financial interests, control over decision-making, information sharing, and duration.[104] If these factors indicate minimal potential for anticompetitive harm the investigation ends.[105] Otherwise, the FTC and DOJ consider whether the procompetitive benefits of the relevant agreement offset the predicted anticompetitive harms.[106] These procompetitive benefits are recognized when the relevant agreement is reasonably necessary to achieve verifiable "cognizable efficiencies."[107]

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97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.* § 3.31.
101. *See id.*
102. *Id.* § 3.3.
103. *Id.*
104. *Id.*
105. *Id.*
106. *Id.*
107. *Id.* § 3.36. Cognizable efficiencies are described as those efficiencies that do not arise "from anticompetitive reductions in output or service" and "cannot be achieved through practical, significantly less restrictive means." *Id.*

Conversely, per se illegal agreements will always, or almost always, tend to raise prices or reduce output.[108] They are "so likely to harm competition and . . . have no significant procompetitive benefit that they do not warrant the time and expense required for particularized inquiry into their effects."[109] The courts have identified certain specific types of agreements, including those that "fix price or output, rig bids, or share or divide markets," as per se illegal.[110] That being said, even where a certain agreement falls within a category ordinarily considered per se illegal, if that agreement provides for an "efficiency-enhancing integration of economic activity" and is "reasonably necessary to achieve [the alleged] procompetitive benefits," then regulators will defer to the "rule of reason."[111]

In addition to these rules for competitor collaborations, the FTC and DOJ have also published antitrust guidelines specifically addressing the licensing of intellectual property.[112] Restraints related to the licensing of intellectual property are evaluated under the rule of reason analysis, unless the restraint's "nature and necessary effect are so plainly anticompetitive" with no contribution to "an efficiency-enhancing integration of economic activity."[113] Where a licensing arrangement is horizontal in nature, a given restraint might increase the potential for coordinated output and pricing, or the acquisition and maintenance of market power.[114] Yet, where a licensing arrangement is vertical in nature, the agreement could conceivably impair competition between horizontal entities on either the licensor or licensee level, or in another relevant market.[115] This potential is rooted in the concern that such an agreement might prevent competitors from accessing crucial inputs, increase the costs of such inputs, or "facilitate[] coordination to increase price or reduce output."[116] Of course, whatever potential may exist for anticompetitive harm, the existence of overriding procompetitive efficiencies will tend to justify restraints necessary to achieve such efficiencies.[117] The question is whether, on balance, the anticompetitive restraints are outweighed by the procompetitive benefits.

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108. *Id.* §1.2.
109. *Id.*
110. *Id.* § 3.2.
111. *Id.*
112. *See* FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (1995) [hereinafter LICENSING GUIDELINES].
113. *Id.* § 3.4 (citations omitted).
114. *Id.* § 4.1.1.
115. *Id.*
116. *Id.*
117. *Id.* § 4.2.

These guidelines specifically address the pooling arrangements discussed as a rationale supporting the formation of joint ventures.[118] Broadly speaking, these arrangements are not fundamentally anticompetitive.[119] Indeed, they might produce significant procompetitive benefits by "integrating complementary technologies, reducing transaction costs, . . . and avoiding costly infringement litigation."[120] However, the "the joint marketing of pooled intellectual property rights with collective price setting or coordinated output restrictions, may be deemed unlawful if [the restraints] do not contribute to an efficiency-enhancing integration of economic activity among participants."[121] In sum, any restraints on competition must have a procompetitive rationale to counteract any anticompetitive effects.[122]

IV. FORWARD-LOOKING CONSIDERATIONS: STRUCTURING A JOINT VENTURE TO WITHSTAND ANTITRUST SCRUTINY

Joint ventures are potentially viable instruments for any combination of organizations in their efforts to collaborate in the pursuit of a given opportunity. With a collaboration among content providers in the pursuit of online distribution, a general structure involving both a horizontal and vertical component predominates. Within any given content industry, the content providers are rivals competing for consumers to purchase their brand, or brands, of films, music, video games, novels or so forth. However, with the rise of digital technology, they collectively have an interest in guiding the development and implementation of Internet technologies, as a means of distribution, in order to secure the interests of the industry as a whole. As a consequence, the horizontal aspect of a distribution joint venture lies in this collective effort.

This horizontal collaboration is the source of concern, in terms of antitrust scrutiny, but only in relation to the vertical integration of content and delivery.[123] In forming the joint venture, the content owners are not seek-

118. *See* discussion *supra* Part II.C.2.

119. *See* LICENSING GUIDELINES, *supra* note 112, §§ 5.1, 5.5.

120. *Id.* § 5.5.

121. *Id.*

122. *See* Nat'l Collegiate Athletic Ass'n v. Bd. of Regents, 468 U.S. 85, 114-15 (1984) (holding that a restriction on the televising of college football games was unlawful because it was not reasonably related to any efficiency justification).

123. The issues faced by content providers in forming joint ventures for the purpose of distributing content online mirrors, in many ways, the trials of standard-setting organizations in the computer industry. The procompetitive benefits of implementing an indus-

ing to collaborate on the creation of content. Rather, they are seeking to collectively engage in the delivery of that content. Thus, the potential for anticompetitive behavior stems from the joint venture's relationship vis-à-vis third-parties engaged in delivery.

There are, subsequently, two dimensions of this relationship relevant to an antitrust analysis: upstream and downstream. The content owners are in the business of producing entertainment content for consumption by individuals. There are often intermediaries, like movie theaters or television networks, who facilitate the distribution of that content between the content owners and the consumers. In the formation of a joint venture, rather than solely relying on third-party distributors similar to Apple's iTunes, content owners operating as online retailers expand their operations beyond the mere creation of content by distributing directly to consumers themselves.

As such, there are upstream concerns relating to the possible exercise of market power by the collaborating content owners in their licensing arrangements with third-party distributors.[124] In order for third-party distributors to compete with the joint venture, they must license content from the same companies that own the joint venture. To the extent that the content owners use their control over the content to favor the joint venture, antitrust concerns abound.

In addition to the direct effects upstream, there are corresponding consequences downstream in the ultimate distribution of content to consumers. In an effort to restrain competition among third-party distributors, and control the development of the Internet as a new means of distribution, consumers may suffer from the increased prices and decreased innovation resulting from the joint venture's stranglehold over the new medium.

This Part discusses the relevant considerations when attempting to structure a joint venture, for the online distribution of content, to withstand antitrust scrutiny. First, the fundamental purpose for organizing a joint venture is explored. The upstream and downstream levels are then considered in turn. A discussion of the broader policy concerns follows.

A. Fundamental Purpose of the Joint Venture

There are, as previously discussed, many reasons why a collective of content owners might seek to form a joint venture. Certainly, these reasons

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try standard are balanced against the anticompetitive threats of technology exclusion, collusion and monopoly power. *See* Robert M. Webb, *There Is a Better Way: It's Time to Overhaul the Model for Participation in Private Standard-Setting*, 12 J. INTELL. PROP. L. 163, 209-15 (2004).

124. *See Digital Music Press Release*, *supra* note 6, at 3.

might be anticompetitive. If a given content industry has a substantial investment in the current means of distribution, a new technology may be recognized as an economic threat, disturbing the status quo. As a consequence, that industry may see a joint venture as an effective means of quashing the new technology. Or a group of content owners may view the efficiencies of a new technology as an opportunity to vertically integrate their creation of content with delivery, thereby forcing out third-party distributors. In either case, such clear abuses of market power, in efforts to reduce competition, will garner serious antitrust scrutiny.

Contrarily, joint ventures are also used to generate procompetitive benefits. Where there is a fragmentation of content owners, a joint venture might allow for an appropriate means of creating a one-stop shop. However, this objective ought to be a means to an end. In other words, the rise of Internet technology presents the potential for a new, more efficient, means of distribution. Yet, in order to effectively serve consumers and promote competition, it is important that the technology is widely implemented so that it may be widely adopted. This requires technology sufficiently amenable to consumers and that proper standards and protections are developed in order to ensure the smooth functioning of commerce.

Hence, the one-stop shop does not serve the rigid achievement of vertical integration, to the exclusion of third-party distributors, but rather it acts to spearhead the introduction of online content distributors to demonstrate the viability of online distribution in its ability to offer a wide selection of content. The objective is to launch a new means of distribution. It is an effort, by the industry, to facilitate the advancement of technology to better serve consumers. Thus, the collaboration is geared toward the successful realization of the broader social and economic benefits of the new means of distribution. The day-to-day operations of the joint venture are merely incidental to dual objectives of fostering the growth of the new technology and ensuring that the proper standards and protections are implemented. The economic power of the joint venture is thus being used to promote competition rather than restrain it.

B. Upstream Level

Generally, collaboration at the upstream level translates to cooperation between the venture owners in the areas of research and development, purchasing, and standard-setting.[125] Proceeding collectively for these purposes generally has no direct effect on output or pricing and, indeed, can

125. Thomas A. Piraino, *A Proposed Antitrust Approach to High Technology Competition*, 44 WM. & MARY L. REV. 62, 141 (2002).

generate "substantial efficiencies" and other procompetitive benefits.[126] In terms of the antitrust concerns related to online distribution joint ventures, the focus on the upstream level of development primarily involves the licensing of existing content to the joint venture and to third-parties.[127] As such, antitrust scrutiny is likely to focus on the degree to which the licensing arrangements might restrain competition among potential licensors.[128] Specifically, the concern relates to the potential for collaborating content owners to (1) collectively set unfavorable licensing terms vis-à-vis third-parties or (2) utilize exclusive licensing and block-out third-party distributors altogether while (3) operating at less than arms-length when transacting with the venture itself.

1. Collective Licensing Terms

The structure of a joint venture, and the resulting collaboration, facilitates the possibility of explicit or tacit collusion as to licensing arrangements.[129] This risk of collusion is perpetuated by the potential for the "exchange of competitively sensitive information relevant to each [content owner's] licensing considerations."[130] Any joint venture structure that clearly serves to collectively set licensing terms or allows for the exchange of information that could lead to the collective setting of such terms will likely fail to pass antitrust muster.[131]

2. Exclusive Licensing Terms

Past entertainment joint ventures have engaged in exclusive licensing. Two clear examples are the Premiere pay television network and the Movies.com joint venture. With Premiere, the participating movie studios agreed that the pay television joint venture was "to have certain films distributed by the movie company venturers available to it exclusively for a nine-month period, before those films [were] shown on the existing satel-

126. *Id.* at 141-44.

127. *See Movielink Press Release*, *supra* note 6, at 3. However, it is arguable that the purpose of any given online entertainment joint venture is to create a new product (i.e., digital video downloads or digital music) and thus the collaboration is necessary in order to develop the technology and the appropriate standards. Race, *supra* note 75, at 121-22. It remains, however, debatable whether these products are indeed "new" and whether it is truly necessary for the content owners to control this new means of distribution in order to facilitate the accompanying technological development. *See id.* at 122-23.

128. *See id.* at 123.

129. *See* Maul, *supra* note 3, at 378.

130. *Digital Music Press Release*, *supra* note 6, at 3.

131. *See id.*; *Movielink Press Release*, *supra* note 6, at 3.

lite-fed network programming services."[132] In considering whether such an arrangement was anticompetitive, a federal district court in New York found that there was "ample evidence that the nine-month window was meant to be 'exclusionary and coercive.'"[133] As a consequence, the court held that such an agreement constituted a "group boycott," albeit one that was time-limited, and thus unreasonably restrained competition.[134]

In a similar manner, Movies.com, a proposed joint venture between the Walt Disney Company and 20th Century Fox, planned to control the "exclusive distribution rights [of new film releases from each content owner] for the period of time beginning 'sometime after the movies are available at the video store but before they appear on any cable, satellite or broadcast TV service.'"[135] Ultimately, out of concern over antitrust scrutiny, Fox pulled out of the proposal, leaving Movies.com a strictly Disney-run enterprise and prompting the end of a DOJ investigation.[136]

Viewing these examples, despite whatever mitigating characteristics, such as time-limits, a joint venture might put in place, any attempt at exclusivity in licensing will generally be deemed to have no other reasonably justifiable purpose than to restrain competition. While it is arguable that certain efficiencies could be demonstrated to outweigh the seemingly per se illegal qualities of the exclusive license, it is nevertheless likely that any such agreement will be met with heavy scrutiny.

3. *Arms-Length Licensing*

The most successful form of structuring, at least insofar as licensing is concerned, is an arms-length relationship between the individual content owners and the joint venture. As an example, the pressplay and MusicNet online music joint ventures were cleared by the DOJ, as to their licensing practices, due to the evidence that the licensing arrangements between the labels and third-parties varied significantly and that each label had independently adopted its own unique approach to third-party distribution online.[137] This finding was bolstered by the apparent success of safeguards adopted by the labels to prevent the sharing of confidential business information through the joint ventures.[138] The DOJ similarly cleared the

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132. United States v. Columbia Pictures Indus., Inc., 507 F. Supp. 412, 419 (S.D.N.Y. 1980).

133. *Id.* at 428.

134. *Id.* at 429, 431.

135. Race, *supra* note 75, at 94.

136. *Id.*; *Movielink Press Release*, *supra* note 6, at 1.

137. *Digital Music Press Release*, *supra* note 6, at 3.

138. *Id.*

Movielink joint venture, where the individual studios independently negotiated with the venture as to the pricing and distribution of their respective films.[139]

Thus, a joint venture would likely be able to withstand antitrust scrutiny by requiring the venture owners to transact at arms-length with the venture and to adopt separate licensing terms vis-à-vis both the joint venture and third-parties. This should be accompanied by the implementation of rigorous safeguards to sufficiently demonstrate to regulatory authorities that the sharing of confidential business information has been effectively suppressed.

This is not to suggest that the collaborators should step back from their roles in collectively supporting the new means of distribution or jointly innovating technical and security standards. However, there is an emphasis on the importance of avoiding any improper cooperation as to the vertical integration of content and delivery and setting the boundaries of the venture's operations.

C. Downstream Level

Through the operation of the joint venture, the downstream level relating to consumer retail sales is vertically integrated with the upstream licensing level of the content owners.[140] To a significant extent the antitrust implications of the downstream level are affected by the upstream level. In other words, anticompetitive licensing arrangements upstream might translate into (1) a reduction in competition or (2) a restriction in technological development downstream.

1. Reduction in Competition

As competition is constrained upstream, through exclusive or collusive licensing, there is the potential for restrained innovation, increased prices, or decreased output on the retail distribution level. Thus, in cases of vertical integration, the FTC and DOJ generally seek to examine whether there is the possibility of collusion, generally through the sharing of confidential business information, and the extent to which the products distributed by the joint venture compete with third-party products.[141] The collective organization of major competitors carries a significant incentive to tacitly engage in restrictive licensing[142] and other anticompetitive behavior. The venture may be vested with the exclusive right to distribute, effectively

139. *Movielink Press Release, supra* note 6, at 2.
140. *See id.* at 3.
141. *Id.*
142. *Id.*

blocking out third-party competitors, or it might be afforded an advantage through price-fixing[143] or improper uses of Most Favored Nation clauses.[144]

Thus, in terms of structuring an online distribution joint venture to withstand an antitrust investigation, it would be necessary to adhere to the same principles guiding the upstream analysis. Safeguards should be taken to avoid any appearance of sharing confidential information and licensing decisions should be made independently by the participant content owners at arms-length. Pricing decisions should be made independently and any provisions appearing to discriminate against third-parties, including Most Favored Nations clauses, should generally be avoided. That is not to say that any specific type of clause is fundamentally disfavored. But, to the extent that any given clause enables the content owners of a given joint venture to restrain competition without any clear overriding efficiency benefits, it is likely to become the focus of an antitrust investigation.

Altogether, the hallmark of a joint venture structure should be the independence with which the operations of the joint venture interact with the venturers and with third-parties. Apart from the general collaboration relating to support and development of the new distribution channel, the terms of the licensing agreements, the selection of third-party licensors, and other operational decisions should remain within the province of the venture itself. The venture is a vehicle to produce procompetitive benefits. Thus, it should impose clear safeguards to prevent and minimize the potential for anticompetitive abuse.

2. *Restriction In New Means of Distribution*

Where restrictive licensing takes hold there is also a reduced incentive to innovate and develop the Internet as a means of distribution.[145] In other words, the general purpose of the joint ventures under discussion is to provide for online distribution. There is no reduction in the incentive to innovate content, as competition between the content creators persists.

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143. Explicit price-fixing includes the use of allocation formulas. *See* United States v. Columbia Pictures Indus., Inc., 507 F. Supp. 412, 427 (S.D.N.Y. 1980).

144. Most Favored Nation clauses "are standard devices by which buyers try to bargain for low prices, by getting the seller to agree to treat them as favorably as any of their other customers." Blue Cross & Blue Shield United v. Marshfield Clinic, 65 F.3d 1406, 1415 (7th Cir. 1995). These clauses might be used by "a small number of sellers" to "coordinate manipulation of prices or quantities." Maul, *supra* note 3, at 379.

145. *See Digital Music Press Release*, *supra* note 6, at 3 ("The Division considered in its investigation whether the major record labels used their joint ventures to suppress the growth of the Internet as a means of promoting and distributing music, in order to protect their present positions in the distribution of music on physical media . . . .").

There does remain, however, the possibility of reduced competition as to distribution. Rather than seeking to promote the new technology, there exists a possible incentive to suppress the adoption of the new means of distribution in order to protect existing investments in the status quo.[146]

That is not to say, however, that content owners cannot meaningfully contribute and even bolster the development of a new technology. Certainly there are substantial benefits, as to the ultimate adoption and success of a new means of distribution, in the support and guidance of the major content owners as representatives of the industry. Nevertheless, given the particular interests of content owners in the ultimate success of their existing operations, it is difficult to say where support and guidance ends and restrictive, self-interested control begins.

In the case of pressplay and MusicNet, the DOJ speculated that a collective action by the major record labels might have been directed at exploring the Internet as a means to market and distribute their content "without relinquishing control over the pace and direction of those activities."[147] The initial poor quality and restrictive nature of the online music joint ventures' services supported this theory.[148] Ultimately, though, market pressures prevailed and the liberalization of the online music services, with more consumer-friendly technologies and broad licensing to third-parties, led the DOJ to drop its investigation.[149]

Altogether, there does not appear to be a clear objective standard as to what level of technological development would be considered procompetitive. Yet, it is apparent that attempts to overly control the development of a new technology or a new means of distribution will raise antitrust concerns. The overriding issue is the prospect of content owners suppressing a new, possibly more efficient, means of distribution to further their own interests. Any sort of control exerted by a joint venture should have clear efficiency or procompetitive benefits, especially if such control limits the ability of third-parties to engage in or develop the same means of distribution. Thus, rather than seeking to control and dominate, a given joint venture should focus on guidance and support. The difference, apart from semantics, is the open nature of guidance. The support of the industry is crucial to the successful implementation of a new technology or a new means of distribution. The content owners ought to play a prominent role to en-

146. *Id.*
147. *Id.* at 4.
148. *Id.* at 3-4.
149. *Id.* at 4.

sure that proper standards are developed and to protect their intellectual property. But it is imperative that they use a light touch.

The control asserted by the joint venturers should be limited to guiding development, managing the creation of standards, and encouraging the adoption of the technology throughout the industry. There should be open cooperation with third-party licensors and other possible innovators who might contribute to the development of the technology. Thus, there should be a policy of interacting with third-parties and encouraging innovation and, indeed, competition. The stated intent should be inclusiveness. Otherwise, any attempt to broadly suppress innovation or to otherwise exclude third-parties would raise serious antitrust concerns.

D. Broader Policy Considerations

While the alleged efficiencies and procompetitive benefits of joint ventures have been explored at length above, many scholars contend that these advantages are not supported by a more focused analysis.[150] The agreement forming the Movielink joint venture, owned by five of the major movie studios, advocates for an "open-access technology that does not exclude competitors."[151] Despite the appearances of propriety, scholars have argued that the true intent of the co-venturers should be carefully scrutinized given the potential for these collaborations to engage in anticompetitive behavior.[152] Much of this concern is derived from the leverage afforded to content owners through their intellectual property rights.[153] Similarly, at least one scholar argues that the benefits associated with pooling rights or creating a one-stop shop are overstated given the ability of third-parties to sufficiently deal with multiple rights-holders and provide the same one-stop shopping offered by the content owners.[154]

To the extent that a given joint venture among content owners seeks to dominate a new technology or a new means of distribution through the imposition of vertical or horizontal restraints, its procompetitive benefits are questionable. The impetus behind the organization of the joint ventures previously discussed, however, is to guide the development and implementation of a new technology. Unfortunately, such high-level ideals do not apply perfectly in the real world. Critics are right to suggest that the intent of a given joint venture should be questioned. There may be benefits to pooling rights, like a clearinghouse, or service as a one-stop shop. But

150. *See, e.g.*, FIRST, *supra* note 5; Race, *supra* note 75, at 123.
151. Race, *supra* note 75, at 123.
152. *Id.* at 123-25.
153. *See id.* at 124.
154. *See* FIRST, *supra* note 5, at 21.

where these efficiencies are eroded, the introduction of third-parties and competition would seem to outweigh the benefits of collective action.

On balance, joint ventures may provide substantial procompetitive benefits, but it cannot be denied that the prospect of collective action, particularly given the leverage afforded by intellectual property rights, raises the potential for anticompetitive behavior. Certainly, the intent of the co-venturers must be carefully scrutinized, but so must the structure of the underlying venture. The recommendations described above focus on the distinction between the operations of the joint venture and the higher sócio-economic benefits sought by the venturers. Where the joint venture seeks to dominate the new technology, to stifle innovation, to minimize competition, and to exclude third-parties, certainly the alleged procompetitive benefits are suspect. If, for example, a joint venture seeks to be the sole online distributor, the potential for antitrust abuses is significant. But if the purpose of the venture is to guide the development of the technology, the venture serves only as a vehicle. It may be an example of vertical integration, but to the extent that competition is allowed and encouraged, the procompetitive benefits would seem to prevail.

Ultimately, the line is difficult to draw. The intent to guide and support might easily give way to an intent to manipulate and restrict. There is no clear way to differentiate an attempt to control a new technology, in order to serve the interests of the venturers, from an industry attempt to guide the adoption of a new technology to ensure that it is implemented in an efficient manner. Joint ventures provide ample potential for anticompetitive behavior. But a properly structured entity, founded on the principals of transparency, innovation and competition, can legitimately generate substantial procompetitive benefits.

V. CONCLUSION

The development of digital technology has fostered numerous challenges, and opportunities, for the providers of entertainment content. With the arrival of the Internet as a new means of distribution, joint ventures serve as useful vehicles to enable content owners to collaborate in guiding the development and adoption of online distribution. However, antitrust concerns arise in any collaboration among competitors. Particularly, with the vertical integration of content and delivery, the peril of collusion threatens competition among third-party online distributors.

Nevertheless, significant efficiency and other procompetitive benefits support the formation of such ventures. To realize these benefits, it is necessary to structure a given joint venture to allow for procompetitive advan-

tages, derived from industry support of a new technology and collective standard-setting, while clearly eliminating the potential for anticompetitive behavior.

Thus, in order to structure a joint venture to withstand antitrust scrutiny, it is important to (1) clearly demonstrate the efficiency and other procompetitive benefits unique to the venture; (2) allow for an arms-length relationship between the content owner and the venture; (3) implement safeguards to prevent the sharing of confidential business information; (4) avoid terms that may be deemed to be per se illegal (that is, price-fixing provisions); (5) allow for independent licensing to third-party distributors by co-venturers; (6) avoid exclusive arrangements with the venture; and (7) adequately develop technology to facilitate the use of the Internet as a means of distribution. By emphasizing the procompetitive benefits of a given joint venture and avoiding any structural characteristics that provide for anticompetitive harm, content owners can legally achieve the benefits of a distribution joint venture.

CLARETT V. NATIONAL FOOTBALL LEAGUE

By Jocelyn Sum

Not all of professional sports' hotly contested moments have happened on the playing field. When Maurice Clarett, the star running back at Ohio State University (OSU), announced that he was ready to play in the National Football League (NFL) after only two college football seasons, the NFL eligibility rules ("eligibility rules") were the only obstacle standing in his way of declaring for the 2004 NFL draft. Clarett's lawsuit challenging the validity of the eligibility rules sparked controversies that cut right to the heart of the antitrust and labor laws.

Clarett claimed that the eligibility rules violated antitrust laws by forbidding him to practice and to profit from his calling. In its defense, the NFL claimed that since the labor market for NFL players is organized around a collective bargaining relationship that is provided for and promoted by the federal labor laws, the eligibility rules are immune from antitrust laws. The question, then, was whether a player's right to compete for a position in the NFL overrode the NFL's right to set the terms and conditions of players' employment so long as they arise out of a collective bargaining relationship with the players union. In other words, who wins when antitrust and labor laws collide on the playing field?

This year's *Clarett v. NFL*[1] marked a distinct split between the Second and Eighth Circuits regarding the relationship between antitrust and labor laws as they apply to the eligibility rules. At the district court level, Judge Shira Scheindlin followed an Eighth Circuit test for delineating when a practice falls outside of the labor laws and becomes subject to antitrust scrutiny. Applying this test, she upheld Clarett's claim that the eligibility rules violated the antitrust laws and declared him eligible to participate in the 2004 NFL draft. Given the Second Circuit's strong preference for the application of federal labor law over antitrust law, Judge Scheindlin's ruling was a bold move.

On appeal, however, the appellate court reversed the district court's judgment. Based on its own precedent and the Supreme Court's ruling in *Brown v. Pro Football, Inc.*, the Second Circuit concluded that the antitrust laws should invariably yield to the labor laws in the context of collective bargaining.[2] The NFL, therefore, could impose an eligibility restric-

1. 369 F.3d 124 (2d Cir. 2004) [hereinafter *Clarett II*].
2. 518 U.S. 231 (1996).

tion on players without the risk of antitrust liability because it arose out of a collective bargaining relationship between the NFL and its players. This disagreement between the district and appellate courts in the *Clarett* case underscores the current split between the Eighth and Second Circuits and the different policy choices they have made in deciding when—if ever—the antitrust laws apply to the labor laws.

This Note explores the dispute over the legality of the eligibility rules in the *Clarett* case in the broader context of the conflict between the Second and Eighth Circuits. Part I reviews the legal background of the case vis-à-vis the antitrust and labor laws, their intersection at the nonstatutory labor exemption, and the evolution of the split between the Second and Eighth Circuits. In Part II, the Note describes the facts and procedural background of the *Clarett* case. Finally, Part III examines the validity of the Second and Eighth Circuit approaches to the scope of the nonstatutory labor exemption in professional sports in light of recent Supreme Court precedent, and argues that the narrower standard espoused by the Eighth Circuit should prevail for policy reasons.

I. LEGAL BACKGROUND

Over the past few decades, federal labor and antitrust laws have frequently clashed in the courts. As a result, the Supreme Court has created a nonstatutory labor exemption that protects certain collective bargaining agreements from antitrust scrutiny. The ongoing questions are when does the exemption apply and for which agreements?

A. Antitrust Law: A Potential Limitation on the Collective Bargaining Relationship

The purpose of federal antitrust law is to prohibit unreasonable restraints on competition.[3] Since section 1 of the Sherman Act, if read literally, would condemn many legitimate and essential business practices,[4] the Supreme Court has interpreted section 1 as prohibiting only unreasonable restraints of trade.[5] Under this "rule of reason" approach, courts addressing antitrust claims have had to expend extensive judicial time and resources in order to determine the reasonableness of an alleged restraint

3. *See* Standard Oil Co. v. United States, 221 U.S. 1, 58-60 (1911).

4. *See* 15 U.S.C. § 1 (2000) (providing that "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."); *see also* LAWRENCE A. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 165-166 (1977) (virtually any type of contract will restrain trade in some way).

5. *See Standard Oil*, 221 U.S. at 58-60.

of trade.[6] The exhaustive analysis requires the court to consider the history, purpose and effect of the restraint;[7] the existence of less restrictive alternatives to achieve legitimate, pro-competitive objectives;[8] and the balance of procompetitive and anticompetitive effects.[9]

Though the rule of reason generally governs antitrust claims, the Supreme Court has recognized that some practices are so unreasonable and anticompetitive that they can be deemed illegal per se, without an elaborate inquiry into their justifications.[10] These business practices may include price fixing,[11] market allocation,[12] group boycotts,[13] and tying arrangements.[14] Many labor practices, however, fall into the rule of reason realm, and among them are agreements reached through collective bargaining.

B. Labor Law: A Potential for Expansion of the Collective Bargaining Relationship

Congress enacted the National Labor Relations Act (NLRA) in 1935 to aid and encourage the collective bargaining process, a policy goal it deemed important to promote the free flow of commerce by quelling industrial strife.[15] The NLRA obligates the union and employer to bargain in good faith with respect to "wages, hours, and other terms and conditions of employment," commonly referred to as the mandatory subjects of collective bargaining.[16] Thus the union, acting as the exclusive representative of all employees, secures the standardization of employment terms for employees. Although some will be better off as a result, such standardization of terms will hinder others from acquiring a better individual bargain.[17] The NLRA, however, requires that the individual sacrifice for the good of the whole.[18] By pooling their economic strength and acting solely

6. *See* Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918).
7. *See id.*
8. *See* Smith v. Pro Football, Inc., 593 F.2d 1173, 1187-89 (D.C. Cir. 1978).
9. *See id.* at 1188-89.
10. N. Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958).
11. *See* United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).
12. *See* United States v. Topco Assocs., Inc., 405 U.S. 596 (1972).
13. *See* Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959); Fashion Originators' Guild v. FTC, 312 U.S. 457 (1941).
14. *See* Int'l Salt Co. v. United States, 332 U.S. 392 (1947).
15. 29 U.S.C. § 151 (2000).
16. *Id.* § 158(d); Local Union No. 189, Amalgamated Meat Cutters v. Jewel Tea Co., 381 U.S. 676, 685 (1965).
17. Michael S. Jacobs & Ralph K. Winter, Jr., *Antitrust Principles and Collective Bargaining by Athletes: Of Superstars in Peonage*, 81 YALE L.J. 1, 9 (1971).
18. *Id.*

through a labor organization freely chosen by the majority, employees will exact greater benefits as a group.[19]

Another important cornerstone of national labor policy is the freedom of contract.[20] According to the NLRA, "[the duty to bargain] does not compel either party to agree to a proposal or require the making of a concession."[21] A related principle to the freedom of contract is government noninterference in the collective bargaining process. The NLRA specifically authorizes the courts to ensure that the parties abide by the rules by not engaging in unfair labor practices.[22] Aside from this limited role, the government is prohibited from interfering in the substance of the negotiations or in writing contract terms.[23]

C. The Labor Exemption: Where Labor Law Meets Antitrust Law

The Supreme Court created the nonstatutory labor exemption in *Local Union No. 189, Amalgamated Meat Cutters v. Jewel Tea Co.*[24] in an attempt to accommodate the conflicting policies behind antitrust law, which favors unfettered economic competition in the labor market, and federal labor law, which favors organization of labor to eliminate competition.[25] Designed to recognize the primacy of collective bargaining in the workplace, the exemption fully shields otherwise anticompetitive conduct from antitrust scrutiny when an employee representative and an employer collectively bargain in good faith over the conduct. The exemption is based on the premise that since those who are affected by the agreement have consented to such restraints, the antitrust laws should not subvert their intentions. Still, those restraints that are unreasonable will not be exempt

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19. NLRB v. Allis-Chalmers Mfg. Co., 388 U.S. 175, 180 (1967).

20. *See generally* HARRY H. WELLINGTON, LABOR AND THE LEGAL PROCESS 49-90 (1968).

21. 29 U.S.C. § 158(d).

22. For the exclusive list of what constitutes an unfair labor practice, see 29 U.S.C. § 158.

23. *See* H.K. Porter Co. v. NLRB, 397 U.S. 99, 108 (1970).

24. 381 U.S. 676, 689 (1965) (applying the exemption to a collective bargaining agreement to "accommodat[e] the coverage of the Sherman Act to the policy of the labor laws").

25. *See* 15 U.S.C § 1-2 (2000); 29 U.S.C § 151; N. Pac. Ry. Co. v. United States, 356 U.S. 1, 4 (1958) ("The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade."); Archibald Cox, *Labor and the Antitrust Laws—A Preliminary Analysis,* 104 U. PA. L. REV. 252, 254 (1955) ("The purpose and effect of every labor organization is to eliminate competition in the labor market."); Bernard D. Meltzer, *Labor Unions, Collective Bargaining, and the Antitrust Laws*, 32 U. CHI. L. REV. 659, 659 (1965).

from antitrust scrutiny.[26] For example, in *Jewel Tea*, the Supreme Court noted that it was illegal to contractually force employers to charge a certain price for their products, despite being collectively bargained for with the intent of increasing wages of union members.[27]

While the Supreme Court has considered the labor exemption on many occasions, its decisions do not provide a clear statement of the proper scope of the exemption.[28] Since there are no congressional guidelines to direct the interpretations of courts, courts exercise considerable discretion in defining the limits of the exemption.

D. The Circuit Split

When the Eighth Circuit took the lead in determining the precise boundaries of the nonstatutory labor exemption by crafting a three-part test, the majority of courts facing player restraint claims also followed the same test. However, the Second Circuit, disfavoring application of the antitrust laws to any agreements arising from a collective bargaining relationship, rejected such an approach and split from the majority of courts. Instead of resolving the current split, the Supreme Court, in its most recent treatment of the scope of the nonstatutory labor exemption, again avoided the task of drawing that boundary.

1. Evolution of the Eighth Circuit Standard: The Mackey *Test*

Beginning in the mid-1970s, *Mackey v. NFL*[29] became the standard used by most courts to decide labor exemption issues in professional sports cases involving player restraint claims.[30] The Eighth Circuit fashioned the three-pronged *Mackey* test from Supreme Court precedent to determine the situations in which the federal labor policy would prevail over antitrust laws, and when, therefore, an agreement restraining trade would be exempt from antitrust scrutiny. The first factor required that the restraint on trade primarily affect only the parties to the collective bargaining relationship.[31] Second, the agreement sought to be exempted had to

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26. *See Jewel Tea*, 381 U.S. at 693.

27. *See id.* at 688-89.

28. JOHN C. WEISTART & CYM H. LOWELL, THE LAW OF SPORTS 525 (1979).

29. 543 F.2d 606 (8th Cir. 1976), *cert. dismissed*, 434 U.S. 801 (1977).

30. *See, e.g.*, Powell v. NFL, 930 F.2d 1293 (8th Cir. 1989); Wood v. Nat'l Basketball Ass'n, 809 F.2d 954, 962 n. 6 (2d Cir. 1987) (arriving at a similar conclusion although on somewhat different grounds than *Mackey*); Zimmerman v. NFL, 632 F. Supp. 398, 403-04 (D.D.C. 1986); McCourt v. Cal. Sports, Inc., 600 F.2d 1193, 1197-98 (6th Cir. 1979).

31. *See Jewel Tea*, 381 U.S. at 688-89 (finding that an agreement which affected only the employer and its union was exempt from antitrust scrutiny); United Mine

concern a mandatory subject of collective bargaining, such as wages, hours, and other conditions of employment.[32] Finally, the agreement sought to be exempted had to be the product of bona fide arm's-length bargaining.[33]

In *Mackey*, a group of both active and retired NFL players alleged that the Rozelle Rule ("Rule"), which gave the commissioner discretionary power to award compensation to a team who lost a free agent if the agent's new and old teams could not agree on compensation, was an illegal restraint of trade denying professional football players the right to market their services freely.[34] The NFL defended on the ground that since the Rule was part of a collective bargaining contract with the players union, the nonstatutory labor exemption required that the agreement be immunized from antitrust scrutiny.[35] Applying the three-factored test to the facts in the case, the Eight Circuit found that the Rozelle Rule primarily affected the parties to the collective bargaining relationship and concerned a mandatory subject of bargaining, thus satisfying the first two prongs of the test.[36] The court nonetheless declined to apply the labor exemption after determining that the Rule was not the product of bona fide arm's-length bargaining.[37] The appellate court's review of the record revealed that there was insufficient evidence that the players received some quid pro quo in exchange for including the Rule in the collective bargaining agreement with the NFL club owners.[38] Thus, based on this third factor, the Eight Circuit concluded that the Rozelle Rule failed to qualify for the nonstatutory labor exemption, and invalidated the Rule on antitrust grounds.[39]

Since the inception of the three-part *Mackey* standard, the majority of courts have applied the *Mackey* test in subsequent sports litigation cases

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Workers v. Pennington, 381 U.S. 657, 665 (1965) (finding that a union forfeited its exemption when it agreed with employers to impose a wage scale on other bargaining units).

32. *See Jewel Tea*, 381 U.S. at 689-90 (exempting an agreement involving a marketing-hours restriction from antitrust scrutiny because marketing hours are so intimately related to wages, hours, and working conditions); *Pennington*, 381 U.S. at 664 (recognizing that a wage agreement dealt with a subject about which employers and union are required to bargain);

33. *See Jewel Tea*, 381 U.S. at 689-90.

34. *Mackey*, 543 F.2d at 609.

35. *Id.* at 612.

36. *Id.* at 615.

37. *Id.* at 615-16.

38. *Id.* at 616.

39. *Id.* at 621-22.

involving challenges to player restraint rules on antitrust grounds.[40] With *Clarett*, however, the Second Circuit completed a break from the majority of courts begun three decades before.

2. *Evolution of the Second Circuit Standard: The* Laborers' International Union *Test*

Whereas the Eighth Circuit test draws out the boundaries delineating where the antitrust laws can override the labor laws, the Second Circuit view stresses the irrelevancy of the antitrust dilemma altogether.[41] The beginnings of the Second Circuit approach were formulated in an influential 1971 *Yale Law Journal* article, which asserted that the advent of collective bargaining between professional sports leagues and players signaled an important change in the legal landscape: Now federal labor policy, rather than antitrust law, would be the primary and preeminent legal force shaping employment relationships in professional sports.[42] Simply because certain agreements operate as a restraint of trade does not justify interference by the courts and repudiation of the preference for collective bargaining.[43] Thus, the players, who have elected to invoke a labor law remedy through collective bargaining, should not be allowed the benefit of the antitrust law as well.[44]

Despite the article's recognition nationwide, courts nonetheless ignored the arguments presented in the article for over a decade.[45] It was not until the Second Circuit decisions in *Wood v. National Basketball Ass'n*,[46] *National Basketball Ass'n v. Williams*,[47] and *Caldwell v. American Basketball Ass'n*[48] that the article's views were adopted by any court. These three Second Circuit cases all involved players' claims that the concerted

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40. *See, e.g.*, Powell v. NFL, 930 F.2d 1293, 1298-99 (8th Cir. 1989); Zimmerman v. NFL, 632 F. Supp. 398, 403-04 (D.D.C. 1986); McCourt v. California Sports, Inc., 600 F.2d 1193, 1197-98 (6th Cir. 1979).

41. Jacobs & Winter, *supra* note 17, at 1 (noting that the antitrust dilemma in professional sports league practices is "an issue whose time has come and gone, an issue which has suffered that modern fate worse than death: irrelevancy").

42. *See id.* at 6.

43. *See id.* at 10-13.

44. *See id.* at 13.

45. *See* Gary R. Roberts, *Reconciling Federal Labor and Antitrust Policy: The Special Case of Sports League Labor Market Restraints*, 75 GEO. L.J. 19, 89 n.321 (1986) (noting that although the article was cited generally in several player restraint cases, it was either for other propositions or to acknowledge its position without commenting on or evaluating its merits).

46. 809 F.2d 954 (2d Cir. 1987).

47. 45 F.3d 684 (2d Cir. 1995).

48. 66 F.3d 523 (2d Cir. 1995).

action of a professional sports league imposed a restraint upon the labor market for players' services in violation of antitrust laws.[49] In reaching its conclusion that the nonstatutory labor exemption overcame the players' claims in each case, the Second Circuit relied on federal labor law, which governed the collective bargaining relationship between the players and the leagues.[50] To permit the players to challenge the restraints on antitrust grounds, the court reasoned, would seriously undermine the various policies contained in the labor laws, including the congressional policy favoring collective bargaining, bargaining parties' freedom of contract, and the use of multi-employer bargaining units.[51]

The Second Circuit formally laid out its test for the application of the nonstatutory labor exemption to collective bargaining agreements in 1988 in *Laborers' International Union*:[52]

> First, the agreement at issue must further goals that are protected by national labor law and that are within the scope of traditionally mandatory subjects of collective bargaining. Second, the agreement must not impose a "direct restraint on the business market [that] has substantial anticompetitive effects, both actual and potential, that would not follow naturally from the elimination of competition over wages and working conditions [that results from collective bargaining agreements]."[53]

Though the Second Circuit's test had long differed from that used by the majority of federal courts, the distinction was not sufficiently pronounced to be termed a circuit split until the decision in *Clarett*.

3. Brown v. Pro Football: *The Supreme Court's Most Recent Examination of the Scope of the Nonstatutory Labor Exemption*

The Supreme Court once again took on the issue of the scope of the nonstatutory labor exemption in *Brown v. Pro Football, Inc.* in 1996.[54]

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49. *Clarett II*, 369 F.3d 124, 134-35 (2d Cir. 2004) (summarizing the Second Circuit's prior decisions in *Wood*, *Williams*, and *Caldwell*).

50. *Id.* at 135.

51. *Id.*

52. Local 210, Laborers' Int'l Union v. Labor Relations Div. Associated Gen. Contractors, 844 F.2d 69 (2d Cir. 1988).

53. *Id.* at 79-80 (citations omitted). The Second Circuit's test is an elaboration of the *Jewel Tea* balancing test weighing the "interests of union members" served by the restraint against "its relative impact on the product market." *See Clarett II*, 369 F.3d at 132 (quoting Local Union No. 189, Amalgamated Meat Cutters v. Jewel Tea Co., 381 U.S. 676, 690 n.5 (1965)).

54. 518 U.S. 231 (1996).

However, rather than resolving the burgeoning circuit split, the Court's failure to acknowledge either the Second or Eighth Circuit tests only served to deepen the divide.

Brown involved the issue of whether the NFL could claim that the nonstatutory labor exemption shielded its unilateral implementation of a wage scale on a class of professional football players from antitrust attack.[55] At the district court level, the judge rejected the NFL's claim of exemption from the antitrust laws and awarded the players over $30 million.[56] On appeal, however, the D.C. Circuit reversed, interpreting the labor laws as "waiving antitrust liability for restraints on competition imposed through the collective bargaining process, so long as such restraints operate primarily in a labor market characterized by collective bargaining."[57] The Supreme Court affirmed the appellate court's conclusion that the nonstatutory labor exemption applied to the NFL's wage implementation and thereby immunized its conduct from antitrust scrutiny.[58]

Although the Supreme Court came to the same conclusion as the appellate court, it disagreed with how broadly the lower court interpreted the scope of the nonstatutory labor exemption.[59] Whereas the appellate court expanded the scope of the exemption to include any restraints on competition imposed through collective bargaining process, the Supreme Court was much more reluctant to insulate from antitrust review every employer's joint imposition of terms made in the so-called collective bargaining context.[60] The Court noted, for example, that the labor exemption should not shield those agreements among employers that are "sufficiently distant in time and in circumstances from the collective bargaining process that a rule permitting antitrust intervention would not significantly interfere with that process."[61] Although the Supreme Court refused to specify exactly where that line should be drawn, it seemed to narrow the appellate court's broad reading of the scope of the exemption to those instances where the restraints "constitute an integral part of the bargaining process."[62]

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55. *Id.* at 234.
56. *Id.* at 235.
57. *Id.* (quoting Brown v. Pro Football, Inc., 50 F.3d 1041, 1056 (D.C. Cir. 1995)).
58. *Id.*
59. *Id.*
60. *See id.* at 250.
61. *See id.*
62. *See id.* at 239, 250.

II. THE *CLARETT* CASE

A. Factual Background

1. Maurice Clarett: The Freshman Phenom

In his debut as a true freshman[63] football player at OSU, Maurice Clarett made notable headlines in the sports media. During the 2002-2003 collegiate football season, Clarett became the first college freshman to open as starter at running back for OSU since 1943.[64] He led the team to an undefeated season, and scored the winning touchdown in a thrilling, double-overtime victory in the 2003 Fiesta Bowl to claim OSU's first national championship in thirty-four years.[65] As a result of Clarett's outstanding performance, he was named Big Ten Freshman of the Year and voted the best running back in college football by *The Sporting News*.[66]

However, Clarett did not return to play at OSU for a second year. Following a scandal in which he accepted thousands of dollars in improper benefits and then lied to National Collegiate Athletic Association (NCAA) and school investigators, OSU and the NCAA suspended Clarett prior to the start of the 2003-2004 football season.[67] At the end of the season, Clarett declared his interest in turning professional by entering the 2004 NFL draft.[68] Standing at six feet tall and weighing 230 pounds,[69] and

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63. A "true freshman" describes an athlete who plays at the varsity level in his or her first year of college. Many players are redshirted, or held out of games, during their first year to allow for further development. Justin M. Ganderson, *With the First Pick in the 2004 NFL Draft, the San Diego Chargers Select . . . ?: A Rule of Reason Analysis of What the National Football League Should Have Argued in Regards to a Challenge of its Special Draft Eligibility Rules Under Section 1 of the Sherman Act*, 12 U. MIAMI BUS. L. REV. 1, 2 n.3 (2004).

64. Clarett v. NFL, 306 F. Supp. 2d 379, 387 (S.D.N.Y 2004) [hereinafter *Clarett I*] (citing Affidavit of Maurice Clarett ("Clarett Affidavit") ¶ 4).

65. *Id.* (citing Clarett Aff. ¶ 10).

66. *Id.* at 387-88 (citing Clarett Aff. ¶ 11).

67. Associated Press, *That's a Wrap: Clarett Suspended for the Entire Season*, Sept. 10, 2003, *at* http://sportsillustrated.cnn.com/2003/football/ncaa/09/10/bc.fbc.ohiost.clarett.ap.

68. Clarett claimed that he wanted to declare for the 2003 NFL draft after his strong freshman season, *Clarett I*, 306 F. Supp. 2d at 388 (citing Clarett Aff. ¶ 12), but offered no reasons why he did not challenge the eligibility rules at that time. *Id.* (citing Clarett Aff. ¶ 12). Since it was unclear at the end of his suspended 2003-2004 season whether the NCAA would allow him to play during the next season, Clarett's suspension may have led, in part, to his decision to seek eligibility for the 2004 draft. *See id.* (citing Memorandum of Law in Support of Plaintiff's Motion for Summary Judgment at 9, *Clarett I*, 306 F. Supp. 2d 379 (S.D.N.Y. 2004) (No. 03 Civ. 7441 (SAS))).

69. *Id.* at 388.

given his numerous accomplishments as a freshman at OSU, no one doubted Clarett's ability to play in the NFL.[70] The only obstacle standing in his way was the NFL eligibility rules,[71] from which he found himself one season shy of the three necessary to declare for the NFL draft.[72]

2. *The NFL's Collective Bargaining Relationship with the Players Union*

Founded in 1920, the NFL today is composed of thirty-two member clubs and is the most successful professional sports league in the United States.[73] Representatives of each of the thirty-two teams comprise the National Football League Management Council (NFLMC), the exclusive bargaining representative of the NFL.[74] The NFL players are exclusively represented by the National Football League Players Association (NFLPA), a union that negotiates on behalf of the players to protect their rights under the Collective Bargaining Agreement (CBA).[75] The current CBA between the NFLMC and the NFLPA, which took effect on May 6, 1993 and governs through 2007, does not include the eligibility rules for the draft.[76]

The original eligibility rules were adopted in 1925 and precluded a player from joining the NFL unless four seasons had elapsed since his high school graduation.[77] In 1990, by a separate memorandum issued by the Commissioner of the NFL, the eligibility rules were relaxed to permit a player to enter the draft three full seasons after his high school graduation.[78] While the eligibility rules did not appear in the text of the current

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70. *See* David Kindred, *Let Clarett and Every Other Virtuoso Play*, SPORTING NEWS, Feb. 16, 2004, at 88; *Only Rare are Ready, According to Brown*, TIMES UNION, Feb. 6, 2004, at C7; A Conversation with Jim Brown, NFL.com, Nov. 19, 2003 (interview by Rich Eisen, Seth Joyner, and Terrell Davis with Jim Brown, Hall of Fame running back), *at* http://www.nfl.com/nflnetwork/story/6849446.

71. Every professional sports league has some form of eligibility requirements that prospective players must meet in order to enter the league. Eligibility requirements generally serve two purposes: (1) to reduce the number of athletes who may participate in any particular league to a manageable size while ensuring the highest level of play possible, and (2) to protect the health and integrity of high school and college athletic programs, which perform the important roles of developing the skills and national reputation of amateur players. *See* LIONEL S. SOBEL, PROFESSIONAL SPORTS AND THE LAW 418-20 (1977).

72. *Clarett I*, 306 F. Supp. 2d at 388.

73. *Id.* at 382-83.

74. *See id.* at 384.

75. *See id.*

76. *Clarett II*, 369 F.3d 124, 127 (2d Cir. 2004).

77. *Id.* at 126.

78. *Id.*

CBA, on May 6, 1993—the same day that the current CBA took effect—the NFLPA and the NFLMC executed a side letter acknowledging that the Constitution and Bylaws attached to the letter were referenced in the CBA.[79] These Bylaws cite to the version of the eligibility rules established in the Commissioner's 1990 memorandum.[80] It is this version of the eligibility rules that Clarett challenged.[81]

B. Procedural History

1. *The District Court's Ruling for Clarett Under the* Mackey *Test*

Clarett filed suit against the NFL in September 2003, and after limited discovery, both parties moved for summary judgment.[82] Clarett sought summary judgment on the merits of his antitrust claim.[83] The NFL, in turn, asked for summary judgment on its defenses that (1) Clarett lacked antitrust standing and (2) the eligibility rules were protected from antitrust scrutiny by the nonstatutory labor exemption.[84]

In February 2004, the district court granted summary judgment in favor of Clarett and ordered him eligible to enter the 2004 NFL draft.[85] First, Judge Scheindlin found that Clarett had sufficient standing to sue for antitrust purposes because his injury flowed from a policy that excluded all players in his position from selling their services to the NFL.[86] Next, relying on the Eighth Circuit's *Mackey* test, the district court rejected the NFL's argument that the eligibility rules were immune from antitrust scrutiny.[87] Judge Scheindlin found that the first prong of the *Mackey* test was not satisfied because Clarett could not be considered a party to the collective bargaining relationship when the eligibility rule requirements served to exclude him from the bargaining unit.[88] Second, she found that the eligibility rules did not concern a mandatory subject of collective bargaining because they did not make any reference to wages, hours, or conditions.[89] Judge Scheindlin then determined that the eligibility rules did not meet the third requirement because they did not clearly result from arm's-length

79. *Id.* at 128.
80. *Id.*
81. *Id.* at 128-29.
82. *Clarett I*, 306 F. Supp. 2d 379, 389 (S.D.N.Y. 2004).
83. *Id.*
84. *Id.*
85. *Id.* at 410-11.
86. *Id.* at 403.
87. *See id.* at 391-97.
88. *Id.* at 395.
89. *Id.* at 393-95.

negotiations between the NFL and its players union.[90] She noted that the current text of the CBA did not mention the eligibility rules and the NFL failed to submit any evidence that the rules evolved from the collective bargaining process.[91] Thus, based on the *Mackey* factors, Judge Scheindlin concluded that the nonstatutory labor exemption was not available to shield the eligibility rules from antitrust scrutiny.[92]

Lastly, the district court held that absent any shield, the eligibility rules were an unreasonable restraint of trade.[93] Since the NFL failed to offer any procompetitive justifications for the rules, Judge Scheindlin held that they violated the antitrust laws and, as such, could not preclude Clarett from entering the 2004 NFL draft.[94]

2. *The Appellate Court's Reversal*

On appeal, the Second Circuit reversed the district court's judgment and remanded the case with instructions to enter judgment in favor of the NFL, and vacated the district court's order designating Clarett eligible to enter the 2004 NFL draft.[95]

In reversing the district court's decision, the Second Circuit underscored the split with the Eighth Circuit by stating that it has never regarded the *Mackey* test as defining the appropriate boundaries of the nonstatutory labor exemption.[96] Instead, it relied on its own decisions in *Caldwell*, *Williams*, and *Wood*, which all rejected players' claims that a professional sports league had imposed an illegal restraint of trade on the labor market for players' services in violation of antitrust laws.[97] In each case the Second Circuit found that the nonstatutory labor exemption protected the league's player restraint rules from antitrust attack because the defendant leagues and their players were involved in a collective bargaining relationship.[98] In contrast to the *Mackey* test, which allowed for antitrust review of a collective bargaining relationship if all three elements of the test were not met, the appellate court reasoned in each case that subjecting such a relationship to antitrust scrutiny would subvert the federal

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90. *Id.* at 396-97.
91. *Id.*
92. *See id.* at 393-97.
93. *See id.* at 404-08.
94. *See id.* at 409, 411.
95. *Clarett II*, 369 F.3d 124, 143 (2d Cir. 2004).
96. *See id.* at 133 (citing Local 210, Laborers' Int'l Union v. Labor Relations Div. Associated Gen. Contractors, 844 F.2d 69, 80 (2d Cir. 1988), and U.S. Football League v. NFL, 842 F.2d 1335, 1372 (2d Cir. 1988)).
97. *Id.* at 134-35.
98. *Id.* at 135.

labor laws that governed collective bargaining.[99] Finding that the Supreme Court also used a similar analysis to arrive at the same result in *Brown*, the Second Circuit regarded its own precedent as consistent with *Brown*, while concluding that the *Mackey* test was not.[100]

The central issue, then, facing the Second Circuit was whether subjecting the eligibility rules to antitrust scrutiny would undermine fundamental principles of federal labor policy.[101] The court began its analysis by emphasizing that once a collective bargaining relationship was established between the NFLPA and the NFLMC, federal labor law implemented a set of rules, tribunals, and remedies to govern throughout the duration of the collective bargaining process.[102] It then evaluated each of Clarett's arguments to determine whether antitrust law should allow him to override this scheme established by federal labor law.

First, contrary to the district court, the Second Circuit found that the eligibility rules were mandatory bargaining subjects because they tangibly affected the wages and working conditions of current NFL players.[103] Second, although Clarett contended that the NFL clubs acted in an anticompetitive manner by agreeing among themselves to impose an arbitrary three-season criteria on all prospective players, the appellate court stated that in the context of collective bargaining federal labor law permitted multi-employer bargaining units to set the conditions for player employment.[104] Finally, the court addressed Clarett's claim that the absence of the eligibility rules from the CBA indicated that the rules were not the subject of collective bargaining.[105] Observing that the labor law policies "are not limited to protecting only terms contained in collective bargaining agreements,"[106] the Second Circuit stated that holding that a particular quid pro quo had to be proven in order to escape antitrust liability would completely disregard those policies. Based on the foregoing reasons, the Sec-

99. *See id.*

100. *See id.* at 134, 138.

101. *Id.* at 138.

102. *Id.* at 139. *See generally* 29 U.S.C. § 160 (2000).

103. *Clarett II*, 369 F.3d at 140 (recognizing that the draft is part of a mix of market restraints by which leagues and players unions set individual salaries in professional sports and that the draft's effect of reducing competition in the market for entering players preserves the job security of veteran players).

104. *Id.* at 141. "Such concerted action is encouraged as a matter of labor policy and tolerated as a matter of antitrust law." *Id.* (construing Nat'l Basketball Ass'n v. Williams, 45 F.3d 684, 693 (2d Cir. 1995)).

105. *Id.* at 142.

106. *Id.* (citing Brown v. Pro Football, Inc., 518 U.S. 231, 243-44 (1996), and Caldwell v. Am. Basketball Ass'n, 66 F.3d 523, 528-29 (2d Cir. 1995)).

ond Circuit concluded that allowing Clarett's antitrust suit to proceed would subvert fundamental federal labor laws.[107]

III. DISCUSSION

The NFL eligibility rules, like most player restraints in professional sports, are anticompetitive in nature and thus subject to antitrust laws. However, the Supreme Court created the nonstatutory labor exemption in *Jewel Tea*, and further developed it in *Brown*, to shield those agreements from antitrust scrutiny that comprise an integral part of the collective bargaining process. Since the Supreme Court left the precise boundaries of the exemption undefined, the majority of courts have followed the Eighth Circuit's three-part test set out in *Mackey*. But in *Clarett*, the Second Circuit marked a distinct split from the majority of courts.

The Second Circuit's core conflict with other circuits, however, does not seem to arise from their application of the first two prongs of the *Mackey* test to the context of collective bargaining over player restraint issues. Rather, the focus of the Second Circuit's opinion in *Clarett* was the third prong of the *Mackey* test, which requires that an agreement be the bona fide product of arm's-length bargaining in order to be exempt from the antitrust laws. The Second Circuit favored a broader labor exemption that is not limited to protecting only the terms contained in collective bargaining agreements, but also includes anything that the employers or the union *could have* brought to the table during the collective bargaining process.[108] In essence, the *Clarett* court established a "could-have-bargained-for" element to replace the third prong of the *Mackey* test.

In the professional sports context, the *Mackey* test should be adopted because leagues such as the NFL already enjoy unequal bargaining power over the players union, and this should serve to narrow, not enlarge the scope of the nonstatutory labor exemption. Moreover, *Clarett*'s broad exemption encourages players to decertify their unions in order to place their player restraint claims in the realm of antitrust laws—a result that subverts the very federal labor policies the exemption purportedly upholds.

A. The Circuit Split in Comparison to the Supreme Court Precedent in *Brown*

In keeping with its preference for the labor laws over the antitrust laws, the Second Circuit Court of Appeals applied a broad labor exemption when evaluating the legality of the NFL eligibility rules in *Clarett*.

107. *Id.* at 143.
108. *See id.* at 142-43.

Despite the fact that the eligibility rules are omitted from the text of the current version of the CBA, the Second Circuit still concluded that the nonstatutory labor exemption shielded the eligibility rules from antitrust attack since they arose out of the collective bargaining process.[109] In support for its position, the appellate court cited the Supreme Court's recent decision in *Brown* for the proposition that the exemption is "not limited to protecting only terms contained in collective bargaining agreements."[110] Rather, as the Second Circuit stated in *Clarett*, the reach of the exemption "extends as far as is necessary to ensure the successful operation of the collective bargaining *process*."[111]

While *Brown* is certainly consistent with the view that the labor exemption can apply beyond the explicit text of a collective bargaining agreement,[112] nowhere did the Supreme Court permit a stretching of the exemption to the extent that it encompasses anything that could possibly be the subject of collective bargaining between the parties, but was not actually bargained for. In fact, the Supreme Court explicitly rejected such a broad interpretation of the exemption in *Brown* because it failed to take into account those instances where agreements among employers to jointly impose terms on employees were sufficiently distant in time and in circumstance so as to warrant antitrust scrutiny.[113] Instead, the Court favored an application of the exemption to only those anticompetitive restraints that "constitute *an integral part* of the bargaining process."[114] Therefore, the *Clarett* court's broadening of the exemption to apply to anything that could have been bargained for in the collective bargaining context is not supported by the *Brown* decision.

In addition, although the Second Circuit found some support for its position in *Brown*, this interpretation does not preclude the Eighth Circuit's *Mackey* test from also being consistent with *Brown*. The Second Circuit used *Brown* to dispose of the *Mackey* test by interpreting *Mackey* too narrowly.[115] The third prong of the *Mackey* test, which states that the labor exemption applies when the agreement is the product of bona fide arm's-length bargaining, does not have to be so narrowly construed to mean that the exemption only protects the explicit terms contained within the collective bargaining agreement itself. Although an agreement made between

109. *See id.*
110. *Id.* at 142 (citing *Brown*, 518 U.S. at 243-44).
111. *Id.* at 142-43.
112. *Brown*, 518 U.S. at 243.
113. *See id.* at 235, 250.
114. *Id.* at 239 (emphasis added).
115. *Clarett II*, 369 F.3d at 134.

bargaining parties that later becomes formalized as a term of a collective bargaining agreement is certainly proof of arm's-length bargaining, it is by no means the only evidence of such bargaining.

For example, the history of the parties' collective bargaining relationship can be evidence of bona fide arm's-length bargaining. Although Judge Scheindlin determined that the NFL and players union engaged in no such bargaining, she did not come to this conclusion by merely looking at the text of the CBA, which made no reference to the eligibility rules. Instead, she went further by examining the history of the parties' collective bargaining relationship.[116] Aside from the fact that the eligibility rules were indirectly mentioned in a side letter to the CBA, Judge Scheindlin concluded that that the NFL offered no definitive evidence[117] that the eligibility rules "arose from, or [were] agreed to during, the process of collective bargaining,"[118] let alone attempted to show, as required by *Brown*, that the eligibility rules were an integral part of the bargaining process. Thus, even after conducting a broader examination that went beyond the text of the CBA, Judge Scheindlin did not find that the nonstatutory labor exemption applied to the eligibility rules.[119]

B. The Advantages of the *Mackey* Test

As the foregoing discussion suggests, both the Second and Eighth Circuits may find support for their respective approaches in the Supreme Court's decision in *Brown* depending on how narrowly or broadly they view the scope of the nonstatutory labor exemption. However, as a matter of policy, the Eighth Circuit's *Mackey* test represents the better choice for two reasons: The Second Circuit approach (1) intensifies the unequal bargaining relationship between employers and labor unions and (2) discourages collective bargaining by encouraging union decertification.

Under *Clarett*, the Second Circuit's dramatic broadening of the scope of the nonstatutory labor exemption to include anything that the parties could have possibly bargained for will disrupt the national labor policy favoring free and private collective bargaining. First, such an approach tips the scales in favor of the employer, in this case the NFL, which al-

116. *See Clarett I*, 306 F. Supp. 2d 379, 396 (S.D.N.Y. 2004).

117. The NFL offered no evidence that the eligibility rules were addressed during any collective bargaining negotiations prior to 1993, which is when the current CBA went into effect. *Id.* The only proof that the eligibility rules, which were contained in the Bylaws, might have been addressed in 1993 is the reference in the CBA that the "NFLPA *waived* . . . its rights *to bargain* over any provision of the Constitution and Bylaws." *Id.* (emphasis added).

118. *Id.*

119. *See id.*

ready has the upper hand in negotiations with the players union.[120] The NFL possesses both monopoly and monopsony power.[121] Two other professional football leagues, the World Football League and the United States Football League, were unable to compete with the NFL and were driven from the professional football league market in 1975 and 1986, respectively.[122] While there are three other professional football leagues in North America in existence today—the Arena Football Leagues, the National Indoor Football League and the Canadian Football League—the NFL indisputably dominates in terms of both revenues and television ratings.[123] Not only does the NFL outperform all professional football leagues, it outperforms all other professional *sports* leagues as well.[124] Consequently, the NFL does not have any real competitors in the market for aspiring professional football players' skills, nor is there an equivalent substitute that exists for the league's product.[125] Furthermore, the inherently weak bargaining position of players, a consequence of their lack of job security and brief work-life, only enhances the NFL's superior bargaining power.[126]

Given the existing lopsided bargaining relationship between the NFL and the players, the Second Circuit's broadening of the nonstatutory labor exemption to encompass policies that were not actually bargained for further increases this disparity and allows the NFL to impose its terms on players unilaterally. The league has no incentive to bring player restraints

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120. *See* Chris L. Dickerson, Note, Brown v. Pro Football, Inc.—*The Nonstatutory Exemption From Antitrust Liability Becomes a Management Weapon*, 1997 WIS. L. REV. 1047, 1074.

121. *Id.* at 1073; Ethan Lock, *The Scope of the Labor Exemption in Professional Sports*, 1989 DUKE L.J. 339, 356. Monopoly power is the "power to control prices or to exclude competition. The size of the market share is a primary determinant of whether monopoly power exists." BLACK'S LAW DICTIONARY 1028 (8th ed. 2004). A monopsony is defined as a "market situation in which one buyer controls the market." *Id.* Restraints on input markets (i.e., labor markets) where a monopsony exists violate antitrust laws because potential employees have no other options when deciding where to work. Dickerson, *supra* note 120, at 1072.

122. Lock, *supra* note 121, at 356; Peter Bonventre, *Thrown for a Loss*, NEWSWEEK, Nov. 3, 1975, at 56; The History of the USFL 1982-1986, *at* http://www.remembertheusfl.8m.com/history.html (last visited Feb. 7, 2005).

123. *Clarett I*, 306 F. Supp. 2d at 383.

124. *Id.*

125. Dickerson, *supra* note 120, at 1073; Locke, *supra* note 121, at 357.

126. Locke, *supra* note 121, at 354-56. The average career for an NFL player is about three and one-half seasons. National Football League Players Association, How long do most NFL careers last?, *at* http://nflpa.org/aboutus/main.asp?faq=ALL&subPage=InfoForNFLHopefuls (last visited Jan. 23, 2005). Players generally leave the NFL because of injury, self-induced retirement, or being cut by the team. *Id.*

or other anticompetitive practices to the bargaining table if it knows that those policies will invariably be exempted by the courts, regardless of whether they were negotiated for or not. Players will thus have little choice but to accept any and all unfavorable terms that the NFL wishes to thrust upon them. Although the NFL may argue that requiring the parties to bargain over every little issue will make the collective bargaining process overly burdensome, it is important for parties to negotiate particularly for those policies that have the most anticompetitive effects on the labor market. Indeed, the Supreme Court has affirmed that there are limits to the collective bargaining process, and simply because an employer and the union must bargain does not mean that the agreement reached may disregard other laws.[127]

Second, as demonstrated by the series of events following the Eighth Circuit's *Powell v. NFL* decision,[128] the Second Circuit's broadening of the scope of the nonstatutory labor exemption may actually encourage the union to decertify rather than resort to the collective bargaining process. In *Powell*, a group of professional football players challenged various player restraint rules on antitrust grounds after the players union and the NFL had reached an impasse in negotiations.[129] Applying the *Mackey* test, the district court held that the nonstatutory labor exemption shielded the player restraints from antitrust attack, but only until the parties reached a bargaining impasse on those issues.[130] On appeal, however, the Eighth Circuit broadened the scope of the labor exemption to protect the player restraint rules even beyond an impasse in negotiations.[131] The Eighth Circuit's holding meant, therefore, that so long as the NFLPA and the NFLMC maintained some sort of an ongoing collective bargaining relationship, the labor exemption would always shelter any illegal restraints of trade from antitrust scrutiny.[132]

After the *Powell* decision, the players were left with two unsavory choices: to accept the NFL's anticompetitive league practices to which they never agreed, or to decertify the players union to allow players to invalidate the NFL's labor exemption defense and pursue their antitrust

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127. United Mine Workers v. Pennington, 381 U.S. 657, 665 (1965) (holding that "a union forfeits its exemption from the antitrust laws when it is clearly shown that it has agreed with one set of employers to impose a certain wage scale on other bargaining units").

128. 930 F.2d 1293 (8th Cir. 1989).

129. *Id.* at 1295.

130. Powell v. NFL, 678 F. Supp. 777, 788-89 (D. Minn. 1988).

131. *Powell*, 930 F.2d at 1303.

132. *See id.* at 1303.

rights.[133] Unsurprisingly, the players chose the latter option—a move "invited by the *Powell* decision and . . . designed unabashedly to end the 'ongoing collective bargaining relationship' between the NFL and NFLPA."[134] After being released from the collective bargaining relationship, eight football players immediately filed an antitrust suit against the NFL for its first refusal/compensation system in *McNeil v. NFL*.[135] In the absence of the labor exemption defense, the court concluded that the NFL's system violated the antitrust laws and awarded the players damages of $1.63 million.[136]

The *Powell* and *McNeil* cases illustrate a crucial point: The most successful recourse professional football players have when courts apply a broad labor exemption is to decertify and abandon the collective bargaining process altogether rather than to give the NFL an endless right to circumvent the antitrust laws. Indeed, shielding anticompetitive restraints from antitrust review that merely could have been bargained for turns the labor exemption on its head and encourages it to be used against employees, rather than for their protection. While courts such as the Second Circuit in *Clarett* may claim that such a broad exemption is justified in order to protect the collective bargaining relationship, a look back at history demonstrates that it in fact only promotes the breakdown of relations between unions and employers.

IV. CONCLUSION

Although in *Clarett* the Second Circuit endorsed a broad application of the nonstatutory labor exemption, to hold that the NFL eligibility rules are protected from antitrust scrutiny simply because they arose out of the collective bargaining process between the NFL and the players does not comport with the goals of federal labor laws. Under the rule *Clarett* articulates, so long as players and prospective players alike are subject to a collective bargaining relationship with the more powerful NFL, the league can unfairly restrain them from successfully competing in the labor market for players' services. Players will then either be forced to submit to all of

133. *See* Powell v. NFL, 764 F. Supp. 1351, 1354 (D. Minn. 1991).

134. Robert A. McCormick, *Interference on Both Sides: The Case Against the NFL-NFLPA Contract*, 53 WASH. & LEE L. REV. 397, 415 (1996). "[T]he end result of the majority opinion is that once a union agrees to a package of player restraints, it will be bound to that package forever unless the union forfeits its bargaining rights." *Powell*, 930 F.2d at 1306 (Heaney, J., dissenting).

135. 790 F. Supp. 871 (D. Minn. 1992)

136. McNeil v. NFL, No. 4-90-476, 1992 U.S. Dist. LEXIS 21561 (D. Minn. Sept. 10, 1992).

the NFL's demands, even if unreasonably uncompetitive, or abandon the collective bargaining process that was supposed to aid them, all in the name of giving federal labor policy primacy over the antitrust laws. The *Clarett* case did not only represent a loss for prospective players who want to enter the NFL early, it signified an even greater loss for current NFL players. Perhaps Maurice Clarett will not be the only one sitting out this season.

BERKELEY TECHNOLOGY LAW JOURNAL
ANNUAL REVIEW OF LAW AND TECHNOLOGY

ENTERTAINMENT & CONSTITUTIONAL LAW

UNITED STATES V. MARTIGNON & KISS CATALOG V. PASSPORT INTERNATIONAL PRODUCTS: THE ANTI-BOOTLEGGING STATUTE AND THE COLLISION OF INTERNATIONAL INTELLECTUAL PROPERTY LAW AND THE UNITED STATES CONSTITUTION

By Angela T. Howe

The rock group The Grateful Dead is well-known for allowing and even encouraging its fans to make recordings of their live performances and distribute them to other fans, a practice commonly known as "bootlegging."[1] However, the ability to record and redistribute these bootlegged copies of live performances is not a legal privilege in cases where the artists have not authorized such behavior. In fact, the international intellectual property community has united in the last decade to eradicate such behavior. In accordance with the anti-bootlegging provisions of the international Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), the United States enacted the anti-bootlegging statute in 1994 that deems this behavior to violate the rights of the artist and declares bootlegging illegal.[2]

However, bootleggers may still have a viable defense to the anti-bootlegging laws based on two recent district court decisions that have held the anti-bootlegging statute unconstitutional: *United States v. Martignon*[3] and *KISS Catalog v. Passport International Products*.[4] On September 24, 2004, the Federal District Court for the Southern District of

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1. A list of 1,317 bands that permit fans to record their concerts is located on the website "Bands That Allow Taping", *at* http://btat.wagnerone.com/index.php (last visited Feb. 8, 2005).

2. 17 U.S.C. § 1101 (2000) (civil provision); 18 U.S.C. § 2319A (2000) (criminal provision). Even though there are two codifications of the anti-bootlegging statute, this Note will refer to both as "the anti-bootlegging statute" or "the statute."

3. 346 F. Supp. 2d 413 (S.D.N.Y. 2004).

4. 350 F. Supp. 2d 823 (C.D. Cal. 2004).

New York declared the criminal portion of the U.S. anti-bootlegging legislation unconstitutional for extending beyond Congress's legislative authority.[5] Specifically, the court ruled that the anti-bootlegging statute does not comply with the "Writings" for "limited Times" copyright protection restrictions in the Copyright Clause,[6] and that Congress may not circumvent these restrictions by relying on its alternative grants of power, such as the Commerce Clause and Necessary and Proper Clause.[7] Less than three months later, the Federal District Court for the Central District of California handed down a decision declaring the civil provision of the anti-bootlegging statute unconstitutional, following closely and citing heavily the rationale of the New York District Court.[8] These district court decisions seemingly conflict with Eleventh Circuit case law upholding the constitutionality of the anti-bootlegging statute and ruling that Congress can legitimately implement this legislation under its Commerce Clause power.[9]

The rulings in *Martignon* and *KISS* could have significant implications regarding the constitutional authority of the executive and legislative branches to make U.S. intellectual property law conform with international agreements. The rulings reflect the tension between Congress's power to implement copyright-like legislation and the ultimate strength of the Constitution's Copyright Clause. By showing great deference to the Copyright Clause with a strict construction of its limitations provisions, courts may work to the detriment of the United States' ability to fulfill its international treaty obligations.

Martignon and *KISS* are pivotal cases that highlight several timely copyright law issues. This Note explores both the constitutional issues raised by the anti-bootlegging statute in the domestic sphere, as well as the international law issues stemming from the tension between upholding the Constitution and honoring the United States' obligations to international agreements. Part I describes the anti-bootlegging statute itself, the international treaties that brought about its enactment, the critiques of the statute, and the potential constitutional authority for enacting the statute. Part II lays out the facts and the rationale of the *Martignon* and *KISS* cases. Part

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5. *Martignon*, 346 F. Supp. 2d at 417.

6. *Id.* at 423 ("Because the anti-bootlegging statute provides seemingly *perpetual protection* for *unfixed* musical performances, it runs doubly afoul of Congress's authority to regulate under the Copyright Clause.").

7. *Id.* at 427 & n.15.

8. *KISS*, 350 F. Supp. 2d at 829-836.

9. United States v. Moghadam, 175 F.3d 1269 (11th Cir. 1999), *cert. denied*, 529 U.S. 1036 (2000).

III discusses the possible alternatives for reconciling the anti-bootlegging statute with the Constitution by examining the possible rulings of the higher courts in considering the case on appeal and ways in which Congress might redraft the statute to comply with constitutional limits and international obligations.

I. BACKGROUND

A. The Anti-Bootlegging Statute

Though once the province of the states, regulation of bootlegging moved to the federal stage in 1994, as Congress sought to comply with the United States' international obligations and appease its foreign trading partners who believed the issue merited international harmonization. Bootlegging is defined as making or dealing in illicit goods such as unofficial recordings of copyrighted music.[10] Both the Eleventh Circuit in *United States v. Moghadam* and the *Martignon* court noted that "piracy" is distinct from "bootlegging." Whereas "piracy" refers to the duplication of a sound recording that has already been commercially released, "bootlegging" involves the duplication of a commercially unreleased performance.[11] Enacted in 1994, the anti-bootlegging statute provides that anyone who makes or distributes a fixation or broadcast of a live performance without the permission of the performer is subject to liability under the criminal and civil provisions of the statute. The civil provision is codified at 17 U.S.C. § 1101 and subjects offenders to the same civil remedies as those available for copyright infringement.[12] The criminal provision, 18 U.S.C. § 2319A, subjects violators to fines and possible prison time.[13] The criminal statute was the first to be addressed by the federal courts in two cases challenging its constitutionality—*Moghadam*[14] and *Martignon*.[15] Both courts considered the following portion of § 2319A:

> (a) Whoever, without the consent of the performer or performers involved, knowingly and for purposes of commercial advantage or private financial gain—

10. *See* Susan M. Deas, *Jazzing Up the Copyright Act? Resolving the Uncertainties of the United States Anti-Bootlegging Law*, 20 HASTINGS COMM. & ENT. L.J. 567, 573 (1998).

11. 175 F.3d at 1272 n.3; 346 F. Supp. 2d at 418 n.3.

12. 17 U.S.C. § 1101 (2000).

13. 18 U.S.C. § 2319A (2000).

14. 175 F.3d 1269.

15. 346 F. Supp. 2d 413.

> (1) fixes the sound or sounds and images of a live musical performance in a copy or phonorecord, or reproduces copies or phonorecords of such a performance from an unauthorized fixation;
>
> (2) transmits or otherwise communicates to the public the sounds or sounds and images of a live musical performance; or
>
> (3) distributes or offers to distribute, sells or offers to sell, rents or offers to rent, or traffics in any copy or phonorecord fixed as described in paragraph (1), regardless of whether the fixations occurred in the United States;
>
> shall be imprisoned for not more than 5 years or fined in the amount set forth in this title, or both . . . .[16]

The District Court for the Central District of California was then first to consider the constitutionality of the civil provision, which reads:

> (a) Unauthorized acts. Anyone who, without consent of the performer and performers involved—
>
> (1) fixes the sound or sounds and images of the live musical performance in a copy or phonorecord . . .
>
> (2) transmits or otherwise communicates to the public the sound or sounds and images of a live musical performance, or . . .
>
> (3) distributes or offers to distribute, sells or offers to sell . . . any copy or phonorecord fixed as described in paragraph (1) . . .
>
> shall be subject to the remedies provided in sections 502 through 505, to the same extent as an infringer of copyright.[17]

Before the enactment of the anti-bootlegging statute, the question of whether the law prohibits bootlegging was a matter of common law or state statute.[18] Although federal copyright law prohibited the copying of recorded musical performances through the Sound Recording Act of 1971,[19] there was no protection for live, unfixed performances. Under common law, musicians and record companies usually sought protection under the doctrine of unfair competition or unjust enrichment.[20] They

16. 18 U.S.C. § 2319A.

17. 17 U.S.C. § 1101.

18. Lee H. Rousso, *The Criminalization of Bootlegging: Unnecessary and Unwise*, 1 BUFF. INTELL. PROP. L.J. 169, 179 (2002).

19. Sound Recording Act of 1971, Pub. L. No. 92-140, 85 Stat. 391 (amended 1976). Before this act, early copyright statutes protected only the reproduction of musical notation rather than the reproduction of actual sound.

20. *See* Rousso, *supra* note 18, at 179. For example, Bob Dylan, Columbia Records, and his publishing company successfully obtained a restraining order against a pressing

could also obtain recourse under various state anti-bootlegging statutes, which were surprisingly non-uniform.[21]

B. The International Treaties that Give Rise to the Anti-bootlegging Statute

The enactment of the anti-bootlegging statute grew out of the United States' obligations under the Uruguay Round of trade negotiations under the General Agreement on Tariffs and Trade (GATT).[22] In 1994, the United States Congress enacted the Uruguay Round Agreements Act (URAA),[23] a comprehensive act dealing with matters of international trade, which was the United States' implementation of its obligations under TRIPs.[24] The United States was the leading proponent of TRIPs, which Professor David Nimmer describes as "the highest expression to date of binding intellectual property law in the international arena."[25] Sections 512 and 513 of the URAA correspond with the United States' civil and criminal anti-bootlegging provisions, respectively.[26] In passing the URAA and therefore inserting the anti-bootlegging statute into federal law, Congress extended federal protection against bootlegging in live performances for the first time in history and departed from its tradition of leaving this protection in the hands of the states.[27]

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plant manufacturing the Great White Wonder bootleg by relying on the doctrine of unfair competition and unjust enrichment. *See* Todd D. Patterson, *The Uruguay Round's Anti-bootlegging Provision: A Victory for Musical Artists and Record Companies*, 15 WIS. INT'L L.J. 371, 383-84 (1997).

21. Lionel S. Sobel, *Bootleggers Beware: Copyright Law Now Protects Live Musical Performances, But New Law Leaves Many Questions Unanswered*, 17 ENT. L. RPTR. 6 (1995) (explaining that the variations in state law lead to cumbersome and uncertain application of the law).

22. David Nimmer, *The End of Copyright*, 48 VAND. L. REV. 1385, 1389 (1995).

23. Pub. L. No. 103-465, 108 Stat. 4809 (1994).

24. Joseph C. Merschman, Note, *Anchoring Copyright Laws in the Copyright Clause: Halting the Commerce Clause End Run around Limits on Congress's Copyright Power*, 34 CONN. L. REV. 661 (2002). In April 1994, the United States was one of 111 nations to sign the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, and thereby adopting TRIPs. United States v. Martignon, 346 F. Supp. 2d 413, 414 (S.D.N.Y. 2004).

25. Nimmer, *supra* note 22, at 1391-92.

26. *See* Uruguay Round Agreements Act Pub. L. No. 103-465 §§ 512, 513, 17 U.S.C. § 1101 (2000), 18 U.S.C. § 2319A (2000).

27. Uruguay Round Agreements Act § 512, 17 U.S.C. § 1101, does, however, recognize the role that state law has played in regulating the practice of bootlegging and provides that the URAA's anti-bootlegging provisions do not preempt any remedies available to artists under state common law or statutory law.

Before TRIPs, most international intellectual property law was silent as to anti-bootlegging provisions.[28] The United States had signed three prior intellectual property treaties, the Universal Copyright Convention,[29] the Berne Convention,[30] and the Geneva Convention,[31] largely because their provisions were relatively limited.[32] The Rome Convention, on the other hand, was the first treaty to prohibit bootlegging.[33] The United States chose not to become a party because, in addition to prohibiting bootlegging, the Rome Convention also requires party states to give sound recording copyrights which would mandate that radio stations pay royalties to record companies or recording artists.[34] Nonetheless, United States adherence to TRIPs ushered in a policy change whereby the United States became obliged to meet Rome Covention standards as mandated by the TRIPs agreement. These include performers' rights and remedies for unauthorized fixations of their live performances.[35] TRIPs has been characterized as the most effective international copyright enforcement mecha-

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28. Robert M. Blunt, Comment, *Bootlegs and Imports, Seeking Effective International Enforcement of Copyright Protection for Unauthorized Musical Recordings*, 22 HOUS. J. INT'L L. 169, 176 (1999).

29. Enacted after World War II, the Universal Copyright Convention unfortunately lacked effectiveness in providing comprehensive copyright protection in the international arena. *See id.*

30. Administered by the World Intellectual Property Organization (WIPO), the Berne Convention sets a minimum standard for copyright protections, including recording rights, but also says nothing about bootlegging. *See* Blunt, *supra* note 27, at 176.

31. The Geneva Convention, largely redundant in providing similar protections as the Berne and Universal Copyright Conventions, is formally known as the Convention for the Protection of Producers of Phonograms of Unauthorized Duplication of their Phonograms, Oct. 29, 1971, 25 U.S.T. 309, 866 U.N.T.S. 67. *See* Blunt, *supra* note 28, at 176.

32. *See* Blunt, *supra* note 28, at 176.

33. The Rome Convention is formally known as the International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations, Oct. 26, 1961, 496 U.N.T.S. 44. Article 7, § 1, provides protection to artists against fixation, without their consent, of their unfixed performances. Currently, seventy-nine states are a party to the convention. *See* WIPO, Treatises and Contracting Parties, http://www.wipo.int/treaties/en/ip/rome/index.html (last visited Feb. 27, 2005).

34. Sobel, *supra* note 21, at 11.

35. Under TRIPs, all World Trade Organization (WTO) members must follow the Rome Convention for performance and neighboring rights. *See* Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND vol. 31, 22, I.L.M. 81, art. 1(3) (1994) [hereinafter TRIPs]; *see also* Deas, *supra* note 10, at 587-88 ("TRIPs incorporates most Berne provisions by reference and adopts Rome Convention standards for all signatories."); Blunt, *supra* note 28, at 186.

nism in existence for recording artists, record companies, and broadcasters concerned about bootleg recordings.[36] One reason for this perceived strength is that for the first time, TRIPs incorporated World Trade Organization (WTO) enforcement mechanisms and dispute settlement procedures to protect intellectual property rights.[37] For example, TRIPs article 4 invokes the Most-Favored Nation (MFN Treatment) provision which requires all WTO signatories to give reciprocal treatment of "any advantage, favour, privilege, or immunity" to all WTO members.[38] Thus, TRIPs effectively brings intellectual property law to the forefront of issues within the realm of international trade.

Moreover, the internationalization of intellectual property law is becoming more prevalent every day—on May 20, 2002, the United States became a party to the WIPO Performances and Phonograms Treaty (WPPT).[39] This treaty is even broader than TRIPs in the scope of its anti-bootlegging protections, including protection for artists' moral rights in live performances and a more expansive definition of the "performer" who merits this protection.[40]

C. Critiques of the Anti-bootlegging Statute

The anti-bootlegging statute has a number of critics who have noted its major flaws.[41] One criticism is that the provisions were not well thought out, as evidenced by their meager legislative history. Professor David Nimmer states that "[o]ne seeks in vain for evidence that anyone in Washington even considered the constitutional basis for these vitally important amendments to United States copyright law."[42] Furthermore, neither the

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36. Patterson, *supra* note 20, at 407-08; *see also* Nimmer, *supra* note 22, at 1392 ("Indeed, [TRIPs] embodies 'trade with teeth.'")

37. *See* TRIPs, *supra* note 35, art. 9.

38. *Id.* art. 4. ("With regard to the protection of intellectual property, any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members.")

39. World Intellectual Property Organization Performances and Phonograms Treaty, Geneva, Dec. 20 1996, 36 ILM 76 (1997). The United States Senate approved the treaty on October 21, 1998, and the treaty entered into force on May 20, 2002. Performances and Phonograms Treaty, *available at* http://www.wipo.int/treaties/en/ie/wppt/index.htm (last visited Feb. 27, 2005).

40. *See* Deas, *supra* note 10, at 595 (characterizing the WPPT as a "TRIPs-Plus" agreement).

41. *See generally* Nimmer, *supra* note 22; Ruosso, *supra* note 18; Dawn R. Maynor, Note, *Just Let the Music Play: How Classic Bootlegging Can Buoy the Drowning Music Industry*, 10 J. INTELL. PROP. L. 173 (2002); Merschman, *supra* note 24.

42. Nimmer, *supra* note 22, at 1409.

statute nor its legislative history make any mention of the doctrines of fair use, work made for hire, or statute of limitations, which form important bounds on the exclusive rights of copyright holders. The statute is also apparently retroactive[43] and not incorporated into the flow of the Copyright Act.[44]

Critics also contend that the statute does more harm than good. Those who advocate legalizing bootleg recordings note that such recordings are complements and not substitutes for the studio recordings.[45] For example, those who own bootlegs normally acquire them in addition to the studio manufactured copy, rather than as a replacement of the official version. Further, critics argue that the music industry can easily address the bootlegging problem by releasing live concert recordings, thereby fulfilling the demand for these works and eliminating incentives for unauthorized recording and distribution.[46] Critics of the statute also note that the legal restrictions are ineffectual considering the ease with which bootleggers can continue their practices.[47] Defenders of the anti-bootlegging statute, on the other hand, maintain that bootlegging causes significant loss of revenue to the artist and that the bootlegged copies do act as substitutes for the studio recordings, which therefore compete with the mainstream music sales.[48]

D. Constitutionality of the Statute: *Moghadam* and the More Recent Challenges

Without much mention of the policy issues surrounding the anti-bootlegging statute, the current litigation addresses a more fundamental question: its constitutionality. The question was previously adjudicated by the Eleventh Circuit in *United States v. Moghadam* in 1999, which upheld the statute in the face of a narrow constitutional challenge.[49] The more re-

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43. *Id.* at 1399-400. Note, however, that the criminal provision, 18 U.S.C. § 2319A(f) (2000), provides that applicability of this section occurs on or after the date of enactment of the Uruguay Round Agreement Acts, which was enacted December 8, 1994. This argument was also quashed in *Kiss*, where the court ruled that even though the unauthorized recording occurred before the time period covered by the statute, the current distribution of the concert footage is actionable. KISS Catalog v. Passport Int'l Prods., 350 F. Supp. 2d 823, 828-29 (C.D. Cal. 2004).

44. Nimmer, *supra* note 22, at 1399-400. The criminal provision is not even incorporated into Chapter 17 of the United States Code.

45. *See, e.g.*, Rousso, *supra* note 18, at 191.

46. *See id.* at 174 (noting that bootleg collectors continue to buy studio recordings which are usually released before the artist goes on tour and are of better quality); *see also* Patterson, *supra* note 20, at 417.

47. *See* Blunt, *supra* note 28, at 208.

48. *See id.* at 174.

49. 175 F.3d 1269 (11th Cir. 1999).

cent challenges are broader and require a deeper analysis of the constitutional authority underlying the law's enactment.

There are theoretically three constitutional sources of power under which Congress may enact a statute such as the anti-bootlegging law: the Copyright Clause, the Commerce Clause, and the Necessary and Proper Clause. The Copyright Clause states that Congress is empowered "to promote the Progress of Science and the Useful Arts, by securing for limited Times to Authors and Inventors the exclusive right to their respective Writings and Discoveries."[50] The Commerce Clause grants to Congress the power "to regulate Commerce with foreign Nations and among several States."[51] The Supreme Court generally has interpreted the broad scope of the Commerce Clause as empowering Congress to legislate regarding channels of interstate commerce, the subjects of interstate commerce, and intrastate activities that substantially affect interstate commerce.[52] Congress also passes laws pursuant to its treaty power as augmented by the Necessary and Proper Clause, which states "Congress shall have power . . . To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers."[53] This last clause is the most controversial source of congressional authority due to its inextricable tie to United States foreign affairs and diplomacy concerns.

Before the two 2004 cases, the only prior case law ruling on the constitutionality of the anti-bootlegging statute was *Moghadam*.[54] In that case, Ali Moghadam was convicted of violating the anti-bootlegging statute after he pled guilty to knowingly distributing, selling, and trafficking in bootleg recordings of live musical performances by artists such as Tori Amos and the Beastie Boys.[55] Moghadam moved to dismiss on the grounds that the statute was unconstitutional because it did not fall within the enumerated legislative powers of the Copyright Clause. The district court denied the motion to dismiss. The Eleventh Circuit also rejected Moghadam's challenge on the grounds of constitutionality and affirmed his conviction.[56]

The *Moghadam* court avoided the issue of whether the anti-bootlegging statute can be sustained under the Copyright Clause by confirming the constitutionality of the statute based on the congressional

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50. U.S. CONST. art. I, § 8, cl. 8.
51. U.S. CONST. art. I, § 8, cl. 3.
52. United States v. Lopez, 514 U.S. 549, 558-59 (1995).
53. U.S. CONST. art. I, § 8, cl. 18.
54. 175 F.3d 1269 (11th Cir. 1999).
55. *Id.* at 1271.
56. *Id.*

source of power found in the Commerce Clause.[57] Ruling that the anti-bootlegging statute regulates conduct that has a substantial effect on both commerce between several states and commerce with foreign nations, the court simply reasoned "[i]f bootlegging is done for financial gain, it necessarily is intertwined with commerce."[58]

In answering what the *Moghadam* court termed the "more difficult question," the court ruled that Congress can use its Commerce Clause power to pass the same legislation that may not have been explicitly permitted under the Copyright Clause.[59] The court reasoned that, despite being partially incorporated into Title 17, neither the civil nor criminal provision of the anti-bootlegging statute mesh with the overall structure of the copyright code.[60] The court concluded that "the protections that the anti-bootlegging statutes confer on musicians are best described as 'quasi-copyright' or *sui generis* protections."[61] In its analysis of the statute, the *Moghadam* court cited *Nimmer on Copyright* in describing the anti-bootlegging provisions created by the URAA as "hybrid" rights that in some ways resemble the protections of copyright law but in other ways are distinct from copyright.[62]

Additionally, the Eleventh Circuit distinguished between the affirmative requirements and negative limitations on the power granted by the Copyright Clause: the fixation requirement of the Copyright Clause, evident through the word "Writings," is an affirmative requirement in the clause, whereas "for limited Times," is a negative limitation regulating copyright protection. The court reasoned that the statute does not directly violate the affirmative fixation requirement of the Copyright Clause.[63] It

57. *Id.* at 1274 (citing U.S. CONST. art. I, § 8, cl. 3). The court "assumed without deciding" that the Copyright Clause would not provide Congress with the authority to protect these unfixed works. *Id.*

58. *Id.* at 1276. The court held that the anti-bootlegging statute passes the "substantial effects" test of the post-*Lopez* Commerce Clause jurisprudence. That is, bootlegging is done for financial gain and is necessarily intertwined with commerce between several states and with foreign nations. *Id.*

59. *Id.* at 1277-80 (citing Heart of Atlanta Motel v. United States, 379 U.S. 241, 250 (1964), for illustrating that the fact that legislation reaches beyond the limits of one grant of legislative power has no bearing on whether it can be sustained under another grant of power.)

60. *Id.* at 1273.

61. *Id.*

62. *Id.* at 1272-73 (citing 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8E.03[B][1] (1997)).

63. *Id.* at 1280-81 (setting up a "fundamentally inconsistent" test whereby "extending copyright protection in the instant case is not fundamentally inconsistent with the

explained that "the grant itself is stated in positive terms, and does not imply any negative pregnant that suggests that the term 'Writings' operates as a ceiling on Congress's ability to legislate."[64] Since the defense in the *Moghadam* case only advanced the fixation requirement in arguing against the constitutionality of the statute, the Eleventh Circuit did not have to address the constitutional question of the "for limited Times" durational limitation.[65] Based on this distinction, the Eleventh Circuit upheld the constitutionality of the anti-bootlegging statute under the Commerce Clause as an alternative to the Copyright Clause.[66]

As this Part demonstrates, the anti-bootlegging statute has a surprisingly complex background. In analyzing the statute, courts must consider the legislative intent behind its enactment, the international legal environment surrounding the statute, and its constitutional underpinnings.

II. CASE SUMMARIES: *MARTIGNON* AND *KISS*

After ten years of relatively quiet acceptance of the anti-bootlegging statute, the year 2004 delivered two cases ruling against the constitutionality of statute. *Martignon* was the first case to hold the criminal provision of the statute unconstitutional, and *KISS* followed three months later, holding the civil provision of the anti-bootlegging statute unconstitutional for largely the same reasons.

A. *United States v. Martignon*

Jean Martignon is the operator of Midnight Records, which sells music through its Manhattan store location, a catalog service, and an Internet site.[67] In September 2003, federal and state law enforcement agents acting in conjunction with the Recording Industry Association of America (RIAA) arrested Martignon for selling "unauthorized recordings of live performances by certain musical artists."[68] On October 27, 2003, Martignon was indicted by a federal grand jury for violation of 18 U.S.C. § 2319A.[69] The one count indictment provided no details as to the artists that Martignon allegedly bootlegged, the scope of the bootlegging, or the

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fixation requirement" and so the Commerce Clause could be used as an alternative to avoid the requirements of the Copyright Clause.)

64. *Id.*

65. *Id.* at 1282 n.17.

66. *Id.* at 1271.

67. United States v. Martignon, 346 F. Supp. 2d 413, 417 (S.D.N.Y. 2004).

68. *Id.* (quoting Indictment ¶ 1).

69. *Id.*

distribution of the bootlegged works. On January 15, 2004, Martignon moved to dismiss the one count indictment pursuant to Rule 12(b) of the Federal Rules of Criminal Procedure for failure to state an offense.[70]

Martignon challenged the anti-bootlegging statute on several constitutional grounds, most significantly arguing that because the statute regulates "live" performances for "unlimited" time periods, the statute exceeds the Copyrights Clause's authority to protect "Writings," which are defined as fixed pieces of work, for "limited Times."[71] Martignon also challenged the constitutionality of the statute based on its violation of the free speech protections of the First Amendment and its violation of the basic tenets of federalism.[72]

The district court granted the Martignon's motion to dismiss, holding the anti-bootlegging statute unconstitutional.[73] Specifically, the court upheld the first of Martignon's challenges to the constitutionality of the anti-bootlegging statute in finding that the anti-bootlegging statute is impermissible under the Copyright Clause. The court found that the statute comes under the purview of the Copyright Clause, that Congress must be subject to the limitations thereunder, and that *Moghadam* was a narrow holding that is distinguishable.[74]

1. *The Anti-bootlegging Statute Is Subject to the Copyright Clause*

Because the court considered the anti-bootlegging statute to be more like copyright law than a commercial regulation, it concluded that the statute fell under the purview of the Copyright Clause.[75] The court noted that the context of Congress's passage of the anti-bootlegging statute was to abide by the TRIPs agreement, whose subject matter dealt completely with intellectual property.[76] The court further reasoned that the wording, legislative history, and placement of the statute within the United States Code demonstrated that it was an exercise of Congress's Copyright Clause power.[77] The court highlighted that the civil provision of the statute "subjects bootleggers to civil remedies *under the Copyright Act*."[78] Since the Copyright Clause necessarily bears on the issue, the *Martignon* court held

70. FED. R. CRIM. P. 12(b).
71. 346 F. Supp. 2d at 417 (citing U.S. CONST. art. I, § 8, cl. 8).
72. *Id.* at 416-17.
73. *Id.*
74. *Id.*
75. *Id.* at 417.
76. *Id.* at 418.
77. *Id.* at 418-20.
78. *Id.* at 418.

that this copyright-like legislation could not escape the constraints therein.[79]

Since the court found that § 2319A allowed "*seemingly* perpetual protection for *unfixed* music performances," the statute violated both the fixation and durational limits prescribed by the Copyright Clause.[80] The government conceded that the live musical performances are not "Writings" as defined by Title 17. The court pointed out that the lack of a durational limitation was incongruent with the express limitation of copyright protection in the Constitution's "limited Times" wording which has been statutorily set at a term of the life of the author plus 70 years for all other provisions of the Copyright Act.[81] Therefore, the court held the anti-bootlegging statute to be an improper exercise of Congress's Copyright Clause Powers.

2. *Congress Cannot Side-Step the Copyright Clause*

Because the anti-bootlegging statute was "fundamentally inconsistent"[82] with the restrictions of the Copyright Clause, the *Martignon* court further ruled that Congress was not permitted to resort to another constitutional grant of authority, such as the Commerce Clause, in order to evade the limitations imposed by the Copyright Clause: "Congress may not do indirectly what it is forbidden to do directly."[83] The court assumed that the Commerce Clause or the Necessary and Proper Clause could have otherwise supported the legislation.[84]

The opinion relied on *Railway Labor Executives' Ass'n v. Gibbons*, where the Supreme Court ruled that Congress may not utilize its Commerce Clause authority to bypass the affirmative uniformity requirement of the Bankruptcy Clause of the Constitution.[85] Furthermore, the court rea-

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79. *Id.*

80. *Id.* at 420 (emphasis added).

81. *Id.*; *see* 17 U.S.C. § 302 (2000).

82. *Martignon*, 346 F. Supp. 2d at 427. The court noted the standard used in *United States v. Moghadam*, 175 F.3d 1269, 1289 (11th Cir. 1999), *cert. denied*, 529 U.S. 1036 (2000), that the Commerce Clause could not be used to avoid a limitation in the Copyright Clause if the use was "fundamentally inconsistent" with the Copyright Clause.

83. *Id.* at 424.

84. *Id.* at 425 n.14

85. *Id.* at 426 ("If we were to hold that Congress had the power to enact nonuniform bankruptcy laws pursuant to the Commerce Clause, we would eradicate from the Constitution a limitation on the power of Congress to enact bankruptcy laws.") (quoting Ry. Labor Executive Ass'n v. Gibbons, 455 U.S. 457, 468-69 (1982)). The court explained the analogy: "Just as Congress may not override the Bankruptcy Clause's limitation through reference to the Commerce Clause, Congress may not side-step the Copyright Clause's limitations through legislating under the Commerce Clause." *Id.*

soned that even when Congress may enact copyright-like legislation under other Constitutional grants of power, such legislation may not be "fundamentally inconsistent" with the fixation and durational limitations imposed by the Copyright Clause.[86]

3. *Divergence with the Eleventh Circuit's* Moghadam *Opinion*

The *Martignon* court began its discussion by noting that the Eleventh Circuit's decision in *Moghadam* was a narrow holding.[87] The key difference between the two cases was that the *Moghadam* defendant did not challenge the statute as unconstitutional under the "limited Times" provision in the Copyright Clause, instead only arguing that the "Writings" fixation requirement was not met because bootlegs were of live performances.[88]

On the other hand, the *Martignon* case dealt with a broader constitutional challenge, by bringing the issue of the durational requirement to the table. *Moghadam* ruled that because "Writings" is not an affirmative restriction in the Copyright Clause, it is not directly in conflict with the Constitution to pass such a statute. The "limited times" restriction of the Copyright Clause, however, provides that Congress may not grant indefinite or perpetual protection for the fruits of intellectual labor.[89] The anti-bootlegging statute states no specific duration for the term of protection granted to live performances and therefore is allegedly in violation of the Constitution. In contrast to the *Martignon* case, the defendant's challenge in the *Moghadam* case only covered the constitutionality of live music as a fixed work or "Writing."

The requirement that copyright protection afforded to authors (or performers in this case) only be granted for "*limited* times" is a more obvious affirmative limitation, which is concededly different from "Writings."[90]

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86. *Id.* at 428.

87. *Id.* at 417.

88. U.S. CONST. art. I, § 8, cl. 8 ("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.")

89. U.S. CONST. art. I, § 8, cl. 8.

90. The court in *Moghadam* held:

> that the Copyright Clause does not envision that Congress is positively forbidden from extending copyright-like protection under other constitutional clauses, such as the Commerce Clause, to works of authorship that may not meet the fixation requirement inherent in the term Writings. The grant itself is stated in positive terms, and does not imply any negative pregnant that suggests that the term 'Writings' operates as a ceiling on Congress's ability to legislate pursuant to other grants.

The *Martignon* court distinguished the narrow *Moghadam* ruling by stating, "[i]n concluding that the anti-bootlegging statute was not 'fundamentally inconsistent' with the Copyright Clause, the [*Moghadam*] Court did not consider the durational component."[91] The court further differentiated the issue at hand from the ruling in the Eleventh Circuit, noting that "[t]his Court is faced with a much broader challenge . . . to both the Copyright Clause's fixation and durational limitations."[92] Indeed, in *Moghadam*, the Eleventh Circuit noted that its ruling could well have come out differently if the defendant's objection to the statute was articulated on a broader scale.[93]

Both the *Moghadam* and *Martignon* courts seem to agree that the statute cannot be upheld under the Copyright Clause of the Constitution, but could otherwise conceivably be authorized by the Commerce Clause or perhaps the Necessary and Proper Clause.[94] *Martignon* builds upon *Moghadam*, using the "fundamentally inconsistent" test employed by *Moghadam* to strike down the statute based on the broader constitutional challenge at hand.[95]

B. *KISS Catalog v. Passport Int'l Prods.*

The constitutionality of the anti-bootlegging statute also arose in a suit by members of the iconic rock band, KISS, against Passport International Products, a California corporation involved in the distribution of DVDs for the allegedly unauthorized distribution of the KISS "Spirit of '76"

United States v. Moghadam, 175 F.3d 1269, 1280 (11th Cir. 1999), *cert. denied*, 529 U.S. 1036 (2000).

91. 346 F. Supp. 2d at 419. Another recent example of legislation clashing with the Copyright Clause's "limited times" provision is the Copyright Term Extension Act (CTEA). Critics argue that the CTEA achieves perpetual copyright "on the installment plan." *See* Graeme W. Austin, *Does the Copyright Clause Mandate Isolationism?*, 26 COLUM. J.L. & ARTS 17, 24 (2002). The U.S. Supreme Court held otherwise in *Eldred v. Ashcroft*, 537 U.S. 186 (2003).

92. 346 F. Supp. 2d at 419.

93. 175 F.3d at 1281, 1274 n.9, 1282 n.17 ("[O]ur holding in this case is further narrowed by the fact that we do not address potential arguments based on the 'Limited Times' requirement.").

94. *See* 175 F.3d at 1274-77; 346 F. Supp. 2d at 425 n.14.

95. Note that the scope of the *Martignon* holding is arguably broader than that of *Moghadam*. The *Moghadam* court seemed willing to strike down the statute based on constitutional challenges based on the durational requirement of the Copyright Clause. In contrast, the *Martignon* court was willing to strike down the statute as unconstitutional based on either the fixation or durational requirement. Therefore, the *Martignon* court enforced both the affirmative limitations and the normal requirements of the Copyright Clause.

concert footage.[96] In response to the copyright infringement and anti-bootlegging claims put forth by KISS, defendant Passport contended that a "Stock Footage License Agreement" allowed them to use the footage.[97] While the plaintiff's copyright infringement claim survived the defendants' motion to dismiss,[98] the Federal District Court for the Central District of California largely echoed the rationale of the *Martignon* opinion in deciding that the anti-bootlegging claim should be dismissed because the statute was unconstitutional.

The court agreed that the civil provision of the anti-bootlegging statute, just like the criminal provision of the statute in the *Martignon* decision: (1) was sufficiently copyright-like legislation; (2) was not a proper exercise of power under the Copyright Clause; and (3) that Congress may not resort to its legislative powers under the Commerce Clause because the statute is in direct conflict with limiting language of the Copyright Clause.[99] *KISS* is highly similar to *Martignon* in its constitutionality analysis, save for the fact that the California district court only ruled on the anti-bootlegging statute's conflict with the "limited times" provision of the Copyright Clause, while abstaining on the analysis of the fixation requirement.[100]

III. ANALYSIS: RECONCILIATION OF THE ANTI-BOOTLEGGING STATUTE WITH THE CONSTITUTION

Based on the rationale of *Martignon* and *KISS*, the incongruence between the anti-bootlegging legislation and the U.S. Constitution cannot stand. The Second and Ninth Circuits have the option of overruling these district court decisions, perhaps by reading a durational limitation into the statute[101] or by extending the rationale of the *Moghadam* court to allow the

96. Kiss Catalog v. Passport Int'l Prods., 350 F. Supp. 2d 823, 824-25 (C.D. Cal. 2004).

97. *Id.* at 825.

98. *Id.* at 827 ("The court holds that Plaintiffs' copyright infringement claim should not be dismissed since they have pled ownership of the copyright via the work-for-hire arrangement, registration of the copyright, and infringement by the Defendants.")

99. *Id.* at 829-31.

100. *Id.* at 832 ("Like the *Moghadam* court, *see* 175 F.3d at 1274, this Court will not attempt to reach a conclusion on this question. As further discussion will indicate, the Court finds other unconstitutional defects with § 1101.") The broader *Martignon* opinion held the statute unconstitutional because it violated both the fixation and durational limitations. United States v. Martignon, 346 F. Supp. 2d 413, 428 (S.D.N.Y. 2004).

101. Courts have previously exercised judicial restraint and deference to Congress in the area of intellectual property law. *See* Eldred v. Ashcroft, 537 U.S. 186 (2003) (deciding that the Copyright Term Extension Act, which enlarged the duration of copyrights by

anti-bootlegging statute to remain intact, thereby granting deference to the federal legislature to enact the statute according to the Commerce or Treaty powers afforded by the Constitution. Perhaps a better solution, hinted at by the *KISS* court, is for Congress to redraft the statute to include a durational limitation and/or state specifically which grant of Constitutional authority under which it is acting.

A. Granting Congressional Authority Outside of the Copyright Clause

The Courts of Appeals have many options on how to approach the constitutional challenge posed by the anti-bootlegging statute. First, the courts could overrule the district court holdings by simply stating that the anti-bootlegging statute does not fall within the purview of the Copyright Clause and therefore does not have to abide by its limitations. Thus, Congress could have legitimately passed the statute under the Commerce Clause or the Necessary and Proper Clause. This argument was summarily dismissed by the *Martignon* court, however, since courts repeatedly refer to the statute as "copyright-like" and since the civil provision is incorporated into the Copyright Act and relies upon other parts of the Act for instructions on remedies.[102] Nonetheless, the alternative argument exists that the statute is not copyright-like because it is not regulating "Writings" but objects of interstate commerce. As the *KISS* court pointed out, "it would seem that a live performance protected by § 1101 is not a fixed work. . . . Thus, one would be inclined to think that . . . live performances could not be regulated via the Copyright Clause."[103] If the statute does not come in under the Copyright Clause, then it is not bound by the clause's

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20 years, did not violate the First Amendment or the Copyright and Patent Clause of the United States Constitution); Moviecraft v. Ashcroft, 321 F. Supp. 2d 107 (D.D.C. 2004) (holding that Section 514 of the URAA does not overstep Congress's constitutional grant of power).

102. The government argues, circuitously, that because the anti-bootlegging statute regulates a subject matter, live performances, that is not copyrightable—by virtue of the lack of fixation and durational limitation—Congress was not bound by the Copyright Clause's restrictions. I find this argument to be wholly unconvincing. Congress is not bound by the Copyright Clause's limitations when it legislates in an unrelated field and enacts legislation for a purpose other than the one embodied in the Copyright Clause. However, when Congress enacts copyright or copyright-like legislation, for the purpose stated in the Copyright Clause, it is constrained by the Copyright Clause's boundaries.

346 F. Supp. 2d at 426 n.17

103. 350 F. Supp. 2d at 831. Despite noting this possibility, the court ultimately held that the statute does fall under the purview of the Copyright Clause.

limitations. Since these live performances are not "Writings," they do not have to be regulated as copyright and the courts could find the statutes easily accord with Congress's power under the Commerce or Treaty Clauses.

1. *The Commerce Clause*

The Commerce Clause offers Congress the ability to enact a wide range of regulatory laws. Congress has used the broad scope of this clause to legislate on a range of other concerns, including racial discrimination, environment, crime, safety, and, of course, trade.[104] Presumably, it is within Congress's Commerce Clause power to implement international trade agreements. In the case of the anti-bootlegging statute, there is little doubt that it is within the power of Congress under the the Commerce Clause to enact this legislation.[105] The Eleventh Circuit explicitly stated:

> The specific context in which [the anti-bootlegging statute] was enacted involved a treaty with foreign nations, called for by the World Trade Organization, whose purpose was to insure uniform recognition and treatment of intellectual property in international commerce. The context reveals that the focus of Congress was on interstate and international commerce.[106]

The pertinent international trade agreement is TRIPs, as enacted by the URAA. The anti-bootlegging statute also fulfills the United States's obligations under the WIPO Performances and Phonograms Treaty. According to Nimmer:

> The law that [enacts the Uruguay Round Agreement Act] amends the 1976 Act to extend past 'writings,' beyond 'limited times,' and to unpublished works. It mandates these revolutionary outcomes in order to bring U.S. law into conformity with the constraints of international *commerce* requisite to join the World Trade Organization. Therefore, although that 1994 enactment does not expressly invoke the Commerce Clause, its various heresies, if defensible, must find their justifications thereunder.[107]

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104. *See generally* GEOFFREY STONE ET AL., CONSTITUTIONAL LAW (4th ed. 2001).

105. Both cases involving the statute acknowledge that the Commerce Clause is a legitimate authority for the enactment of the anti-bootlegging statute. The *Martignon* opinion held that if the statute was not copyright-like in nature, it could have alternatively been legislated under the Commerce Clause. *See* discussion *infra* Part II.B.

106. United States v. Moghadam, 175 F.3d 1269, 1276 (11th Cir. 1999).

107. 1 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 1.09 (2004) (emphasis added).

The higher courts could rule that the statute escapes the purview of the Copyright Clause since it does not regulate "Writings,"[108] but is contemplated under the Commerce Clause authority of Congress.[109]

The WTO is the primary international organization dealing with the rules of trade between nations. Its mission is to facilitate commerce for producers of goods and services, exporters, and importers to conduct their business.[110] It is imperative to the financial interests of the United States that it remain a member in good standing of the WTO and be able to reap the benefits of the most-favored nation status, which stretches beyond the boundaries of international intellectual property law into all areas of trade. In this way, intellectual property law has become intertwined with international commerce, as evidenced by the significant involvement of the United States Trade Representative in intellectual property matters.[111] Therefore, the anti-bootlegging statute is necessary to bolster the U.S. national interest in international commerce, and it should be permissible under the Commerce Clause of the Constitution.

2. *The Necessary and Proper Clause*

A lesser explored alternative is Congress's power to enact the anti-bootlegging statute under its treaty power, which stems from the Necessary and Proper Clause of the Constitution. This treaty power authorizes Congress to implement legislation as a necessary and proper means of effectuating a treaty. While the *Moghadam* court mentioned this option of congressional authority, all three cases failed to explore it.[112] This Note contends that the treaty power is a viable source of authority for enacting the anti-bootlegging statute.

A controversial point as to whether Congress's treaty power could be a viable option is whether or not the anti-bootlegging obligations are actually part of a treaty to which the United States is an adherent. Nimmer maintains that the treaty power may not be used to enact the anti-bootlegging statute because:

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108. ROBERT P. MERGES ET AL., INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 336 (3d ed. 2003) ("[T]he definition of 'fixation' would exclude from the concept purely evanescent or transient [works] . . . .") (quoting H.R. Rep. No. 94-1476, at 52-53 (1976)).

109. *See Moghadam*, 175 F.3d 1269.

110. *See* WTO—What is the WTO?, *at* http://www.wto.org/english/thewto_e/whatis_e/whatis_e.htm (last visited Nov. 19, 2004).

111. *See* Office of United States Trade Representative, *at* http://www.ustr.gov (last visited Mar. 19, 2005).

112. 175 F.3d at 1281 n.13.

> The United States does not adhere to the Rome Convention. And Congress explicitly decided not to ratify any treaty when it enacted the Uruguay Round Agreements Act, concluding that all that needed to be done was accomplished by the domestic legislation. There is therefore no treaty on which to hang an invocation of treaty authority.[113]

On the contrary, the substantial body of international agreements adhered to by the United States containing anti-bootlegging provisions is a sufficient source in which to anchor Congress's treaty power. The United States was a leading proponent of the TRIPs agreement, and is an active member of the WTO and signatory of the WPPT. Even though TRIPs is not a formal treaty, it *implies* adherence to the Rome Convention.[114] Also the implementation of the anti-bootlegging legislation is part of U.S. obligations under the WTO, to which the United States must adhere in order to maintain its most-favored nation status with other trading partners of the WTO. Finally, and most convincingly, implementation of anti-bootlegging legislation is called for by the WPPT, to which the United States became a party in May 2002.[115] Article 6 of this treaty provides for exclusive rights of performers to authorize the broadcasting and communication of their unfixed performances to the public and the fixation of their unfixed performances.[116]

Congress or the President can invoke the treaty power even when the agreement is not an official treaty. Even though TRIPs was approved as a Congressional-Executive Agreement (requiring simple majorities of both Houses of Congress) as opposed to formal treaty ratification (requiring two-thirds of Senate approval), the Supreme Court has recognized that Congressional-Executive Agreements may "pass constitutional muster."[117] In fact, only approximately five percent of all the international agreements entered into by the United States are submitted to the Senate for advice

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113. 3 NIMMER & NIMMER, *supra* note 107, § 8E.05 (2004) (citations omitted).

114. *See* Blunt, *supra* note 28.

115. World Intellectual Property Organization Performances and Phonograms Treaty, Geneva, Dec. 20 1996, 36 I.L.M. 76 (1997); *see also supra* note 39.

116. Marian Nash, *Contemporary Practice of the United States Relating to International Law*, 92 AM. J. INT'L L., 44, 57-58 (1998) ("[The Article 6 provision] generally corresponds to the standards in the Rome Convention and the TRIPS Agreement.").

117. Made in the USA Found. v. United States, 56 F. Supp. 2d 1226 (N.D. Ala. 1999) (upholding the constitutionality of a Congressional-Executive Agreement); Peter S. Menell, *Economic Implications of State Sovereign Immunity from Infringement of Federal Intellectual Property Rights*, 33 LOY. L.A. L. REV. 1399, 1462 (citing United States v. Belmont, 301 U.S. 324, 331 (1937), which stated that international agreements are to be treated like treaties and given supremacy over state law).

and consent.[118] The President usually passes international agreements that explicitly or implicitly follow on to a prior treaty without obtaining further approval from the Senate.[119] The TRIPs obligations are part of a continuing body of integrated international intellectual property law that began over 100 years ago with the Berne Convention. The Constitution itself implies the validity of alternative types of international agreements,[120] and further, the practice of entering into international agreements while foregoing the formal treaty process is a long-standing tradition in U.S. history and reflects the practical accommodation of the mandates of foreign affairs. Finally, the URAA *did* receive two-thirds of the Senate's vote.[121] Thus, the URAA should be regarded as a legitimate implementation of treaty obligations.

Pursuant to the power of the Necessary and Proper Clause, Congress may sometimes enact required statutes by treaty that it would otherwise lack the authorization to pass. For example, in *Missouri v. Holland*, the Supreme Court found that the federal government could regulate migratory birds pursuant to a treaty, even though the statute was deemed unconstitutional because this matter was usually reserved for the states.[122] This case exemplifies the extensive power of the Necessary and Proper Clause—the Court validated a measure which was normally beyond Congress's power to enact because it was passed to give effect to a treaty.[123] By way of analogy to the case at hand, the treaty power of Congress should be sufficient to nullify its contravention with the Copyright Clause of the Constitution.

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118. CONGRESSIONAL RESEARCH SERV., LIBRARY OF CONGRESS, TREATIES AND OTHER INTERNATIONAL AGREEMENTS: THE ROLE OF THE UNITED STATES SENATE: A STUDY 39 (2001) (study prepared for the Committee on Foreign Relations, United States Senate), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=106_cong_senate_print&docid=f:66922.pdf. This trend is especially true for the past fifty years.

119. JOHN NORTON MOORE ET AL., NATIONAL SECURITY LAW ch. 18 (2d ed. 2004).

120. U.S. CONST. art. I, § 10, cl. 1 (such as agreements by "alliance," "confederation" and "compact"); *see also* LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 4-5 (3d ed. 2000).

121. *See* Deas, *supra* note 10, at 574.

122. 252 U.S. 416 (1920). *But see* Reid v. Covert, 354 U.S. 1 (1957) (plurality opinion) (ruling that treaties are also subject to constitutional limitations).

123. *See Holland*, 252 U.S. 416 (1920); *see also* Palila v. Haw. Dept. of Land & Natural Res., 471 F. Supp. 985, 995 (D. Haw. 1979) (holding that "the Tenth Amendment does not restrict enforcement of the Endangered Species Act, both because of the power of Congress to enact legislation implementing valid treaties and because of the power of Congress to regulate commerce").

When ruling on the legitimacy of the anti-bootlegging statute, the courts should exercise judicial deference because the treaty power bestowed upon the legislative and executive branches is especially broad in areas of foreign affairs and international commerce. Since the statute was implemented as part of an *international* trade agreement, the courts should be especially wary of nullifying these efforts containing political questions of foreign affairs.[124] For instance, Frances Fitzgerald and Professor John Yoo state that the judicial branch should avoid the business of treaty development and interpretation.[125] Fitzgerald and Yoo argue that both a formalist and functionalist interpretation of the Constitution mandate absolute deference to the President in the interpretation of treaties due to the executive's expertise in foreign affairs.[126] The Supreme Court has also recognized that the executive branch's interpretation of treaty deserves deference.[127] Furthermore, Congress's role in shaping foreign policy and power to regulate foreign commerce also demands judicial deference. Clearly, both the legislative and executive branches did not interpret this anti-bootlegging provision to be in contravention with the Constitution.

B. Redrafting the Statute to Conform with the Constitution

Regardless of what the Courts of Appeals decide, Congress has the option to amend the anti-bootlegging statute to rectify its current tension with the Constitution. There are at least two different ways Congress can redraft the statute so as to be in congruence with the constitutional mandates. One way is for Congress to expressly invoke its authority for implementing this legislation under the Commerce Clause or the Necessary and Proper Clause. The Commerce and Treaty powers would be sufficient to sustain the anti-bootlegging statute for all of the reasons addressed

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124. In general, the political question doctrine is most liberally employed in offering political autonomy to the non-judicial branches in areas of foreign affairs. "A controversy is non-justiciable—*i.e.*, involves a political question—where there is '. . . lack of judicially discoverable and manageable standards for resolving it.'" Nixon v. United States, 506 U.S. 224, 225 (1993) (citing Baker v. Carr, 396 U.S. 186, 217 (1962)). The Supreme Court has established that the conduct of foreign relations involves "considerations of policy . . . certainly entirely incompetent to the examination and decision of a Court of Justice." Ware v. Hylton, 3 U.S. (3 Dall.) 199, 260 (1796). Furthermore, the Supreme Court has been reluctant to hear cases involving the legality of executive actions, for example, in the Vietnam War. RICHARD H. FALLON, JR. ET AL., HART AND WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM 264 (5th Ed. 2003).

125. Frances Fitzgerald & John Yoo, *Politics as Law?: The Anti-Ballistic Missile Treaty, the Separation of Powers, and Treaty Interpretation*, 89 CALIF. L. REV. 851, 879 (2001).

126. *Id.* at 868-71.

127. *See* United States v. Stuart, 489 U.S. 353 (1989).

above.[128] This clarification would likely prevent courts from ruling the statute unconstitutional under the Copyright Clause, since the statute would explicitly be independent from the Copyright Clause and its limitations.[129]

Perhaps the most fitting solution to this constitutional dilemma is for Congress to amend the anti-bootlegging statute by adding a "limited Times" provision, which will presumably bring the statute in line with the affirmative limitations of the Copyright Clause.[130] Various proposals have been made to effectuate a "limited Times" provision.[131] For example, Congress could apply existing copyright duration provisions to the performer's rights in a live musical performance. Specifically, the legislature could mandate that live performances be treated as other copyrightable material and afforded the protection of life of the author plus 70 years.[132] The *KISS* court suggested as much in its discussion of the constitutionality of the statute.[133] Upon the suggestion by the plaintiff for the court to incorporate the terms for copyright contained in 17 U.S.C. § 302, the court answered that it was "unwilling to insert the statutory term of protection provided by § 302 without some indication that Congress had contemplated doing so at some point during its deliberation."[134] Further the California district court stated that incorporating § 302 into § 1101 was "much closer-to legislating an amendment to the United States Code than this Court is willing to venture."[135] Evidently, the court was signaling Congress to re-draft the anti-bootlegging statute in order to alleviate judicial concerns for its constitutionality.

Congress could also opt to apply Article 17(1) of the WPPT, which required a fifty-year term of protection from the end of the year in which

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128. *See infra* Parts III.A.1 and III.A.2.

129. Congress should state explicitly that the statute falls outside of the purview of the Copyright Clause, as its subject matter of live performances does not fall within the protections of copyright.

130. Note that this change would still not satisfy the "Writings" requirement of the Copyright Clause.

131. *See* Deas, *supra* note 10, at 579.

132. In 1998, the Sonny Bono Copyright Term Extension Act added 20 years to 1976 Copyright Act so that the duration of copyright protection extended from the life of author plus seventy years, or 95 years after for a work made for hire. *See* 17 U.S.C. § 302 (2000).

133. 350 F. Supp. 2d 823, 832-33 (C.D. Cal. 2004).

134. *Id.* at 833. A variation of this option is for Congress to analogize or apply 17 U.S.C. § 301(c) to fixations of live performances. This suggestion would extend Section 301(c) duration limitations to all similar fixations that are now subject to Section 1101. Deas, *supra* note 10, at 588.

135. *Kiss*, 350 F. Supp. 2d at 833.

fixation occurs.[136] Similarly, the TRIPs agreement also suggested such a time limit. The *KISS* court noted that Article 14 of TRIPs specified that anti-bootlegging protection "shall last at least until the end of a period of 50 years computed from the end of the calendar year in which the fixation was made."[137] However, the court noted that the agreement established only a floor rather than a ceiling for intellectual property protection and the intent of Congress was still unknown.[138] Nonetheless, it is apparent that these international agreements also contain examples of durational limitations that Congress can draw from.

By following these suggestions and invoking a time limit, Congress would ensure that bootlegs which have already been recorded will not be subject to perpetual protection.

C. Effects of *Martignon* and *KISS*

If upheld on appeal, the decisions of *Martignon* and *KISS* effectively nullify the anti-bootlegging statute and will cause the United States to come into direct conflict with its international obligations. This will undoubtedly lead to undesirable consequences in the arena of foreign affairs.

The absence of a federal anti-bootlegging law, and the subsequent failure to comply with TRIPs obligations, may lead to difficulty in the international trade arena, potentially manifesting as an adverse WTO ruling. Professor David Nimmer has pointed out five likely outcomes when a U.S. judicial decision comes into conflict with a WTO panel ruling.[139] The United States could:

1) play the elephant in international trade by throwing its weight around and resisting WTO pressure;

2) withdraw from the WTO altogether;

3) refuse to obey WTO panel rulings and therefore leave itself open to cross-sectoral retaliation;

4) simply pay off the aggrieved party; or

136. World Intellectual Property Organization Performances and Phonograms Treaty, Geneva, Dec. 20 1996, 36 I.L.M. 76 (1997); *see* Deas, *supra* note 10, at 579.

137. *Kiss*, 350 F. Supp. 2d at 829 n.2. (citing TRIPS, *supra* note 35, art. 14(5).

138. *Id.*

139. Nimmer, *supra* note 22, at 1417-18.

5) change the law or practice that gave rise to the offending situation (that is, amend the bootlegging statute).[140]

The United States explored several of these options in previous cases in which the United States' WTO obligations were left unmet. For example, in 1999, WTO members requested a panel to examine the conflict between the TRIPs agreement and the Fairness in Music Licensing Act of 1998, which places limitations on the exclusive rights provided to owners of copyright with respect to certain performances and displays.[141] Following four years of settlement negotiations between the United States and the European Communities, in 2001, a panel of arbitrators issued an initial judgment of $1.1 million a year owed to European musicians.[142] However, the case is far from resolved. The United States delayed by asking for multiple time extensions in order to implement the required changes to the national legislation. The European Communities responded by threatening reciprocal trade sanctions in the form of tariffs on imported U.S.-copyrighted goods. The WTO Dispute Settlement Understanding further permits the European Communities to impose tariffs on other types of goods (having nothing to do with copyright) manufactured in the United States and exported to Europe. Currently, the case is still tied up on the grounds of procedural objections to the WTO arbitration.[143]

In another case, after noting the discrepancies between United States copyright law and European Union copyright law, a German regional court of appeals denied copyright protection to artists for an unauthorized bootleg that was recorded at a concert in New Orleans. The court urged reciprocity among the international community and reasoned that the United States should not be able to garner the benefits of Germany's protection if there was no analogous United States law that would protect German nationals.[144]

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140. *Id.* (footnotes omitted). Nimmer notes that this "would be a rather disappointing culmination to years of American effort, to say the least." *Id.* at 1417-18.

141. Fairness Licensing Act of 1998 § 202, 17 U.S.C. § 110(5) (2000); *World Trade Organization, United States—Section 110(5) of the Copyright Act* ¶ 1.1, WT/DS160/R (June 15, 2000), *available at* http://www.wto.org/english/tratop_e/dispu_e/1234da.pdf.

142. World Trade Organization, *United States—Section 110(5) of the Copyright Act—Recourse to Arbitration under Article 25 of the DSU* 34, WT/DS160/ARB25/1 (Nov. 9, 2001), *available at* http://www.wto.org/english/tratop_e/dispu_e/160arb_25_1_e.pdf.

143. World Trade Organization, *Recourse by the United States to Article 22.6 of the DSU*, WT/DS160/22 (Mar. 1, 2002).

144. Re Copyright in an Unauthorized U.S. Recording, [1993] ECC 428, Regional Court of Appeal, Cologne, Germany.

Absent the anti-bootlegging provisions in 17 U.S.C. § 1101 and 18 U.S.C. § 2319A, the lack of reciprocity between U.S. law and the law of other nations' laws could reverse generations of integrated efforts to develop sound international intellectual property law. Bootleggers will simply find safe havens in the countries with the least restrictive laws and/or enforcement mechanisms against bootlegging. Moreover, without the federal anti-bootlegging provisions, the United States will run the risk of international trade sanctions, diplomatic pressures, and endless international court proceedings. In the context of today's increasing pressure to protect global intellectual property rights, the discrepancies between U.S. law and that of its trading partners may give rise to trade wars.

Obviously, these cases have importance beyond whether Joe Bootlegger can bring a tape-recorder to his next concert. There are many issues on the horizon of international intellectual property law that may run up against the same or similar concerns as the anti-bootlegging statute. For instance, the WIPO is currently engaging in discussions about treaty protection for genetic resources, traditional knowledge, and folklore.[145] These treaties would be important for protecting the intellectual property rights of developing countries, which are normally left without any intellectual property rights and therefore have no incentive to adhere to international intellectual property legal regimes. Treaties protecting folklore and native plants may encounter the same problems as the anti-bootlegging statute in reconciling with the Constitution's limited times provision and U.S. law's conception of the public domain.[146] It is also likely that WIPO or the WTO

> German copyright law already grants foreign artists a considerable degree of protection by way of section 125(2)-(4) and also offers other states the opportunity by way of section 125(5) of extending that protection for their artists in Germany by acceding to international conventions or by concluding reciprocal agreements . . . If other countries (like the USA in the present case) do not make use of that opportunity, the gap cannot be filled by an extension of the sphere of application of section 125(6). Otherwise there would be no point in the incentive, deliberately created by the scheme of sections 121 and 125 in the interests of protecting German claimants abroad, for other states to act in accordance with the opportunity provided for in section 125(5) of the Act.

145. *See* WIPO, Intellectual Property and Genetic Resources, Traditional Knowledge, and Folklore, *at* http://www.wipo.int/about-ip/en/studies/publications/genetic_resources.htm (last visited Feb. 27, 2005).

146. *See* Anupam Chander & Madhavi Sunder, *The Romance of the Public Domain*, 92 CALIF. L. REV. 1331 (2004). Chander and Sunder argue that despite scholar's romantic portrayals of the public domain, it can function as a means for perpetuating global inequality. The article states that under the current concept of the public domain,

will soon propose a database protection treaty much like the one recently passed by the European Union (the Directive on the Legal Protection of Databases).[147] Such a treaty would also come into contention with the United States' conception of what the public domain should entail, as under *Feist Publications v. Rural Telephone Service*, unoriginal database information is not protected from being copied.[148]

IV. CONCLUSION

Due to increased globalization and technological advancements, the need for improved international cooperation and coordination is imperative. However, the anti-bootlegging cases discussed in this Note demonstrate that this can be easier said than done because of the tension between international intellectual property law and our constitutional limits on the grant of intellectual property protection. Courts and Congress alike should strive to maintain the constitutionality of the anti-bootlegging statute for the sake of international treaty obligations and foreign relations concerns. Since most states already have such statutes, there is little reason to quash the effort to federally regulate bootlegging altogether. The real harm of maintaining the statute in its current form, as interpreted by *Martignon* and *KISS*, is that it would do a disservice to the founding father's efforts to regulate copyright through the Constitution. Therefore, a redrafting of the statute to provide for a limited time provision is the best alternative to reconcile the anti-bootlegging statute with the U.S. Constitution, thereby appeasing the international community and allowing the United States to participate and progress in the arena of international law.

> likely beneficiaries of the public domain resources of traditional knowledge . . . are multinational companies that are capable of converting these public domain resources into valuable patentable products. . . . In the end, the international intellectual property regime leads to a transfer of wealth from the poorer countries of the world to the richer countries.

Id. at 1353.

147. Directive 96/9/EC of the European Parliament and of the Council of 11 March 1996 on the Legal Protection of Databases, 1996 O.J. (L77) 20, *available at* http://europa.eu.int/information_society/topics/ebusiness/ecommerce/8epolicy_elaw/law_ecommerce/legal/documents/396L0009/396L0009_EN.doc.

148. 499 U.S. 340 (1991).

ADDITIONAL DEVELOPMENTS—CONSTITUTIONAL LAW, PART II

GOLAN V. ASHCROFT

310 F. Supp. 2d 1215 (D. Colo. 2004)

LUCK'S MUSIC LIBRARY, INC. V. ASHCROFT

321 F. Supp. 2d 107 (D.D.C. 2004)

Two district courts reached opposite conclusions regarding the validity of an act of Congress granting a retroactive extension of copyright protection to works that had already passed into the public domain. A district court in Colorado ruled to allow constitutional challenges to the Uruguay Round Agreements Act (URAA), while in Washington, D.C., the district court ruled that Congress can constitutionally extend copyright protection to works that have already fallen into the public domain, and thus granted the government's motion to dismiss.

Section 514 of the URAA implemented Article 18 of the Berne Convention by providing copyright protection to foreign works that, for one of three reasons, had entered the public domain in the United States because their authors did not comply with since-repealed copyright formalities; because of lack of subject matter protection (for sound recordings before 1972); or because the United States did not recognize copyrights from their origin country.

In *Golan v. Ashcroft*, plaintiff artists and art sellers sued to prevent enforcement of § 514, claiming that it exceeded Congress's power under the Intellectual Property Clause, violated the First Amendment, and violated their rights to substantive due process. The court denied the defendant's motion to dismiss for failure to state a claim, finding that the URAA, in making previously public domain works protectable, changed copyright law sufficiently to warrant First Amendment scrutiny. The court also found that the URAA might violate substantive due process rights by unsettling plaintiffs' reasonable expectations about which works would be in the public domain. The court consequently denied the motion to dismiss, though noting that the plaintiffs' claims might ultimately be unsuccessful.

Plaintiffs also pled a constitutional challenge to the Copyright Term Extension Act (CTEA), which extended existing copyright terms for an additional twenty years. The court granted defendant's motion to dismiss with respect to this claim, holding that it was foreclosed by the Supreme Court's decision in *Eldred v. Ashcroft*, 537 U.S. 186 (2003), which upheld the constitutionality of the CTEA.

In *Luck's Music Library, Inc. v. Ashcroft*, brought by sellers of public domain music and movies, the court considered similar arguments. However, in this case the court granted the government's motion to dismiss for failure to state a claim. The court found that Congress had consistently granted retroactive copyrights that removed works from the public domain in the past. In particular, Congress granted retroactive protection to existing works when it passed the first Copyright Act in 1790. The court rejected the argument that the Act merely federalized an existing right, finding that state common law

copyrights did not exist prior to 1790. The court also referred to World War I- and II-era laws that extended copyright protection to foreign authors who were unable to comply with U.S. copyright formalities due to the hostilities. In those cases, works were also in the public domain until they were retroactively granted protection. The court further rejected the argument that the UPAA failed to "promote the Progress of Science and useful Arts" because the Act's purpose was to procure copyright protection for work by U.S. citizens in foreign countries, and found that the UPAA did not violate the constitutional originality requirement. Finally, the court found the UPAA did not violate the First Amendment. Relying on *Eldred v. Ashcroft*, the court held that copyright law's traditional limits, including the idea/expression dichotomy and fair use, were enough to satisfy the First Amendment. The court consequently held the extension of copyright protection to be constitutional.

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TELECOMMUNICATIONS

CELLCO PARTNERSHIP V. FCC & VONAGE HOLDINGS CORP. V. MINNESOTA PUBLIC UTILITIES COMMISSION: VOIP'S SHIFTING LEGAL AND POLITICAL LANDSCAPE

By Sunny Lu

A Palos Verdes, California attorney makes a landline telephone call to his mother, who lives just down the street. What options for providers does the lawyer have, what level of government has jurisdiction over his phone call, and what are the basic rules governing the company (or companies) providing his phone call?

The answers to these questions may have been obvious in a world before Voice over Internet Protocol (VoIP), a technology that provides for voice communications using the Internet. In the old world of traditional telephone systems, local phone providers would probably be the lawyer's only option, the state government would have jurisdiction over this intrastate call, and the providers would be subject to a host of regulations, such as taxes, access fees, and wiretap laws. In the new world of VoIP (also commonly called "Internet telephony"), the distinctive nature of the technology as compared to that of traditional telephony, coupled with the lack of regulations has thus far created a policy vacuum not yet filled by Congress, the FCC, the courts, or state governments. This policy vacuum yields uncertain answers to the attorney hypothetical.

The policy vacuum exists because of uncertainty over the new technology.[1] A hint at the brewing jurisdictional and regulatory battles lies in the holding of *Vonage Holdings Corp. v. Minnesota Public Utilities Commission*.[2] In *Vonage*, the court held that a company that provides voice communication services through VoIP was not subject to Minnesota state laws regulating telephone companies.[3] The court found that VoIP was not a telecommunications service, but rather an information service, and therefore not regulable under the Telecommunications Act of 1996.[4]

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1. *See* 2-14A TELECOMMUNICATIONS & CABLE REGULATION § 14A.03 (2004) (discussing the difficulty the FCC had in classifying VoIP services as "information services" or "telecommunications services" under the Telecommunications Act of 1996).
2. 290 F. Supp. 2d 993 (D. Minn. 2003).
3. *Id.* at 1002.
4. *See id.* at 999-1000.

In addition, *Cellco Partnership v. FCC*[5] provides important support for the Federal Communications Commission's (FCC) jurisdiction, which is currently being challenged by state public utilities commissions. In this case, the Court of Appeals for the District of Columbia broadly construed the FCC's regulatory power, finding that the FCC need not establish that a regulation was absolutely "necessary" in order to comply with a statutory provision requiring necessity for the agency to regulate.[6]

The focus of this Note is how the policy vacuum should and probably will be filled. Part I compares traditional telecommunications services with VoIP in terms of their technical features and industry profiles, and the resulting regulatory tugs-of-war. Part II summarizes the regulation of the VoIP industry to date by all the different players involved: the federal courts, Congress, the FCC, and the states. Part III focuses on the possible ways to resolve the various regulatory issues introduced in Part I. It argues that a wholesale application of existing telecommunications regulations is technically infeasible and often inappropriate. Part IV argues that, despite the great potential benefits this technology could bring to the public in the forms of lower-cost services and the ease of convergence of services and technologies, we should be concerned about what we might sacrifice on the road to VoIP regulation—including access, safety, and privacy.

I. TRADITIONAL TELEPHONY AND VOIP: TECHNOLOGY AND REGULATION

The technical and historical differences between VoIP and traditional telephony have shaped the parameters of regulatory debates as well as the significantly different industries. Unlike traditional telephony, the VoIP industry is not beginning its commercial life cycle burdened with the federal regulations that govern natural monopolies.[7] While some access issues in the two industries are similar (the incumbent local exchange carriers (ILECs) own the local lines in traditional telephony, while the cable companies own bandwidth that VoIP providers need), most manifestations of VoIP have thus far escaped federal regulation because of the federal government's classification of VoIP as an information service not subject to regulation. As VoIP begins to replace traditional telephony, the FCC and

5. 357 F.3d 88 (D.C. Cir. 2004).

6. *See id.* at 99.

7. For a definition of "natural monopoly," see BLACK'S LAW DICTIONARY 1028 (8th ed. 2004) ("A monopoly resulting from a circumstance over which the monopolist has no power, as when the market for a product is so limited that only one plant is needed to meet demand."). *See also infra* Part I.A.1.

Congress, among others, are reevaluating the federal government's hands-off policy towards information services, in light of the pressing policy issues of universal service, emergency services, and federal wiretap laws.

A. Technical Background

1. Traditional Telephony

Traditional telephone service providers employ circuit switching.[8] In such a system, a consumer using traditional telephone service is connected from her phone by way of underground or aboveground wiring[9] to the public switched telephone network (PSTN), which the local telephone companies operate.[10] Today, when two parties make a call, the voices are digitized and the connection is maintained over a single fiber optic cable, along with thousands of other voices and telephone calls, for most of the duration of the call.[11] In a ten-minute conversation, the total transmission amount is roughly equal to ten megabytes (which would fill about seven floppy disks[12]), much of which is wasted in a typical phone conversation because of silent intervals and the typical give-and-take nature of conversations; this results in only half the connection being in use at any given time.[13]

The government had jurisdictional and regulatory concerns, particularly about universal service, from the birth of the telecommunications industry. Congress created the Interstate Commerce Commission in its 1910 Mann-Elkins Act, and gave the agency the authority to regulate telephone service.[14] The Commission possessed broad powers to preempt state regulations.[15] The Communications Act of 1934 replaced the Commission with the FCC, and also purported to narrow the power of the FCC to regulate

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8. *Vonage*, 290 F. Supp. 2d at 995.

9. *See* Marshall Brain, *How Telephones Work*, HOWSTUFFWORKS, *at* http://electronics.howstuffworks.com/telephone.htm (last visited Mar. 13, 2005).

10. *Vonage*, 290 F. Supp. 2d at 995.

11. Jeff Tyson & Robert Valdes, *How VoIP Works*, HOWSTUFFWORKS, *at* http://computer.howstuffworks.com/ip-telephony.htm (last visited Mar. 13, 2005). Traditional telephone calls also utilize copper wire going into each user's residence. *Id.*

12. *See* Gary Brown, *How Floppy Disk Drives Work*, HOWSTUFFWORKS, *at* http://computer.howstuffworks.com/floppy-disk-drive.htm (last visited Mar. 13, 2005) (explaining that a floppy disk holds 1.44 megabytes of information).

13. Tyson & Valdes, *supra* note 11.

14. STUART MINOR BENJAMIN ET AL., TELECOMMUNICATIONS LAW AND POLICY 611 (2001).

15. *Id.* (discussing judicial reinforcement of the breadth of the Interstate Commerce Commission's power in *The Shreveport Rate Case*, which was overridden by the Communications Act of 1934).

only interstate and foreign communications.[16] The Communications Act thus reserved intrastate communications for the states to regulate.[17]

In 1877, one year after Alexander Graham Bell invented the telephone, his Bell Telephone Company held all the patents and thus wielded a monopoly over commercial telephone service.[18] The Bell Telephone Company's monopoly gradually decreased in the early 1900s, but its president Theodore Vail revitalized the business.[19] By 1912, the company had acquired competitors or forced them out of business to the point that the U.S. Department of Justice became alarmed by the growing monopoly.[20]

The Bell Telephone Company maintained its monopoly over telephone service, until the company's breakup in 1982, by highlighting two main arguments. First, Bell argued that telephone service is a natural monopoly because of the network effects of a telephone exchange, which becomes more valuable to the user as the exchange gains more customers on its network and the customer is thereby connected to more users.[21] Second, Bell argued that an integrated phone service provider would be best able to adjust prices according to income in order to make phone service affordable for all, a policy rationale that came to be known as "universal service."[22] Bell president Vail's slogan reflected his understanding of the importance of widely available service: "One Policy, One System, Universal Service."[23] The basic idea behind universal service is that all consumers, including those with low incomes, should have access to affordable phone service.[24] The rationale of cross-subsidization in order to provide universal service featured three options that were popular with regulators in the early 1900s: (1) charging business customers higher prices to subsidize lower-price residential service; (2) subsidizing rural service with urban service, which costs less to provide than rural service because of population density; and (3) subsidizing local telephone service with inflated long-distance rates.[25]

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16. *Id.* at 610-11.

17. *See id.*

18. *Id.* at 607 (excerpting PETER W. HUBER ET AL., FEDERAL COMMUNICATIONS LAW (1st ed. 1992 & 2d ed. 1999) (discussing history of the Bell monopoly)).

19. *Id.*

20. *Id.* at 609.

21. *See id.* at 606.

22. *Id.* at 618-19.

23. *Id.* at 608.

24. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(4)(a).

25. BENJAMIN ET AL., *supra* note 14, at 618-19.

The policy of allowing law enforcement to intercept communications is also entrenched in federal regulation. Currently, law enforcement's ability to intercept communications and their content falls under the standards provided by Title III of the Omnibus Safe Streets and Crime Control Act of 1968.[26] More recently, in 1994, Congress passed the Communications Assistance for Law Enforcement Act (CALEA) to aid law enforcement in its efforts to intercept communications more efficiently.[27]

Finally, the regulatory concern that consumers should be able to access emergency services by the traditional dialing of 911 has been addressed by the states.[28] As a result, most states impose this requirement upon local exchange carriers.[29]

2. *Internet Telephony*

VoIP is a communication technology in which the analog audio signals of communication are turned into digital data that can be transmitted over the Internet.[30] Instead of the circuit switching of traditional telephony, VoIP features "packet switching," wherein telephone calls are broken into bits of data using the Internet Protocol (IP), and then delivered over the Internet.[31] IP is the most common method for electronic devices to communicate.[32] VoIP providers offer consumers one or more choices among three general ways to communicate: computer-to-computer, telephone-to-computer (and vice versa), and telephone-to-telephone.[33] The FCC has typically classified these services according to the network on which the call originates and ends.[34]

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26. Elec. Frontier Found., *CALEA—Frequently Asked Questions*, *at* http://eff.org/Privacy/Surveillance/CALEA/?f=faq.html (last visited Jan. 24, 2005). In addition, the Patriot Act allows law enforcement more leeway in obtaining wiretaps in some circumstances. *Id.*

27. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(4)(f).

28. *Id.* § 14A.04(5)(a).

29. *See id.*

30. Tyson & Valdes, *supra* note 11.

31. *Id.*

32. Ben Charny, *FCC: Broadband Top Issue in 2004*, CNET NEWS.COM, Jan. 9, 2004, *at* http://news.com.com/2102-1034_3-5138451.html.

33. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.02.

34. *See In re* Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges, 19 F.C.C.R. 7457, 7461-62 (2004) (comparing the networks and services employed by computer-to-computer and phone-to-phone IP telephony providers) (citing the standards laid out in *In re* Federal-State Joint Board on Universal Service, 13 F.C.C.R. 11,501, 11,541-45 (1998)). Computer-to-computer IP telephony is "provided over the Internet . . . , [where] callers use software

Computer-to-computer VoIP calls originate and end on the Internet.[35] Examples of computer-to-computer VoIP would be Skype or Free World Dialup's free services. The FCC ruled in February 2004 that Free World Dialup and other computer-to-computer VoIP providers were exempt from regulations because calls made in computer-to-computer VoIP never utilize the PSTN.[36]

Telephone-to-computer and computer-to-telephone VoIP calls originate on the PSTN and end on the Internet, or vice versa.[37] An example of computer-to-phone telephony would be that provided by Vonage. The FCC also definitively stated in a November 2004 ruling that state regulation of the computer-to-telephone services provided by Vonage is preempted even if the phone calls might possess intrastate elements.[38] The agency also hinted that Vonage's services would constitute an information service, and thus would be exempt from most of the traditional federal telephony regulations.[39]

Finally, telephone-to-telephone VoIP calls originate and end on the PSTN, passing through the Internet somewhere in between.[40] An example

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and hardware at their premises to place calls using Internet access provided by an unregulated Internet service provider (ISP), and the ISP may not even be aware that a voice call is taking place." *Id.* at 7461. Phone-to-phone IP telephony is "tentatively" classified by the FCC as

services in which the provider meets the following conditions:

> (1) it holds itself out as providing voice telephony or facsimile transmission service; (2) it does not require the customer to use [customer premises equipment ("CPE")] different from that CPE necessary to place an ordinary touch-tone call (or facsimile transmission) over the public switched telephone network; (3) it allows the customer to call telephone numbers assigned in accordance with the North American Numbering Plan, and associated international agreements; and (4) it transmits customer information without net change in form or content.

Id. at 7462 (citing *In re* Federal-State Joint Board on Universal Service, 13 F.C.C.R. at 11543-44).

35. *See* 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.02.

36. *See* Declan McCullagh and Ben Charny, *FCC: "Pure" VoIP Not a Phone Service*, CNET NEWS.COM, Feb. 12, 2004, *at* http://news.com.com/FCC+Pure+VoIP+not+a+phone+service/2100-7352_3-5158105.html.

37. *See* 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.02.

38. *See In re* Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minn. Pub. Utils. Comm'n, 19 F.C.C.R. 22404 § III(A)(2) (2004).

39. *See id.* § III.

40. *See* 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.02.

of telephone-to-telephone VoIP would be AT&T's CallVantage service, in which consumers use their regular telephones, a telephone adapter, and a broadband connection to make long-distance phone calls.[41] The Internet portion of the call is in the middle of the process, where AT&T routes the phone call over the Internet, at a great cost savings to AT&T.[42] As might be predicted, this form of VoIP is the most likely target of regulation by the federal government because of the great similarities to traditional circuit-switched communications. In April 2004, the FCC ruled that AT&T had to reimburse local phone carriers for accessing the PSTN at the beginning and end of calls under its CallVantage service.[43]

Packet switching is much more efficient than circuit switching because it lets networks route the packets along the least congested lines.[44] It also does not monopolize the two computers communicating with each other, which enables them to also communicate with other computers.[45] Instead of forcing all packets onto a dedicated line, as in circuit switching, packet switching allows the data packets to flow through a chaotic network, sharing the available bandwidth with unrelated packets, over thousands of possible paths.[46] In fact, packets on the Internet could travel between states or even between countries just for someone to make a local phone call from his house to his mother's house down the street. Also, while circuit switching maintains a constant open connection for the duration of the call, even when there are silent intervals, packet switching only opens a connection for long enough to send a packet of data from one system to the other.[47]

Although the furor over VoIP regulation has come to a head only in recent years, the technology has been around since 1995, developed by Israeli hobbyists.[48] That same year, VocalTec Communications released

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41. *AT&T CallVantage: Important Info and FAQs*, *at* http://www.usa.att.com/callvantage/faqs/general.jsp (last visited Dec. 21, 2004).

42. *See* Ben Charny, *Feds Ding AT&T over Internet Calls*, CNET NEWS.COM, Apr. 21, 2004, *at* http://news.com.com/2102-7352_3-5197204.html; *see also* Tyson & Valdes, *supra* note 11 (explaining how phone companies currently routing long-distance phone calls over an IP gateway can "seriously reduce the bandwidth they're using for the long haul").

43. *In re* Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Servs. are Exempt from Access Charges, 19 F.C.C.R. 7457, 7468 (2004); *see also* Charny, *supra* note 42.

44. Tyson & Valdes, *supra* note 11.

45. *Id.*

46. *Id.*

47. *Id.*

48. Intertangent Technology Directory, *History of VoIP*, *at* http://www.intertangent.com/023346/Articles_and_News/1413.html (last visited Mar. 13, 2005).

Internet telephony software, and thus the first commercial Internet phone was born.[49] At that time, the sound quality of the voice transmissions was much poorer than that of traditional telephone services.[50] By the year 2000, total Internet telephony calls were estimated at 3 billion minutes, a number still much lower than the 5.7 trillion minutes carried by traditional telephone companies.[51] That number is growing, however, and one research firm estimates that 75% of the voice traffic worldwide by 2007 will be provided through VoIP.[52] Improvements in technology no doubt contribute to the increased adoption of the technology; one survey of Global 2000 firms revealed that 79% of those surveyed who were "early VoIP adopters" said they were "either mostly or highly satisfied" with the technology.[53]

The federal government has taken notice of this rapid technology development and market expansion. In 1998, the FCC issued a report to Congress on the future of universal service that gave an in-depth treatment to issues of fair competition and compensation between VoIP providers and traditional telephony providers.[54] Demonstrating great foresight, the FCC took an early step toward the increasingly-controversial and debated regulation of the fast-growing industry, hinting that it would likely find phone-to-phone telephony to constitute a "telecommunications service" that would therefore be subject to regulation as are traditional telecommunications providers.[55] The FCC followed up this report with the aforementioned April 2004 ruling requiring that AT&T pay traditional local access charges for its phone-to-phone CallVantage service, and limited its ruling only to those VoIP offerings that were phone-to-phone.[56]

B. Industry Profile

Before the breakup of the Bell Telephone Company monopoly that resulted from the U.S. Department of Justice's 1974 antitrust lawsuit, the

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49. *Id.*

50. *Id.*

51. BENJAMIN ET AL., *supra* note 14, at 950.

52. CommWeb Indus. Statistics Ctr., *VoIP/IP Statistics* 2 (Nov. 17, 2004), *at* http://www.commweb.com/showArticle.jhtml?articleId=53700310&pgno=2.

53. *Deloitte Study Projects Rapid Expansion of Enterprise Desktop VoIP*, CommWeb, Oct. 27, 2004 (citing Deloitte & Touche's survey statistics on Global 2000 companies), *at* http://www.cconvergence.com/shared/article/showArticle.jhtml?articleId=51201008.

54. *See In re* Federal-State Joint Board on Universal Service, 13 F.C.C.R. 11501 (1998).

55. *See id.* at 11503.

56. Charny, *supra* note 42.

industry was just that—monopolized by Ma Bell.[57] Even after the breakup, both the local and long-distance markets were still dominated by just a few carriers.[58] Today, only three companies dominate the long-distance market: AT&T, Sprint, and Worldcom.[59] In the provision of local telephone services, regulatory efforts to introduce competition also have succeeded only in part, as four of the original twenty-two ILECs existing after the breakup of local phone service still dominate the market.[60] There are a few competitors for the provision of local phone service, but more have failed than have succeeded over the years.[61]

The increasing popularity of VoIP technology has attracted many companies, from "alternative" VoIP providers and pioneers such as Vonage, to traditional telecom giants like AT&T, and even cable companies and Internet Service Providers (ISPs) like AOL. Although the "alternative" VoIP providers have the great advantage of being the first to attract customers with their technology, it is unlikely that they will retain their dominant market share because the traditional telecom industry leaders and ISPs have more resources and brand power.[62] Reflecting this concern, small VoIP provider Nuvio Corp. filed a request with the FCC in September 2004 to prevent broadband providers who also offered VoIP services from discriminating against rival VoIP providers seeking to share their bandwidth.[63]

C. Issues in Regulation

The preceding discussion illustrates the substantial technical and market differences between VoIP and traditional telephony. From a consumer standpoint, both provide the same service of voice communications, but it is unclear whether and how certain regulations imposed on the traditional telephone industry could be directly transferred to the budding VoIP industry. It is particularly important to consider these regulatory questions as it is predicted that VoIP will replace traditional telephony in significant

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57. *Telecommunications Services Industry Profile*, Yahoo! Finance, *at* http://biz.yahoo.com/ic/42.html (last visited Mar. 13, 2005).

58. *See id.*

59. *Id.*

60. *Id.*

61. *Id.*

62. Tim Richardson, *BT Spins Prop on SME VoIP Promo*, REGISTER, Nov. 1, 2004, http://www.theregister.co.uk/2004/11/01/bt_voip.

63. Alan Breznick, *VoIP Provider Presses FCC to Block Broadband Discrimination*, CABLE DIGITAL NEWS, Nov. 1, 2004, *at* http://www.cabledatacomnews.com/nov04/nov04-8.html.

ways within the next decade.[64] The following examples of current regulatory schemes for traditional telephony illustrate how technological differences between Internet and traditional telephony complicate the imposition of these regulations on VoIP. These regulatory schemes include fees to ensure universal telephone service, provision of adequate emergency service, and compliance with federal wiretap laws.[65]

1. *Universal Service*

"Universal service" has been a public policy objective that the government has imposed upon local phone providers for most of the history of local phone service.[66] With this policy goal in mind, the FCC tries to ensure its ability to subsidize customers where the costs of providing local phone service are high, as well as subsidize schools, libraries, and health care providers.[67] Section 254(d) of the 1996 Telecommunications Act (the main statute governing the traditional telephone industry) provides for the funding of the universal service program through its requirement that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis," to the universal service fund.[68] The universal service program has historically been a great success in terms of ensuring almost universal subscribership: nearly 95% of U.S. homes were estimated to have at least basic telephone service by 1997.[69] Many states also have a hand in imposing

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64. Then-FCC Chairman Powell cited such a statistic in his October 2004 remarks to a VoIP conference in Boston: "[T]he Yankee Group estimates that there will be 1 million VoIP subscribers by the end of 2004, up from just 131,000 last year." FCC Chairman Michael Powell, Remarks at the Voice on the Net Conference (Oct. 19, 2004) [hereinafter Powell Conference Remarks], *at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-253325A1.doc.

65. There are many other regulations that the federal government imposes on telecommunications service providers, but which it does not impose on information service providers, such as Local Number Portability administration, North American Numbering Plan administration, the Telecommunications Relay Services Fund, and access by individuals with disabilities. However, as this Note seeks to focus on the currently most hotly debated discrepancies between traditional and IP telephony of universal service, emergency services, and CALEA, the other issues are beyond the scope of this Note and thus will not be discussed here.

66. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(4)(a); *see also supra* Part I.A.

67. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04.(4)(a); *see also* BENJAMIN ET AL., *supra* note 14, at 770.

68. Telecommunications Act of 1996 § 254(d), 47 U.S.C. § 254(d) (2000).

69. BENJAMIN ET AL., *supra* note 14, at 769.

universal service funding requirements.[70] State universal service programs provide $1.9 billion in funding a year for states to support their universal service policy goals.[71]

The Telecommunications Act of 1996 expanded the idea of universal service from simply access to basic telephone service to encompass access to new telecommunications technologies as they develop.[72] The Act created a Federal-State Joint Board that formulated a new federal universal service standard that the Joint Board recommended to the FCC in November 1996.[73] The Joint Board defined universal service as including, among other things, basic telephone and emergency services access.[74]

In 1997, the FCC determined that Internet access service providers did not fall within the definition of "telecommunications service" and therefore ISPs were not required to contribute to the universal service fund.[75] The FCC followed up this determination with a 1998 report suggesting that computer-to-computer VoIP probably did not constitute "telecommunications," while phone-to-phone VoIP probably did.[76] The distinctions laid out in the 1998 report supported the FCC's suggestion in 2004 that phone-to-phone VoIP constituted "telecommunications" through its imposition of access rates on AT&T's CallVantage phone-to-phone VoIP offering.[77]

This distinction between "telecommunications" and "information" services for the purposes of imposing universal service fees on voice providers raises a market distortion issue: regardless of whether a voice communications service originates or ends on the PSTN or on the Internet, the function of the services are the same—to provide voice communications. If certain voice communications providers (traditional telecommunications providers, and likely phone-to-phone VoIP providers) are required to pay universal service funds, while other voice communications providers (computer-to-phone and computer-to-computer VoIP providers) are not,

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70. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(4)(a).

71. Stephen Labaton, *F.C.C. Takes on Oversight of Internet Phone Services*, N.Y. TIMES, Nov. 10, 2004, at C8, http://www.nytimes.com/2004/11/10/technology/10fcc.html.

72. BENJAMIN ET AL., *supra* note 14, at 769.

73. *Id.*

74. *Id.*

75. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(4)(a).

76. BENJAMIN ET AL., *supra* note 14, at 946-48.

77. *In re* Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges, 19 F.C.C.R. 7457, 7465 (2004).

then the traditional telecommunications and phone-to-phone IP telephony providers are at a competitive disadvantage.

The likely effect of the disparate treatment of certain voice communications providers is that the computer-to-phone and computer-to-computer VoIP providers will eventually replace the other providers because the "alternative" providers would not be forced to pay the extra fees. As a result, the sources of universal service funding would be eliminated, having been replaced by providers not subject to the universal funding requirements of the Telecommunications Act of 1996. The elimination of the universal service fund would likely have a great impact on the ability of low-income residents to secure basic communications services. The elimination of the fund would also pose problems for the government's ability to meet the Telecommunication Act of 1996's expansion of the meaning of "universal service" to encompass the newest telecommunications technologies.[78] Therefore, low-income residents would also not be able to move to newer technologies, and would be stuck with traditional telecommunications and an underfunded universal telephone service.

2. *Emergency Services*

There are two problems surrounding the emergency services issue in the VoIP context: 911 call routers have difficulty processing VoIP protocols, and VoIP customers could have difficulty dialing out in power outages.[79]

Regarding the first problem, 911 emergency service providers presently find it difficult to identify callback and location information about VoIP callers.[80] This problem is exacerbated by the fact that the nature of VoIP technology allows customers, in many cases, the ability to take their phone connections with them.[81] For example, a Vonage customer based in Iowa could take her Internet phone with her to Florida and make calls there. Providers of computer-to-computer or computer-to-telephone services such as Vonage have also had to get more creative with the limitations imposed by having a system that originates not on circuit-switched networks, but rather on the disorganized packet-switched world of the

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78. *Id.*

79. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(5)(a).

80. *Id.*

81. *See* Anne Marie Squeo, *Federal Ruling on Web Calling Is Supposed to Aid Sector's Growth*, WALL ST. J., at A2, Nov. 9, 2004 (quoting Vonage chairman Jeffrey Citron as criticizing the attempts of states to assert jurisdiction: "That's incredibly problematic for a global company [Vonage] that doesn't know where its customers are at any given time."), *available at* http://online.wsj.com/article/0,,SB109995886468268278,00.html.

Internet. Such creative methods include instructing customers that they must actually tell emergency operators of their physical location when they dial 911.[82] Even AT&T's CallVantage program, a phone-to-phone VoIP service, requires customers to keep their physical location on file with AT&T in order to ensure accuracy when customers dial 911.[83] Both "solutions" seem to be impractical and dangerous, considering that customers may not know their exact locations, especially when they have taken their Internet phones with them to other locations, and also because emergency situations are precisely when customers may find it difficult to communicate clearly with emergency operators.

The second problem of power outages derives from the different power sources of packet-switched networks and circuit-switched networks. Circuit-switched networks have built-in power sources that supply electricity to phone lines independently of other sources of electricity in the house; consequently, customers can make phone calls from regular (not cordless) phones even during power outages.[84] In contrast, packet-switched networks do not have the same built-in power source, and thus shut down during power outages.[85] Consequently, customers on packet-switched networks are more likely to be unable to make calls during power outages because their VoIP service will also likely be affected by the outages.[86]

3. *Communications Assistance for Law Enforcement Act (CALEA)*

Congress enacted CALEA in 1994 to give law enforcement the ability to conduct effective and efficient searches of telecommunications.[87] The general burden that CALEA imposes upon telecommunications providers is that providers must be capable of providing "call-identifying information" and call content to law enforcement.[88] In its 1999 order implementing CALEA, the FCC found that facilities that are used to provide both

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82. Vonage, *Vonage Lets You Dial 911*, *at* http://vonage.com/features.php?feature=911 (last visited Mar. 13, 2005).

83. AT&T, *AT&T CallVantage Service 911 Emergency Dialing*, http://www.usa.att.com/callvantage/faqs/about_911.jsp (last visited Mar. 13, 2005).

84. *Why Does the Phone Still Work When the Electricity Goes Out?*, HOWSTUFFWORKS, *at* http://electronics.howstuffworks.com/question62.htm (last visited Mar. 13, 2005).

85. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(5)(a).

86. *Id.*

87. *Id.* § 14A.04(4)(f).

88. Elec. Frontier Found., *supra* note 26.

telecommunication and information services are subject to CALEA, but facilities "used solely to provide" information services are not.[89] Therefore, even if the FCC found computer-to-computer and computer-to-phone IP telephony to constitute an "information service," such providers would not be exempt from CALEA requirements if their services also had elements of telecommunications services.[90]

The reasoning in this 1999 order, combined with the FCC's 2004 Notice of Proposed Rulemaking ("CALEA NPRM") regarding an expansion of CALEA to VoIP, appears to contradict two prior FCC actions. First, the FCC's 1998 report on universal service suggested that information services that only used the infrastructure of telecommunications services were still information services for the purposes of regulation.[91] Second, the FCC's 2002 ruling regarding cable modems stated that VoIP services that used cable modems constituted a hybrid telecommunication and information service in which the two types of services were inseparable, and thus VoIP in that context was an information service.[92] With the 1999 order and the 2004 NPRM, the FCC has seemingly redefined what factors should be dispositive in the regulation of VoIP. Instead of considering Congress's expressed intent of leaving information services unregulated because of the benefits to the public of increased innovation and competition, the FCC has adopted an analysis that prioritizes the consideration that VoIP services substantially replace traditional telephone services, and therefore VoIP services are subject to CALEA requirements.[93]

Applying CALEA to VoIP communications is much more difficult than applying it to traditional telecommunications because of significant technical and economic hurdles.[94] In this context, it is useful to think of the Internet as an open, global system with data and voice packets (which are, again, indistinguishable from each other) traveling over many differ-

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89. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(4)(f).

90. *Id.*

91. *See id.* § 14A.03(1)(a).

92. *Id.* § 14A.03(1)(b).

93. Elec. Frontier Found., *The Perils of Wiretapping the Internet*, *at* http://www.eff.org/Privacy/Surveillance/CALEA (last visited Mar. 13, 2005).

94. *See* Joanna Sabatini, *VoIP Carriers Calculate Tap Tariff*, *at* http://www.lightreading.com/document.asp?doc_id=57578&site=lightreading (Aug. 10, 2004); *see also* Joint Reply Comments of Industry and Public Interest, *In re* Communications Assistance for Law Enforcement Act and Broadband Access and Services at 15-20, ET Docket No. 04-295 (Fed. Communications Comm'n Dec. 21, 2004) [hereinafter Joint Reply Comments of Industry and Public Interest], *available at* http://www.cdt.org/digi_tele/20041221joint.pdf

ent networks; by contrast, the phone system is a closed system.[95] A surveillance system that might be easy to apply to the closed phone system, in which all voice packets in any given communication travel on the same wire, is much more difficult and inefficient to apply to the open Internet, where voice and data packets travel over different wires in the most efficient ways to get to their destinations.[96] Voice packets could be forced onto one wire, but that would appear to eliminate many of the efficiencies of the VoIP technology itself. In addition, there are public policy considerations of Internet privacy, as packet monitors could not distinguish between voice and data packets without looking at their content.[97]

II. VOIP REGULATION TO DATE

Numerous regulators oversee traditional telecommunications: the courts, Congress, the FCC, and state governments. In VoIP, however, only the FCC has thus far emerged with the most definitive pronouncements on VoIP: the federal government has exclusive jurisdiction over VoIP, so state regulation is preempted except on a few narrow issues.[98] Exclusive federal jurisdiction is likely the best scenario because it avoids the confusion that might result from states imposing a hodgepodge of regulations.[99] As for other actors, various congressional proposals have been unsuccessful and, thus, Congress has not been able to speak with a clear voice on VoIP regulation.[100] The federal courts have thus far supported the FCC's authority in cases like *Cellco* and *Vonage*.[101] Despite the FCC's assertion of federal jurisdiction, however, regulatory issues like universal service funding, emergency services, and CALEA still remain largely unsettled.[102]

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95. Elec. Frontier Found., *supra* note 93.

96. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.02; Tyson & Valdes, *supra* note 11.

97. *See* Sabatini, *supra* note 94 (discussing the solution adopted by some VoIP providers of using third party companies to intercept and process the data, but which poses the privacy concern of data vulnerability).

98. *In re* Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minn. Pub. Utils. Comm'n, 19 F.C.C.R. 22,404, § I(1) (2004).

99. *See, e.g.*, 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.03(3) (discussing the various attempts by states to regulate Vonage and other VoIP providers).

100. *See infra* Part II.C.

101. *See infra* Part II.B.

102. *In re* Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minn. Pub. Utils. Comm'n, 19 F.C.C.R. at 22,411-12, § III(14) n.46.

A. FCC Action

The FCC has taken the most decisive and influential action in determining which governmental bodies control VoIP. The FCC, however, has to date not yet ruled on the regulatory issues surrounding VoIP, which it states it will attempt to resolve in the IP-Enabled Services Proceeding that began in 2004.[103]

In its 1998 report regarding universal service, the FCC provided a detailed analysis of IP telephony, finding that this service made the traditional distinctions between telecommunications services and information services much less clear, especially in the case of telephone-to-telephone VoIP service.[104] The Commission did not go so far as to classify IP telephony definitively as either a telecommunications or information service, stating that it would decline "to make any definitive pronouncements in the absence of a more complete record focused on individual service offerings."[105] It did, however, recognize that information service providers would often interact with existing telecommunications service structures, often even building their own information service structures on top of existing telecommunications structures.[106] Nevertheless, the FCC concluded that public policy dictated that such information services should still remain separate from telecommunications services in a regulatory sense.[107]

In 2002, the FCC released its ruling on cable modems, which has implications for the classification of VoIP services provided via a cable modem.[108] In this ruling, the FCC determined that cable modem service is an interstate information service, because the telecommunications component of cable modem service is inseparable from its information service elements.[109]

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103. *Id.* § I(2).

104. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.03(1)(a) (describing content of *In re* Federal-State Joint Board on Universal Service, 13 F.C.C.R. 11,501 (1998)).

105. *Id.* (quoting *In re* Federal-State Joint Board on Universal Service, 13 F.C.C.R. at 11,544).

106. Vonage Holdings Corp. v. Minn. Pub. Utils. Comm'n, 290 F. Supp. 2d 993, 1001 (D. Minn. 2003).

107. *Id.* "Limiting . . . regulation to those companies that provide the underlying transport ensures that regulation is minimized and targeted to markets where full competition has not emerged." *Id.* (quoting *In re* Federal-State Joint Board on Universal Service, 13 F.C.C.R. at 11,546).

108. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.03(1)(b).

109. *Id.* This FCC ruling was challenged in *Brand X Internet Services v. FCC*, 345 F.3d 1120 (9th Cir. 2003), *cert. granted*, 125 S. Ct. 655 (2004).

In early 2004, the FCC made a series of definitive rulings regarding VoIP, such as Free World Dialup's computer-to-computer telephony (exempt from regulations) and AT&T's phone-to-phone CallVantage service (subject to access charges).[110] These orders provided the general sense that the FCC would be more loathe to regulate services that appeared to take place only on packet-switched networks, consistently with Congress's desire to leave the Internet unregulated, but that the FCC would tend to impose regulation on services that began and ended on the PSTN and thus seemed more like traditional telecommunications services.[111]

In his statement to the Voice on the Net ("VON") conference in October 2004, then-FCC Chairman Powell took what was largely viewed as a decisive step towards establishing FCC jurisdiction over VoIP when he urged the FCC to find that VoIP services were subject to federal jurisdiction only.[112] Chairmain Powell reasoned that "[t]o hold that packets flying across national and indeed international digital networks should be subject to state commission economic regulatory authority is to dumb down the Internet to match the limited vision of government officials. That would be a tragedy."[113] Powell's statement foreshadowed the FCC's unanimous order in November 2004, which found that VoIP services of the kind provided by Vonage were purely interstate services and thus not regulable by states.[114]

B. *Cellco* and *Vonage*: Two Steps Toward Federal Jurisdiction

1. Cellco Partnership v. FCC

The holding in *Cellco* has important implications for the regulatory future of the VoIP industry because it increases the FCC's power to regulate in the public interest. In this case, Cellco Partnership, doing business as Verizon Wireless, brought suit against the FCC, challenging the FCC's broad interpretation of "necessary" in § 11 of the Telecommunications Act of 1996.[115] Cellco wanted to impose a narrow construction of "necessary" specifically in the portion of the statute requiring the FCC to repeal or modify any regulation that is "no longer necessary in the public interest as

110. *See supra* Part I.A.2.

111. *See* 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.03(1).

112. Colin Haley, *Powell Calls for Federal VoIP Rule*, INTERNETNEWS.COM, Oct. 19, 2004, *at* http://www.internetnews.com/bus-news/print.php/3423761.

113. Powell Conference Remarks, *supra* note 64.

114. *See In re* Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minn. Pub. Utils. Comm'n, 19 F.C.C.R. 22,404 (2004).

115. Cellco P'ship v. FCC, 357 F.3d 88, 90 (D.C. Cir. 2004).

the result of meaningful economic competition between providers of such service."[116]

The Court of Appeals for the District of Columbia provided a brief history of the Communications Act of 1934 and the Telecommunications Act of 1996 in order to address the deregulatory purpose cited by Cellco as determining the narrowness of the construction of "necessary."[117] As the court discussed, the Telecommunications Act of 1996 was enacted by Congress to ensure "a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector development of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."[118]

The court held that because of the "chameleon-like nature" of "necessary" and its dependence on statutory context, the court would defer to the FCC's broader interpretation of § 11 of the Telecommunications Act as reasonable, and that § 11 does not require "the Commission to repeal or modify every rule that the Commission does not determine to be absolutely essential."[119] The court determined that the FCC could in fact adopt rules upon finding that they "advance a legitimate regulatory objective; it need not find that they are indispensable."[120] Thus, the *Cellco* holding strengthened the FCC's power to regulate in the public interest, even absent absolute necessity.

Despite what may appear to be an increased power to regulate by the FCC, however, the market (as well as the political climate in years to come) may be the main factor dictating how much regulation the FCC will impose upon VoIP. Former FCC chairman Michael Powell has stated that he does not yet support regulating broadband service providers, with a possible reason being that the fledgling industry would avoid regulation by moving to other, less-regulated countries.[121] Therefore, even though *Cellco* apparently increases the power of the FCC to regulate the VoIP industry, the FCC may not choose to do so for economic reasons, especially

116. *Id.* at 93 (quoting 47 U.S.C. § 161 (2000)).

117. *Id.* at 91-92.

118. *Id.* at 91 (quoting S. REP. NO. 230-104, at 1 (1996)).

119. *Id.* at 88.

120. *Id.* at 96 (interpreting 47 U.S.C. § 201(b)).

121. *See* Charny, *supra* note 32 ("We'd better realize that if you create a hostile environment, there is nothing that stops [the broadband service providers] from dropping that server in Italy . . . [t]he minute they don't like it, they're gone. That's not what we want.") (quoting Michael Powell, Commissioner, FCC).

if the FCC remains a commission dominated by anti-regulators.[122] Regardless, *Cellco* provides important support for the FCC to regulate, which could allow the FCC to define clearly the boundaries of regulation among different types of VoIP providers, without much time-consuming interference by the industry.

2. Vonage Holdings Corp. v. Minnesota Public Utilities Commission

The *Vonage* holding is significant for the future of VoIP in two ways: (1) it established that Vonage's services constituted information services, and (2) closely related to the classification as an information service, the holding established that federal law preempted Minnesota's regulation of Vonage.[123] The specific issue in this case was whether Vonage may be regulated under Minnesota state law that requires telephone companies to obtain certification authorizing them to provide telephone service.[124] The general issue was whether Vonage's previously-described telephony service constitutes a telecommunications service (and thus is regulable) or an information service (and thus is not regulable).[125]

The court here relied heavily on the FCC's 1998 universal service report in formulating its opinion, and also focused on four conditions set forth in the FCC report to determine whether a provider's offering constituted phone-to-phone IP telephony. The four conditions that had to be met were where the provider:

> (1) . . . holds itself out as providing voice telephony or facsimile transmission service; (2) . . . does not require the customer to use [customer premises equipment ("CPE")] different from that CPE necessary to place an ordinary touch-tone call (or facsimile transmission) over the public switched telephone network; (3) . . . allows the customer to call telephone numbers assigned in accordance with the North American Numbering Plan, and associated international agreements; and (4) . . . transmits customer information without net change in form or content.[126]

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122. *See* Declan McCullagh, *Congress Runs Into VoIP Divide*, CNET NEWS.COM, July 7, 2004, *at* http://news.com.com/2102-7352_3-5260162.html.

123. Vonage Holdings Corp. v. Minn. Pub. Utils. Comm'n, 290 F. Supp. 2d 993, 994 (D. Minn. 2003).

124. *Id.* at 996.

125. *Id.* at 999.

126. *Id.* at 999-1000 (quoting *In re* Federal-State Joint Board on Universal Service, 13 F.C.C.R. 11,501, 11,543-44 (1998)).

Taking the four factors into consideration, the court concluded that Vonage did not provide phone-to-phone IP telephony service because it failed to meet the second and fourth requirements—specifically, because "from the user's standpoint the form of a transmission undergoes a net change."[127] The court concluded that the Minnesota PUC had no statutory authority to regulate Vonage's services or VoIP in general, because Congress had obviously delineated between information and telecommunications services, Congress had explicitly declined to regulate information services, and Vonage's services did not constitute telecommunications services.[128]

While it is a boon for VoIP companies that provide only computer-to-computer, computer-to-phone, or phone-to-computer telephony, the *Vonage* holding does not state how phone-to-phone IP telephony should be regulated. Since Vonage did not provide such a service, the *Vonage* court did not address that category of IP telephony.[129] However, it is likely that if Vonage had provided phone-to-phone service as well, the *Vonage* court would have found that the FCC's 1998 universal service report established such a service as a telecommunications service rather than an information service.[130]

The *Vonage* opinion, if followed by other courts, has important implications not only for the classification of broadband telephone services, but also for the federal-state jurisdictional battle over VoIP. The opinion weakens the ability of states to assert jurisdiction over VoIP services such as those provided by Vonage, because its finding that Vonage was an information service provider preempts states' ability to regulate.[131] The

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127. *Id.* at 1000 (quotations omitted).

128. *Id.* at 1003 ("It only *uses* telecommunications, and does not *provide* them.") (emphasis added).

129. *See id.* at 1000-03.

130. *See id.* at 1000 (discussing the FCC's rationale for finding that phone-to-phone IP telephony constituted a telecommunications service rather than an information service). The court stated that:

> The FCC's conclusion focused on gateway providers [providers of computers that transform circuit-switched voice communication into packet-switched] that provide phone-to-phone telephony services. The FCC noted that from a "functional standpoint," the users were only receiving voice transmission, and not information services. . . . In other words, because a person using a [traditional] telephone was on either end of the call, even if the call was routed over the Internet, there was no form change sufficient to constitute information services.

Id. (citations omitted).

131. *See id.* at 994 ("In its role as interpreter of legislative intent, the Court applies federal law demonstrating Congress's desire that information services such as those pro-

Vonage holding, when considered along with the November 2004 FCC ruling expressly preempting state jurisdiction of VoIP services such as those provided by Vonage,[132] indicates judicial support for federal preemption of state regulation of computer-to-computer and computer-to-phone IP telephony services.

C. Congressional Action

Congress has thus far not been able to successfully pass any legislation dealing with the regulation of VoIP, despite the fact that several bills have been introduced.[133] It has, however, provided the framework for discussion through its enactment of the Telecommunications Act of 1996, which is the primary statute governing the traditional telephone industry and separating regulable communication services from nonregulable information services.[134]

Congress might also overhaul the Telecommunications Act in 2005 to reclassify services.[135] One such proposal is the Advanced Internet Communications Service Act, introduced in 2004, which purports to overhaul the Telecommunications Act of 1996 by classifying all Internet-based communications as interstate information services.[136] One of the bill's cosponsors emphasized that the goal of the legislation was "to treat all advanced IP applications, including VoIP, with a light regulatory touch," and that VoIP services should not be regulated as traditional telecommunications because "every Internet user who is equipped for advanced services

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vided by Vonage must not be regulated by state law enforced by the [Minnesota Public Utilities Commission]. State regulation would effectively decimate Congress's mandate that the Internet remain unfettered by regulation.")

132. *In re* Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minn. Pub. Utils. Comm'n, 19 F.C.C.R. 22,404, § IV(46) (2004).

133. *See* McCullagh, *supra* note 122 (describing three such bills introduced in Congress in 2004).

134. *See* Telecommunications Act of 1996, 104 Pub. L. No. 104, 110 Stat. 56 (1996). The codification of the Act defines "telecommunications service" as "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used." 47 U.S.C. § 153(46) (2000). It defines "information service" as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service." *Id.* § 153(20).

135. *See* Kevin Werbach, *Hail to the VoIP?*, TECH CENTRAL STATION, Oct. 29, 2004, *at* http://www.techcentralstation.com/102904N.html.

136. Roy Mark, *Federal Lawmakers Bid for VoIP Control*, TELEPHONY ONLINE, July 7, 2004, *at* http://www.wi-fiplanet.com/voip/article.php/3377611.

will have a broad choice of service providers, [so] the services will be highly competitive . . . . Accordingly, the regulations which have governed monopoly telephone networks should not apply to new competitive Internet-based technology."[137]

Congress has also lobbied the FCC to ensure that VoIP is established as an interstate service that the federal government therefore can regulate. Rep. Chip Pickering (R-Miss.) and sixty-one other members of Congress signed a letter to then-FCC Chairman Powell, asking the FCC to claim exclusive jurisdiction over VoIP services.[138] Some state utility lobbyists view this solicitation of action on the part of the FCC to be a way for Congress to avoid the judicial scrutiny they might otherwise encounter by legislating such a claim of exclusive jurisdiction over VoIP.[139]

D. State Action

States have a deep interest in gaining jurisdiction over VoIP because of the implications for their own universal program funds, which could be endangered as consumers move from traditional phone services to VoIP.[140] While state jurisdiction over the issues discussed earlier—universal service, emergency services, and CALEA—has largely been preempted by the FCC's November 2004 order regarding Vonage, states will likely still have room to regulate in the consumer protection realm.

As the court discussed in *Vonage*, states have historically been preempted from regulating information services because of the FCC's authority in that arena.[141] The FCC cited the public policy objective of encouraging the growth of information services for its finding that state and federal governments must refrain from regulating such services.[142] The main problem in determining whether a particular VoIP call is interstate (and thus controlled by the FCC) or intrastate (thus possibly allowing states the room to regulate) is that it might be difficult for VoIP providers themselves to determine whether VoIP calls are interstate or intrastate.[143] This is because in determining jurisdiction, regulators typically use an end-to-end analysis that considers the communication's starting and ending

137. *Id.* (quoting Rep. Rick Boucher (D-Va.)).

138. Donny Jackson, *Feds Fight to Take VoIP Out of State*, Oct. 11, 2004, *at* http://telephonyonline.com/mag/telecom_feds_fight_voip/index.htm.

139. *Id.* (quoting Libby Beaty, Executive Director, Nat'l Ass'n of Telecommunications Officers and Advisors).

140. *Id.*

141. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(1).

142. *Id.*

143. *Id.*

points.[144] Using the end-to-end analysis structure, the FCC determined that both Digital Subscriber Line Service (DSL) and cable modem were interstate services.[145]

The FCC's Vonage ruling establishing federal jurisdiction over computer-to-computer and computer-to-telephone telephony was important because it avoids application of a hodgepodge of state regulations. For instance, New York's Public Service Commission in 2002 classified an IP telephony company as a provider of telecommunications service and not information service, thereby subjecting it to intrastate access charges.[146] In Florida, the legislature started down the path of VoIP taxation when it failed to postpone the enforcement of a previously-obscure tax that targets substitute communications like VoIP.[147]

The FCC ruling is not necessarily the last word on the matter, however, because states may still seek to challenge the boundaries of the ruling. The California Public Utilities Commission's finding that it had concurrent jurisdiction with the FCC over DSL service, despite the FCC's determination of the interstate nature of DSL service, shows that a state might seek to obtain such concurrent jurisdiction even in the face of a contrary ruling by the FCC.[148]

Beyond *Cellco* and *Vonage*, it is uncertain whether the courts will address further issues regarding VoIP in a way that shapes the young industry before the executive or legislative branches make any decisions, especially considering the FCC's assertion of dominance on the issue and Congress's deferral to the FCC. An example of a possible court intervention into the FCC's VoIP lawmaking in the near future would be the Minnesota PUC's appeal regarding the *Vonage* decision.[149] A more likely scenario is that courts would defer to the FCC and Congress to create more substantive law governing the industry before making further determinations. This is probably the better outcome for public policy because it avoids the possibility of creating conflicting law which would be a problematic way to govern such a young industry.

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144. *Id.*

145. *Id.*

146. *Id.* § 14A.03(3)(b).

147. Marguerite Reardon, *Florida Paves Way for VoIP Taxation*, CNET NEWS.COM, May 3, 2004, *at* http://news.com.com/2102-7352_3-5204656.html?tag=st.util.print.

148. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.03(3)(c).

149. Ben Charny, *States Battle FCC Internet Phone Ruling*, CNET NEWS.COM, Jan. 4, 2005, *at* http://news.com.com/States+battle+FCC+Internet+phone+ruling/2100-7352_3-5512432.html.

III. REGULATORY POSSIBILITIES

A number of different interests have been discussed above, and policymakers must prioritize these various interests to determine the best schemes for regulation of this exploding industry. Congress's main goals are the development of a robust array of information services unfettered by unnecessary regulation, as well as the availability of affordable communications services for all. As Congress, the FCC, the courts, and state governments continue to regulate the VoIP industry, they must take care to keep in mind the often conflicting concerns of industry growth versus affordable communications (in the case of universal service), industry growth versus public safety (in the case of emergency services), and industry growth and privacy rights versus an efficient and effective law enforcement (in the case of CALEA).

A. Jurisdiction—Federal and/or State?

As the FCC has already asserted exclusive federal jurisdiction over VoIP, most of the jurisdictional battles have ended. This preemption of state regulation is good for the industry in the sense that providers and state regulators will not have to draw the difficult and technology-inappropriate distinctions between the interstate and intrastate portions of the voice communications.[150] However, as discussed earlier, federal jurisdiction puts states at a disadvantage in terms of their taxation revenues and emergency service regulation.[151] In its order, the FCC also carved out areas of state regulation, generally in the area of consumer rights.[152]

States currently impose certain consumer protection regulations on telecommunications providers, such as regulations barring fraud and deceptive trade practices.[153] In its November 2004 Vonage ruling, the FCC stated that it expected that states would still retain a vital role in enforcing consumer protection regulations on VoIP providers.[154] As for other consumer protection requirements that may be preempted by federal regulation, the FCC stated that the role of state regulation will be fleshed out in

150. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(1).

151. *See* Part I.C.1-.2.

152. *See* 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(4)(e). For a discussion of possible state regulation, see *supra* Part II.D.

153. *In re* Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minn. Pub. Utils. Comm'n, 19 F.C.C.R. 22,404, § I(1) (2004).

154. *See In re* Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minn. Pub. Utils. Comm'n, 19 F.C.C.R. 22,404, §§ I(1), III(14) n.46.

the ongoing IP-Enabled Services Proceeding.[155] State involvement in the regulation process would ensure that they would have some oversight over harms to resident consumers of VoIP services, but limiting the involvement of states in the process would prevent VoIP providers from having to wade through a mess of state regulations.

B. Federal Regulatory Possibilities

1. *Universal Service*

It seems appropriate that universal service, once the dominant regulatory issue at the birth of traditional telephone service, was the issue that first troubled the FCC about VoIP. In its 1998 universal service report to Congress, the FCC focused on the problems of applying the universal service regulations, originally designed to apply to circuit-switched networks, to the wide variety of offerings in IP telephony. A possible proposal would be to simply apply universal service charges to voice packets that travel over the Internet by, for example, imposing a broad-based tax on all voice service users.[156] It is extremely difficult, however, if not impossible, to distinguish voice packets from data packets. Therefore, such a broad-based tax might necessarily implicate Internet users sending data packets as well, contrary to Congress's expressed desire to keep the Internet regulation-free. Some academics suggest that simple regulatory changes will not be sufficient, and that there will have to be a sea change in either federal Internet policy, or in U.S. telecommunications regulation.[157]

2. *Emergency Services*

One suggestion is to avoid federal regulation of emergency services for now, and wait for the VoIP industry to self-regulate in this matter. So far, an industry coalition of VoIP providers has begun to do so, working in conjunction with the National Emergency Number Association.[158] The benefit of such a self-regulating system is that it would better enable the industry to adapt the diverse array of VoIP technologies to provide emer-

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155. *See id.*

156. *See* BENJAMIN ET AL., *supra* note 14, at 782 (suggesting that a broad-based tax might be a possible solution to dealing with the market distortions created by the Telecommunication Act's imposition of universal service funding requirements on incumbent local exchange carriers (ILECs) to the benefit of their non-funding competitors, the competitive local exchange carriers (CLECs)).

157. *Id.* at 950.

158. *See* VON Coalition, *Survey Highlights Progress on 9-1-1 for VoIP*, *at* http://www.von.org/usr_files/911%20--%20Survey%2012-1-04.pdf (last visited Dec. 21, 2004).

gency service, instead of having to depend on federal statutes or FCC rulemaking that can be cumbersome and too slow. The federal government must take care, however, to ensure that the standards developed are in the public's best interest and not simply in the industry's best interest.

Another problem with such a scheme is that industry standards would not necessarily resolve the issue of how states should fund emergency services, if no longer by taxing PSTN customers. Perhaps a viable compromise could be found in the coordination of government and industry to develop a set of standards for a self-regulating VoIP industry body to oversee, and with the federal government also imposing and collecting a tax from VoIP providers that would help provide for traditional emergency services funds. Interestingly, a coordinated effort by industry and government could produce a 911 system far superior to the current system based on the PSTN.[159]

The emergency power issue is also likely resolvable at the innovative industry level. Companies have been working on technologies to ensure that VoIP consumers can still have a backup source of electricity for their Internet connections, and therefore VoIP services, during power outages.[160] In addition, this problem of emergency power has already been addressed in a similar context: cable operators providing telecommunications services. In the cable telecommunications situation, many states require cable telecommunications companies to provide customers with a back-up power source in case of power outages.[161] Therefore, regarding the two-pronged objective of providing emergency services to consumers, the FCC will likely only have to work with the industry to ensure that a viable system of 911 connection standards is developed. On the issue of maintaining power during power outages, it seems that companies have sufficient incentive to develop such innovations.

3. *Communications Assistance for Law Enforcement Act (CALEA)*

Congress and the FCC must note that requiring VoIP providers to leave a backdoor for wiretapping will eliminate many of the efficiencies of

159. Joanna Sabatini, *VoIP 911 Still Trails Wireline* (Aug. 4, 2004), http://www.lightreading.com/document.asp?doc_id=57241.

160. *See* Jim Oberweis, *Four-Letter Words for Growth: VoIP and iPod*, FORBES, Nov. 5, 2004 (discussing the example of PowerDsine Ltd.'s development of "power-over-Ethernet" technology to maintain power to Ethernet-based services during power outages), *at* http://www.forbes.com/investmentnewsletters/2004/11/05/cz_jo_1105soapbox.html

161. 2-14A TELECOMMUNICATIONS & CABLE REGULATION, *supra* note 1, § 14A.04(5)(a).

VoIP over traditional telecommunications technology, as well as pose privacy problems for the Internet as a whole. Therefore, the FCC should not impose CALEA requirements because to do so would unduly burden the budding industry, would be inconsistent with Congress's expressed intent to exempt Internet providers, and would contradict policy concerns about privacy.

As discussed in Part I.C.3, CALEA requirements would greatly reduce the efficiency of VoIP. Applying CALEA requirements to VoIP would essentially impose a mandate on VoIP providers to design their network architecture to support the statute.[162] The natures of the Internet and VoIP are to send packets in the most efficient way possible. Thus, forcing packets to travel on a specific path would counteract these efficiencies of VoIP. In addition, applying CALEA to VoIP would contradict the FCC's 2002 cable modem ruling that inseparable hybrid telecommunications and information services should be considered information services, as well as Congress's expressed intent to keep information services regulation-free in order to encourage innovation and competition.[163]

Finally, consumer privacy advocates have expressed concern about the threat that regulation of VoIP technologies poses for the future of Internet regulation.[164] If the FCC and federal law enforcement succeed in requiring VoIP providers to comply with CALEA, then what are the technical barriers that limit the application of CALEA requirements to the Internet at-large? Furthermore, law enforcement officials already have the ability to monitor communications through the existing wiretap laws.[165] Law enforcement has provided no detailed evidence that the existing wiretap laws do not sufficiently address their ability to catch criminals.[166]

Considering the hybrid information service/telecommunications service nature of Internet telephony, Congress's expressed intentions to leave

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162. *See* Fed. Communications Comm'n, *Communications Assistance for Law Enforcement Act* (CALEA), *at* http://www.fcc.gov/calea (last updated Feb. 4, 2005) (discussing how all CALEA-qualifying carriers are obligated to comply with CALEA requirements: even if the FCC grants a carrier a deferral of CALEA compliance, such a carrier is required as soon as practicable to "select CALEA-compliant equipment to replace, modify or upgrade non-compliant equipment").

163. *See supra* Part I.C.3.

164. *See* Joint Comments of Industry and Public Interest, *supra* note 94, at 51 (discussing the dangers posed by one of the CALEA requirements to "privacy and network security going beyond CALEA"); *see also* Elec. Frontier Found., *supra* note 93 (discussing how various third-party intercept service companies such as VeriSign endanger the privacy of personal data in providing Internet-based CALEA services to ISPs).

165. Joint Comments of Industry and Public Interest, *supra* note 94, at 4-5.

166. *Id.* at 6-8.

information services free of regulation in order to promote innovation and development of the Internet, law enforcement's existing wiretapping powers, and the grave privacy concerns, Congress and the FCC should not apply CALEA requirements to VoIP.

IV. CONCLUSION

VoIP will likely replace traditional telecommunications as the vehicle for supplying voice communications in the United States. This eventual replacement includes both benefits and costs. The telecommunications industry is being entirely reshaped by this technological phenomenon. Consumers will benefit from the decreased prices and convergence of technologies. While continued nonregulation of VoIP might threaten the federal and state governments' longstanding commitment to providing telecommunications services for all, the examples of industry attempts to resolve emergency services issues indicate that not all solutions lie in increased regulation by the federal government. In addition, a wholesale application of telephone industry regulations to VoIP technologies might be onerous and inappropriate for the growing VoIP industry, as well as threatening to the public's privacy rights in using information and hybrid services. The FCC, courts, Congress, and states must strike a balance between satisfying the needs of the new industry, ensuring that longstanding public services and safety are provided, and protecting the privacy rights of the public.

BRAND X INTERNET SERVICES V. FCC: THE CASE OF THE MISSING POLICY ARGUMENT

By Steven Aronowitz

People seeking Internet access through their cable lines may soon have new choices. Today, a consumer with Comcast Cable can only purchase cable modem service from Comcast or a Comcast-affiliated provider, usually a Comcast subsidiary.[1] If the decision in *Brand X Internet Services v. Federal Communications Commission*[2] is upheld by the United States Supreme Court, that consumer will eventually be able to choose from other cable Internet Service Providers (ISPs) operating on Comcast's connection to the customer's home.

Regulatory consistency and open access to cable Internet is at stake in *Brand X*. Access to the Internet requires two basic components: a last mile connection and an ISP. The last mile is a physical connection linking a personal computer to the network of computers that make up the Internet. For cable modem Internet service, the connection is a cable line; for Digital Subscriber Line (DSL) service, it is a phone line. An ISP provides a software connection allowing a personal computer to communicate with the network. Telecommunications law and the Federal Communications Commission (FCC) require phone companies to open the last mile of DSL service to competition among ISPs, but do not require cable modem service providers to open their last miles.

The *Brand X* decision harmonizes the regulation of cable modem Internet and DSL by mandating open access to cable Internet. Under an open access system, telecommunications service owners can not create information service monopolies through the restriction of access to telecommunication services. In other words, just because you own the pipes does not mean you can control what is flowing through them.

The United States Court of Appeals for the Ninth Circuit's decision in *Brand X* redefines how cable modem service is classified by the FCC under the Telecommunications Act of 1996.[3] If cable modem service is a telecommunications service, it will be subject to open access require-

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1. STUART MINOR BENJAMIN ET AL., TELECOMMUNICATIONS LAW AND POLICY 892 (2001).

2. 345 F.3d 1120 (9th Cir. 2003) (per curiam), *reh'g and reh'g en banc denied*, 2004 U.S. App. LEXIS 8023 (9th Cir.), *cert. granted*, 124 S. Ct. 655 (2004).

3. *See infra* Part I.C.

ments, but if it is an information service, cable companies will not have to open the last mile to unaffiliated ISPs. The Ninth Circuit, reversing an FCC ruling, held that cable modem Internet provides a telecommunications service in part and so must allow ISPs to compete on cable lines.[4] The Supreme Court has granted certiorari.[5] The outcome will have profound effects on the Internet access industry and consumers while setting a precedent for the regulation of emerging technologies. This Note suggests the correct result will uphold the Ninth Circuit's decision.

The *Brand X* court reached the right result while ignoring the most important rationale for this decision: public policy. The FCC has the best institutional capability to define cable modem service under the Telecommunications Act, but the FCC made a choice that will negatively affect telecommunications regulations and consumers. The Ninth Circuit is properly bound by a previous Ninth Circuit decision, *AT&T v. City of Portland*,[6] because that case took place before any FCC action and so the court did not improperly review the FCC's decision.[7] *Brand X*, however, is not only defensible under the *Portland* precedent; it sets out good telecommunications policy by putting cable modem service and DSL on a level playing field and benefits consumers by creating competition among cable modem ISPs.

This Note explores the rationale and implications of *Brand X*, from the standpoint of both institutional competence and policy concerns, for harmonized telecommunications law and open access to the Internet. Part I reviews the legal and factual background of the *Brand X* decision, including various Internet access technologies, telecommunication regulatory history, the FCC's response to cable modem service, and the procedural history of the Ninth Circuit's decision. Part II summarizes the court's analysis, the reliance on *Portland*, and the concurring opinions. Part III argues that the Ninth Circuit's decision is good for rational regulation and consumer interests alike, even if the court based its holding on a somewhat wooden adherence to precedent rather than the sound policy of offering a level playing field to Internet access providers and a competitive market to consumers.

4. 345 F.3d at 1132.
5. 124 S. Ct. 655 (2004).
6. 216 F.3d 871 (9th Cir. 2000).
7. *See infra* Part II.A.

I. BACKGROUND FACTS AND PROCEDURAL HISTORY

Brand X addresses how telecommunication regulation should respond to a new method of Internet access. An understanding of the regulatory background and the nature of the new cable technology that challenges the efficacy of previous rules clarifies the import of this decision.

A. Connecting to the Internet

There are several ways to connect a home computer to the network of computers that constitute the Internet. Each way consists of connecting a computer in a customer's home to a computer operated by the ISP, which serves as a portal to the Internet for the computer at home. Different access technologies—dial-up, DSL, and cable—utilize different connections between the users' computer and the ISP's computer. Utilizing "dial-up" service, a user's home computer connects to the ISP with a traditional modem over a phone line.[8] The computer dials the phone number for the ISP and communicates using audio tones. DSL service also utilizes phone lines, but without dialing; the connection is digital and always on.[9] The drawback of DSL is that a customer must be within a certain geographic proximity to a central station, which makes DSL expensive for rural areas. Cable modems, unlike dial-up and DSL connection to the Internet, do not use a phone line as the last mile. Instead, cable modems connect the home computer to the ISP through the coaxial cable originally installed to deliver television content.[10] Prior to the *Brand X* decision, cable line providers enjoyed the monopoly right to exclude ISPs from their networks.[11] Thus, most cable companies provide the Internet connection themselves or through an affiliated ISP created and owned by the cable operators.[12]

Dial-up Internet access service illustrates the separation between the physical last mile connection and the software connection to the ISP. The last mile for dial-up service is existing phone lines, which can be used by any consumer to connect to any ISP for the price of an ordinary phone call. For DSL and cable modem service, the distinction is more theoretical because consumers do not normally make independent data connections over high-speed digital phone or cable lines; in addition, specific software and hardware connections are required that go beyond normal phone or cable service. Creating multiple physical last mile connections for DSL or cable modem service would be just as inefficient as creating multiple con-

8. *Brand X*, 345 F.3d at 1123.
9. *Id.* at 1124.
10. *Id.*
11. *See id.* at 1124-25.
12. *Id.* at 1124.

nections for each home to the telephone network. Thus, the first company to install the last mile enjoys a natural monopoly over the connection that makes the open access question particularly pressing.

Cable modems and DSL provide "broadband" access[13] with data transfer rates significantly higher than dial-up or "narrowband" access rates. Broadband speeds the sending and receiving of information, allowing customers to view streaming media, transmit large files, and load websites more quickly. With the rising customer demand for the advantages of broadband access, regulatory differences between DSL and cable modem services are causing increasing market effects.[14]

B. Telecommunications Regulatory History and the Common Carrier

The idea of a common carrier began before modern telecommunications.[15] The United States inherited the idea of a common carrier as a service provider that was open to all and, in exchange, was immune from certain liabilities and competition.[16] Today, telecommunication common carrier regulations include the requirement that service providers allow competitors to use their lines, but that was not always the case.

The regulation of the telecommunication industry began in 1910 with the passage of the Mann Elkins Act of 1910,[17] which defined telecommunications companies as common carriers but did not require them to carry the information of other carriers on their lines.[18] This omission, combined with the network effect of telephone service, created a strong monopoly effect.

A network effect occurs when technology is more useful as an increasing number of people use it. For example, a single telephone has no value, but it becomes more useful as it is connected to more and more tele-

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13. *Id.*

14. *See In re* Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities, 17 F.C.C.R. 4798, 4799-800 (2002) [hereinafter Inquiry Concerning High-Speed Access] (recognizing the increasing demand for broadband and the legal pressure that has created).

15. In England, the King granted exclusive monopolies to transportation companies operating services like ferryboats or a commercial pier. English common law evolved to constrain Crown monopolies while protecting their control of the market. *See* BENJAMIN ET AL., *supra* note 1, at 608.

16. *Id.*

17. Pub. L. No. 218, ch. 309, § 7, 36 Stat. 539 (1910) (amending Interstate Commerce Act of 1887, ch. 104, § 1, 24 stat. 379 (1887) (codified as amended in scattered sections of 49 U.S.C.))

18. BENJAMIN ET AL., *supra* note 1.

phones. Telecommunications companies, like Bell, were not forced to carry the signals of competing companies over their lines, so they established an exclusive network. Thus, a Bell consumer could only communicate with other Bell consumers. Customers had a large incentive to purchase telephone service from the company with the largest network, eventually leading to a monopoly.[19] The federal government removed the monopolistic impact of the network effect in the Telecommunications Act of 1996 by requiring telecommunications companies to carry and deliver signals of competitors on their networks.

Even with a requirement to carry competitors' signals, parts of the telecommunications industry are natural monopolies, including, of particular relevance to the Internet access question, the so-called last mile. The fixed costs associated with installing local wires between customers' homes and nearby aggregation centers make multiple competing networks, each with a last mile wire connection to all consumers, inefficient.[20] Economies of scale, demand variability, and equity concerns also argue for a telephone monopoly.[21]

The natural monopoly inherent in the last mile connection creates economic reasons to require providers to carry the information of competitors. This open access requirement preserves the efficiency of limited last mile wires while creating competition in the consumer market. To this end, Congress created an open access telecommunication system by enacting the Telecommunications Act of 1996. Suddenly, the Telecommunications Act gave companies the right to purchase services from a telecommunication provider at wholesale rates and resell those services to consumers in competition with the original provider.[22] In the past, telecommunications policy focused on controlling monopoly power regulation, but the Telecommunications Act of 1996 sought to control monopoly power with market power. This shift to open access set the stage for new consumer choice and competition in telecommunications service.

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19. *Id.* at 616.

20. *Id.* at 614.

21. Constructing one large network is less expensive than constructing several small networks. In addition, putting one company in charge allows that company to realize economies of scale as the network grows. One large network can equalize demand variability over more customers. More customers in a network reduce the expense per customer to provide subsidies aimed at equity. *See id.* at 617-18.

22. *See* 47 U.S.C. § 251(b)(1), (c)(4) (2000); BENJAMIN ET AL., *supra* note 1, at 717.

C. The FCC Responds to Cable Modem Service

The Telecommunications Act of 1996[23] distinguishes cable services, telecommunication services, and information services. The three services are subject to different levels and kinds of regulation, which has proven to have important and unforeseen effects on the Internet access market. The Act defines cable service as transmission of video content to subscribers and interaction involving the selection and use of the content.[24] For instance, a cable television company provides cable service when it transmits television programs into customers' homes and allows them to select pay-per-view programs through the cable connection. Telecommunication service is defined as provision of telecommunications to the public for a fee through any facilities.[25] This classification covers phone companies and any other company that creates the infrastructure for people to communicate. Finally, the Act defines information service as provision of the use of information through telecommunications but specifically does not cover the operation or management of a telecommunications system.[26] An example of an information service is a stock quote company that provides information about stocks by phone, fax, e-mail and/or a website but is not engaged in operating any of those telecommunication systems.

The FCC did not immediately categorize cable modem Internet service.[27] Regulators and commentators believed that market forces and improving technology were changing the industry too quickly to make regulation effective at the time, but as cable modem Internet service became a

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23. Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.).

24. 47 U.S.C. § 522(6) (defining cable service as "(A) the one-way transmission to subscribers of (i) video programming, or (ii) other programming service, and (B) subscriber interaction, if any, which is required for the selection or use of such video programming or other programming service").

25. *Id.* § 153(46) (defining telecommunications service as "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used").

26. *Id.* § 153(20) (defining information service as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunication service").

27. The FCC took a hands-off approach to regulating cable modem Internet service. *See* William E. Kennard, The Road Not Taken: Building a Broadband Future for America, Remarks Before the National Cable and Television Association (June 15, 1999), *available at* http://www.fcc.gov/Speeches/Kennard/spwek921.html.

viable form of Internet access and communication, the need to formulate a regulatory response became increasingly clear.[28]

On September 28, 2000, the FCC took up the call, issuing a notice of inquiry and taking comments on "what regulatory treatment, if any, should be accorded to cable modem service and the cable modem platform used in providing this service."[29] On March 15, 2002, the FCC issued its Declaratory Ruling and a notice of proposed rulemaking.[30] In the ruling, the FCC classified cable modem service as solely an information service and ruled that cable modem service was neither cable service nor a telecommunications service, thus exempting cable modem service from open access requirements.[31]

The FCC ruling first identified three core principles it strove to uphold: attempting to provide broadband to all Americans; minimizing regulatory interference with the market; and creating a rational framework across technological platforms.[32] Avoiding regulation of broadband in particular is a longtime goal of the FCC.[33] The ruling next looked to the Telecommunications Act and case law on classifying cable modem service, and concluded the statute and case law are unclear, leaving the classification of cable modem service unresolved.[34]

In the absence of statutory or case law guidance on cable modem Internet service, the agency looked to an earlier FCC decision, the *Universal Service Report*,[35] which classified Internet access service over the phone as an information service.[36] In light of this earlier classification the FCC ruled that cable modem service, like Internet access service, was a single integrated service offering use of the Internet.[37] It is notable that the *Universal Service Report* raised but did not decide the issue of how to classify Internet access services that own the telecommunication facilities

28. The FCC may have been too late, according to the Ninth Circuit. By this time cable modem Internet service had already been defined in *Portland*. *See* AT&T v. City of Portland, 216 F. 3d 871, 877 (9th Cir. 2000).

29. *In re* Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities, 15 F.C.C.R. 19287, 19287 (2000).

30. Inquiry Concerning High-Speed Access, *supra* note 14.

31. *Id.* at 4802.

32. *Id.* at 4901-02.

33. In 1999, then-FCC Chairman Kennard discussed the importance of letting early cable modem service develop free of government intervention. *See* Kennard, *supra* note 27.

34. Inquiry Concerning High-Speed Access, *supra* note 14, at 4819.

35. *In re* Federal-State Joint Board on Universal Service, 13 F.C.C.R. 11501, 11535 (1998).

36. Inquiry Concerning High-Speed Access, *supra* note 14, at 4821.

37. *Id.*

used to access the Internet. This scenario fits a cable modem service run by a cable company. While the *Report* noted that such facilities may merit classification as a separate telecommunications service, the FCC pointed out that no decision was reached on that issue.[38] In regards to cable modem service, the agency reached its ruling by finding that the telecommunications facilities are used only to provide access as part of an integrated Internet access service that cannot be separated into a telecommunications service.[39]

Indeed, the FCC ruling explicitly rejected the idea that cable modem service offers a separate telecommunications service for purposes of classification under the Telecommunications Act of 1996.[40] Instead, the FCC found that cable modem capabilities are merely provided "via telecommunications" and that such telecommunications are not offered separately from the Internet access.[41] The agency reasoned that no cable operator has made an independent offer of transmission of information for a fee directly to the public or wholesaler as a common carrier would.[42] The FCC further found that cable companies offering multiple ISPs act as private, not common, carriers because the companies decide which ISPs to work with on an individual basis and are not offering transmission over cable lines to all ISPs.[43]

The FCC ruling was also careful to distinguish cable modem service from Internet access over telephone wires through dial-up or DSL.[44] When an information service is being offered by a traditional telecommunications provider—that is, when a telephone company also acts as an ISP—a separate telecommunications service exits, but the FCC found there is no such separate service in Internet access service over cable wires.[45] Even where cable companies also offer telephone service, the FCC waived the common carrier requirements. This move was designed to prevent uneven application of open access to the limited number of cable modem providers that also offer telephone service, while encouraging cable companies to stay in the telephone market.[46]

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38. *Id.* at 4823-24.
39. *Id.* at 4824.
40. *Id.* at 4823.
41. *Id.*
42. *Id.*
43. *Id.* at 4830.
44. *Id.* at 4825.
45. *Id.*
46. *Id.* at 4826.

Immediately following the ruling, ISPs and other Internet industry groups filed for review of the FCC's action. The petitions were filed in the Third, Ninth, and District of Columbia Circuit Courts of Appeals. On April 1, 2002, the Judicial Panel on Multi-District Litigation transferred and consolidated the related petitions for review before the Ninth Circuit with the Brand X petition.

On May 8, 2003, the Ninth Circuit panel vacated the FCC ruling in part and held that cable modem service had a telecommunications service component.[47] The court held that the FCC's ruling was incomplete because it did not include telecommunication service in the definition of cable modem service and, therefore, vacated that portion of the ruling. The full Ninth Circuit denied rehearing and en banc rehearing of the case.[48] On August 31, 2004, the FCC filed a petition for a writ of certiorari with the United States Supreme Court.[49] On December 3, 2004, the Supreme Court granted the petition and is expected to hear arguments on March 29, 2005.[50]

II. THE NINTH CIRCUIT'S ANALYSIS

Currently, *Brand X*[51] provides the final word in the definition of cable modem services under the Telecommunications Act of 1996. The decision focuses on the precedent set by the Ninth Circuit in *AT&T v. City of Portland*,[52] which found that cable modem Internet service incorporated both information and telecommunication services for purposes of regulation by local franchising authorities. *Portland* left unanswered questions about the status of cable modem service and the future of open access.[53] The *Brand X* decision finalizes the definition of cable modem service as partially a telecommunications service under the Telecommunications Act and overrules the FCC definition. This decision clears the way for open access to cable modem service. The *Brand X* court restated the *Portland* facts and

47. Brand X Internet Servs. v. FCC, 345 F.3d 1120 (9th Cir. 2003) (per curiam), *reh'g and reh'g en banc denied*, 2004 U.S. App. LEXIS 8023 (9th Cir.), *cert. granted*, 124 S. Ct. 655 (2004).

48. Brand X Internet Servs. v. FCC, Nos. 02-70518, 02-70684, 02-70686, 02-70879, 02-71425, 02-72251, 2004 U.S. App. LEXIS 8023 (9th Cir. Mar. 31, 2004) (denying rehearing and rehearing en banc).

49. United States Supreme Court Docket No. 04-281, *available at* http://www.supremecourtus.gov/docket/04-281.htm (last visited Jan. 24, 2005).

50. *Id.*

51. *Brand X*, 345 F.3d at 1132.

52. 216 F.3d 871 (9th Cir. 2000).

53. BENJAMIN ET AL., *supra* note 1, at 901.

analysis and used the previous interpretation to craft a new rule defining cable modem service for the FCC.[54] This Part explains the *Portland* rationale, details why the court in *Brand X* was bound by this precedent, and summarizes the *Brand X* concurring opinions.

A. *AT&T v. City of Portland*

In *AT&T v. City of Portland*, the Ninth Circuit addressed the open access conditions placed on a cable franchise sale by a local franchise authority.[55] The *Brand X* court found that *Portland* held cable modem service did not qualify as a cable service and that it incorporated both information service and telecommunications service.[56]

The *Brand X* court reiterated the logic behind the *Portland* decision and then outlined why *Portland* was indeed the controlling definition of cable modem services. The dispute in *Portland* arose from the merger of AT&T with TCI.[57] TCI was a cable provider that operated in Portland under a franchise from the Local Franchising Authority (LFA), which grants cable companies right of way and other rights in exchange for providing cable service to its residents at negotiated terms. Under the Telecommunication Act, local franchising authorities have the power to include local approval requirements in the franchise agreements.[58] The City of Portland attempted to condition the merger of AT&T with TCI on the provision that AT&T provide open access to cable modem ISPs over the broadband cables in Portland.[59] AT&T brought suit, claiming that an open access requirement was illegal under the Telecommunications Act of 1996 and other statutes and agreements.[60] AT&T eventually won nullification of the open access franchise agreement transfer condition because the court held that cable modem services were not cable services and so could not be directly regulated through the cable franchise authority.[61]

In *Portland*, the court distinguished between the two activities undertaken by a cable modem service provider. One is to provide an informa-

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54. *Brand X*, 345 F.3d at 1128-29.

55. 216 F.3d 871.

56. *Brand X*, 345 F.3d at 1131.

57. *Portland*, 216 F.3d at 873.

58. 47 U.S.C. § 537 (2000). The franchise agreement between Portland and TCI included language allowing the city to "condition any Transfer upon such conditions, related to the technical, legal and financial qualifications of the prospective party to perform according to the terms of the Franchise, as it deems appropriate." *Portland*, 216 F.3d at 875.

59. *Portland*, 216 F.3d at 875.

60. *Id.* at 876.

61. *See id.* at 877.

tional service by sharing data with customers, allowing them to use programs like e-mail and web design—that is, to act as an ISP.[62] But cable modem services also provide a "pipeline" component, transmitting data between customers and other Internet computers without any transformation of the form or content.[63] The court found this component of cable modem service to be a telecommunications service.[64]

Applying these classifications to the dispute at hand, the *Portland* court held that the Telecommunications Act prohibits an LFA from regulating cable modem services because the transmission of Internet service is a telecommunications service,[65] and LFAs are only entitled to regulate information services.[66] AT&T was able to move forward with the merger and ignore the open access requirement put in place by the City of Portland, but the *Portland* decision would come back to haunt AT&T in *Brand X*. In *Portland*, cable companies won a battle to keep the last mile closed, but in the process may have lost the war over open access.[67]

B. *Portland* as Binding Precedent over the FCC Rulemaking

The Ninth Circuit held the *Portland* statutory interpretation to be binding in reviewing the FCC rulemaking at issue in the *Brand X* case. Because the court had already ruled that cable modem service is defined as both an information service and a telecommunications service when the FCC made its ruling on cable modem service, that definition was binding and would be decisive in *Brand X*.[68]

In finding *Portland* to be binding, the court first rejected the argument that the *Portland* discussion of cable modem service definitions was mere dicta.[69] The court held that the definition of cable modem service was necessary to the conclusion of *Portland*,[70] pointing to language in the decision which said the court "must determine how the Communications Act defines ['cable modem']," and a sentence reading, "We hold that subsection 541(b)(3) prohibits a franchising authority from regulating cable broad-

62. *Id.* at 877-78.
63. *Id.* at 878.
64. *Id.*
65. 47 U.S.C. § 541(b)(3) (2000).
66. 216 F.3d at 880.
67. *See* Christian R. Eriksen, *Cable Broadband: Did the Ninth Circuit Beat the FCC to the Punch in Last Mile Regulation?*, 6 TUL. J. TECH. & INTELL. PROP. 283, 291 (2004).
68. Brand X Internet Servs. v. FCC, 345 F.3d 1120 (9th Cir. 2003) (per curiam), *reh'g and reh'g en banc denied*, 2004 U.S. App. LEXIS 8023 (9th Cir.), *cert. granted*, 124 S. Ct. 655 (2004).
69. *Id.* at 1130.
70. *Id.*

band Internet access, because the transmission of Internet service to subscribers over cable broadband facilities is a telecommunications service under the Communication Act."[71] This language does imply the court believed deciding the classification question was essential to the ruling. However, as an FCC declaratory ruling pointed out, such a finding was not logically required to decide the narrow question presented in *Portland*.[72] The court could have resolved the scope of local franchise authority by finding that cable modem service was not cable service. Anything beyond cable service is not subject to local franchise authority regulation. This initial holding, possible without the language quoted above, answers the question at the heart of *Portland* without reaching the issue of whether telecommunications service was the correct classification under the Telecommunication Act.

The court next rejected the contention that the previous holding was not binding under an exception detailed in *Mesa Verde Construction Co. v. Northern California District of Laborers*.[73] *Mesa Verde* crafted an exception to stare decisis in which precedent can be ignored in favor of a later federal agency ruling but "only where the precedent constituted deferential review of [agency] decision making."[74] At the time *Portland* was decided, the FCC had not yet classified cable modem service, suggesting the exception might apply. The *Portland* decision, however, was not a deferential review; rather, it was new law and so the court rejected the argument that the *Mesa Verde* exception applied.[75] The court also pointed to *Neal v. United States*,[76] which holds that once a court has found the meaning of a statute, that is the law against which subsequent agency decisions will be measured.[77]

Brand X sets out an important regulatory definition but avoids a discussion of the policy implications of classifying cable modem service as both information service and telecommunication service. The court relies on the *Portland* decision to define the nature of cable modem service, discussing stare decisis and evading an analysis of the ramifications of this decision.

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71. *Id.*
72. *See* Inquiry Concerning High Speed Access, *supra* note 14, at 4829-30.
73. 861 F.2d 1124 (9th Cir. 1988) (en banc).
74. *Id.* at 1136.
75. *Brand X*, 345 F.3d at 1131.
76. 516 U.S. 284 (1996).
77. *Brand X*, 345 F.3d at 1131-32.

C. Judge O'Scannlain's Concurrence: Institutional (In)Competence

Judge O'Scannlain's concurrence agreed that the result of *Brand X* must be dictated by the precedent of *Portland*, but nonetheless pointed out the incongruity this outcome has with the policy motivating the Supreme Court's decision in *Chevron v. Natural Resources Defense Council, Inc.*[78] Judge O'Scannlain was concerned that *Brand X* truncates the policy debate over cable modem regulation and usurps the authority of the FCC.[79] The FCC is the agency charged with implementing legislation governing communication policy. In this complex and technical area, Judge O'Scannlain contended that a statutory interpretation should have been left to the FCC.[80] He was also concerned that this decision will result in more preemptive and binding interpretation by courts in areas of interpretation that should be left to agencies.[81] In a footnote, he even brought up the idea of possible "nonacquiescence" by agencies in responding to decisions such as *Brand X*.[82]

D. Judge Thomas's Concurrence: Statutory Interpretation Supports the Ruling Without *Portland*

In his concurrence, Judge Thomas likewise found the *Portland* definition of cable modem service to be binding in *Brand X*, but further argued that defining cable modem service as partially a telecommunications service is correct regardless of *Portland*.[83] He first pointed out that *Chevron* deference to agencies only applies when there is statutory ambiguity.[84] In this case, he believed that the Telecommunications Act is not ambiguous and that the court can determine what Congress intended from the statute itself.[85] Judge Thomas then engaged in traditional statutory interpretation, addressing the language question, other interpretations of the statute, other provisions in the act, the act as a whole, the regulatory context, and finally the legislative history.[86] Judge Thomas found everything from the plain language of the statute to the legislative history to support the interpretation of "telecommunications services" as inclusive of cable modem ser-

78. *Id.* at 1132 (O'Scannlain, J., concurring); *see also* Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837 (1984).
79. 345 F.3d at 1133 (O'Scannlain, J., concurring).
80. *Id.* at 1133-34 (O'Scannlain, J., concurring).
81. *See id.* (O'Scannlain, J., concurring).
82. *Id.* at 1133 n.1 (O'Scannlain, J., concurring).
83. *Id.* at 1134 (Thomas, J., concurring).
84. *Id.* (Thomas, J., concurring).
85. *Id.* at 1135 (Thomas, J., concurring).
86. *Id.* at 1136-39 (Thomas, J., concurring).

vices.[87] Even without *Portland*, he believed an accurate statutory interpretation requires cable modem service to contain a telecommunications service component.[88]

III. DISCUSSION

The court in *Brand X* answered the question of how to define cable modem service under the Telecommunication Act without directly addressing the policy dispute over cable modem regulation and open access. The court made a good choice for telecommunications regulation and consumers alike. However, absent explicit consideration of the regulatory and consumer policy implications inherent in this decision, the court may have reached the right result without the right reasons.

A. The Missing Policy Discussion

Brand X makes a good policy decision without a policy discussion. This omission may have been a deliberate choice, as providing a policy rationale for *Brand X* could have exceeded the court's area of competence and ability to reach agreement.

Regulation of cable modem service is an intensely political issue with interested parties on all sides.[89] The courts are not equipped to address input from large numbers of interested parties and are not designed to create policy compromises between interests. Generally, agencies such as the FCC are deemed to have the institutional capability to handle such policy debate. However, in this case, the FCC's conclusion was unpersuasive and at odds with the Ninth Circuit's decision in *Portland*.

There are several problems with the FCC ruling. The decision ignored the impact on consumers and did not balance the benefits and risks of possible classifications. Although the decision succeeded in limiting regulation, the effect on increasing broadband availability or creating a consistent framework across platforms is unclear. The ruling left the status quo in place, so any growth in broadband distribution can be attributed to normal expansion and not the FCC ruling. Also, as Commissioner Copps pointed out in his dissent, this categorization scheme is difficult to understand and apply.[90] The ruling did not standardize regulation and did not necessarily improve broadband access. The only policy goal identified by

87. *See id.* (Thomas, J., concurring).

88. *See id.* at 1140 (Thomas, J., concurring).

89. *See* Inquiry Concerning High-Speed Access, *supra* note 14, at 4872 (listing more than 250 filings received while developing a ruling).

90. *Id.* at 4870.

the FCC and directly furthered by this decision is a limitation on regulation. The FCC also sidestepped how open access requirements will favorably impact consumers by pointing out that some cable companies are voluntarily providing consumers with multiple ISPs.[91] This proactive solution by some cable companies does not address the basic monopoly cable companies will enjoy without open access, or how that will affect consumer choice, price, and service.

Despite the problems with the policy discussion in the FCC ruling, it would have been unconvincing for the court to argue telecommunication policy with the agency created to implement it.

A policy discussion might have also moved beyond the scope of judicial agreement. The concurrences show a varying degree of enthusiasm for the outcome announced, and the Ninth Circuit panel may have been unable to agree on a policy rationale. Judge O'Scannlain had serious reservations about the decision and warned of negative consequences for federal agency independence, while Judge Thomas was so satisfied with the result that he provided additional support in the form of statutory interpretation.[92] This divergence suggests that the panel was only able to agree on the outcome and the binding nature of *Portland*'s precedent.

B. Harmonizing Regulation of New Technologies

The Ninth Circuit's definition aligns the regulatory treatment of DSL and cable modem service, currently the two most popular forms of broadband Internet access. Such alignment is good regulatory policy. *Brand X* extends the regulatory scheme for a traditional technology, telephone lines, onto a new communication method, cable lines. This decision provides symmetry in the regulation and creates a level playing field for providers of Internet access.

Under the FCC classification plan, phone companies providing Internet access through DSL are subject to open access requirements, while cable companies providing Internet access through cable modems are immune because they are using a different technological platform. Whereas cable modem service evolved in the world of cable television providers who, as providers of cable service, were not subject to telecommunications regulation, today the services offered by DSL and cable modem service providers are virtually indistinguishable from a consumer perspective.

As data and communication technologies converge, it becomes more problematic to make regulatory distinctions based on prior technological

91. *See id.* at 4815-18.
92. *See infra* Parts II.C, II.D.

differences.[93] New technologies must be regulated, and those new regulations should be consistent with existing regulatory schemes.[94] Regulatory asymmetry between cable modem service and DSL causes economic harm by distorting the market for broadband Internet and violates basic fairness by giving one group of Internet providers a regulatory advantage.

Harmonization creates an efficient and fair market by not advantaging newer, unregulated technologies.[95] If cable modem providers are not held to common carrier requirements, they may engage in anti-competitive practices such as attracting DSL customers by bundling Internet service with television service. Cable providers would also have an advantage over DSL providers who have to compete within the DSL market and also with cable providers for broadband customers.

Applying old regulations to new technology, however, could also create inefficiencies and discourage the development of new solutions to old problems. Part of the incentive for creating Internet access service over cable wires might have been to escape the telecommunications regulations. The old rules might also have detrimental impact on the technical effectiveness of a new technology. For example, supporting multiple ISPs on one cable system as required by common carrier regulations could reduce the speed and quality of the connection.[96]

In this case, the advantages of a symmetrical regulatory scheme outweigh the risks. Treating all Internet access technology the same will create fair competition and allow market forces to decide which technologies prosper. Cable modem service is past its developmental stage, when it needed to be sheltered from regulation, and should have to compete with other Internet access services on a level playing field.

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93. Philip J. Weiser, *Toward a Next Generation Regulatory Strategy*, 35 LOY. U. CHI. L.J. 41, 41-42 (2003).

94. *See* Christopher T. Hill, *The Impact of Technological Change in the Canada/U.S. Context: The Public Dimension of Technological Change: Impact on the Media, The Citizenry, and Governments—A U.S. Perspective*, 25 CAN.-U.S. L.J. 153, 159-60 (1999) (discussing regulation as a response to new technology from the progressive era forward).

95. *See* Jack Goldsmith, *Regulation of the Internet: Three Persistent Fallacies*, 73 CHI.-KENT L. REV. 1119, 1121 (1998) (arguing that self-regulation of the Internet has negative consequences for the real world by creating double standards in areas like gambling and copyright).

96. *See* Elizabeth Clampet, *Excite@Home Fires Back at Open Access Cable Proponents*, INTERNETNEWS.COM, July 15, 1999 (discussing the back and forth over the technical limitations of cable modem Internet supporting several ISPs), *at* http://www.internetnews.com/xSP/article.php/138271.

C. The Open Access Debate

Even absent the regulatory alignment concern, granting open access to cable modem services is a positive development for consumers.[97] The court made the right policy choice without considering policy concerns. Open access can improve quality and lower price for broadband Internet access through competition. Open access may reduce the incentive for innovation and infrastructure improvements, but in this case extending cable operators' monopoly to Internet access would be a windfall that the cable companies do not need.

Requiring cable companies to open their lines to competing ISPs could benefit and harm the public. Without open access, cable providers could limit cable modem service to affiliated ISPs, giving them a monopoly within the cable ISP market. Although cable providers would face broadband competition from DSL providers, in some areas cable modem service is the only broadband Internet access choice and, even in areas with access to DSL, it can be costly to switch between services.[98] Without competition in the ISP market, cable providers could charge higher access rates and would have no reason to improve the customer service or quality provided by their affiliated cable modem ISPs. It is interesting that cable television monopoly problems are currently addressed by allowing LFAs to oversee cable providers through negotiated franchise agreements. LFAs negotiate rates and service improvements before granting cable providers access to the local market. But, as the dispute that led to *Portland* illustrates, LFAs are not authorized to negotiate terms for cable Internet access because cable modem service is not a cable service, and is therefore not subject to the LFA authority. Thus, the checks on cable monopolies for television content do not extend to Internet access service.

Cable modem competition also comes with a set of risks. By forcing cable modem providers to compete within the cable modem market, the incentive and financial support for innovation could be reduced. Consumer

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97. Open Access also may benefit the entire Internet. *See* Mark A. Lemley & Lawrence Lessig, *Open Access to Cable Modems*, 22 WHITTIER L. REV. 3, 4-5 (2000) (arguing that the "end to end" architecture of the Internet is threatened by control exercised over content in the "last mile" by cable modem service providers); *see also* Jerome H. Saltzer, *Open Access Is Just the Tip of the Iceberg* (Oct. 22, 1999), *at* http://mit.edu/Saltzer/www/publications/openaccess.html.

98. *See* Jerry A. Hausman, *Residential Demand for Broadband Telecommunications and Consumer Access to Unaffiliated Internet Content Providers*, 18 YALE J. ON REG. 129, 168 (2001) (explaining and criticizing the FCC's decision that the AT&T and MediaOne merger did not limit competition in broadband because alternatives to cable modem service exist).

choice between cable modem, DSL, and other developing forms of Internet access might be enough competition to keep cable modem prices from skyrocketing. Allowing cable companies to reap the profit from a cable modem service monopoly would provide money and motivation for cable infrastructure expansion and improvement. Forcing cable companies to compete for cable modem dollars could cause a race to the bottom, leading to lower prices but bringing reduced investment in infrastructure and lower quality service within the cable modem section of the Internet access industry.

One question at the center of the debate over open access is whether cable companies would be poised for a windfall without open access or if ISPs will get a free ride with it.[99] Each side in the debate accuses the other of trying to gain an economic advantage through regulation.[100] ISPs argue that cable modem services are trying to increase profits by putting in place a government sanctioned monopoly that is unnecessary to the success of cable modem Internet.[101] Cable companies can just as easily argue that ISPs should not profit from the cable lines they did not install and do not maintain.

Despite their arguments to the contrary, cable companies do not need an ISP monopoly to recover their investments in infrastructure. The cable industry claims to have invested more than eighty-four billion dollars between 1996 and 2003 to upgrade cable systems, making broadband available to eighty-eight percent of the homes passed by cable (ninety-five million homes).[102] Cable companies will earn a profit on this investment by charging fees for use of the last mile, even without an ISP monopoly. Cable companies will improve the profitability of cable modem service through open access.[103] An ISP monopoly on top of the last mile fees

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99. *See* ROBERT COOTER & THOMAS ULEN, LAW AND ECOMONICS 42, 107 (3d ed. 2000) (explaining free riders are consumers seeking to use a public good without paying because there is no way to capture the cost of the good from the consumers).

100. *See* CABLEMODEM.NET, *Open Access: What It Means To You*, *at* http://www.cable-modem.net/features/fea_open_access.html (last visited Jan. 23, 2005) (setting out the industry arguments by cable modem providers and ISPs).

101. *See* Lee L. Selwyn, *Market Failure in Open Telecommunication Networks: Defining the New "Natural Monopoly*, *in* NETWORKS, INFRASTRUCTURE, AND THE NEW TASK FOR REGULATION 73 (Werner Sichel & Donald L. Alexander eds., 1999) (explaining why network firms seek monopolization and barrier to entry).

102. *See* National Cable and Telecommunications Association, *at* http://www.ncta.com/Docs/PageContent.cfm?pageID=37 (last visited Oct. 10, 2004).

103. *See* Jeffrey K. MacKie-Mason, *Investment In Cable Broadband Infrastructure: Open Access Is Not An Obstacle* (Nov. 5, 1999) (arguing that open access increases the value of the last mile and reduces risk while not threatening cable companies monopoly

would be profit from an unnecessary monopoly.[104] Even without additional profits from last mile or ISP fees, these upgrades help cable companies offer advanced services like video on demand to compete with satellite television systems.[105]

Telecommunications monopolies have negative consequences for consumers, and the *Brand X* decision makes the right choice in not allowing cable modem services to develop into entrenched monopolies. Cable companies, and even independent ISPs, have an incentive to continue innovating and improving cable modem service to compete with DSL and other forms of Internet access. There is no need to create a reward in the form of an ISP monopoly for cable modem operators.

IV. CONCLUSION

The court in *Brand X* defined cable modem service as part information service and part telecommunications service. This decision significantly changed the market for broadband Internet access by bringing cable modem service into the same regulatory scheme as DSL and forcing cable providers to allow competing ISPs to use the cable last mile. Though ostensibly based on precedent from the Ninth Circuit holding in *Portland*, the decision nonetheless has important consequences for the future of new technology regulation and open access to the Internet. The Supreme Court should uphold *Brand X* because it is good law and good policy.

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over the transport fees, and that open access will not slow investment in cable broadband), *available at* http://www-personal.umich.edu/~jmm/papers/broadband.pdf.

104. *See id.*

105. David Lieberman, *Cable Could Rule If It Plays Its Cards Right*, USA TODAY, Jan. 24, 2005, at B1.

THE BROADCAST FLAG AND THE SCOPE OF THE FCC'S ANCILLARY JURISDICTION: PROTECTING THE DIGITAL FUTURE

By Penina Michlin

Television is entering the digital transition: viewers can now receive visually spectacular, crystal-clear pictures that are of far higher quality than television of the past.[1] In fact, this new digital television platform does not just exist in expensive cable or satellite television packages.[2] By 2006, free broadcast television will be digital too[3]—provided, of course, that Congress and the Federal Communications Commission (FCC) can meet their goal to complete the digital transition.[4] As with any change in the status quo, the digital transition has far-reaching implications.

One particularly attractive consequence is that digital television (DTV) will free a significant amount of the radio spectrum for new uses.[5] There is a finite amount of spectrum suitable for carrying information over the airwaves,[6] and some technologies use that spectrum more efficiently than others.[7] DTV signals are a particularly efficient use, requiring much less of the spectrum than analog television signals.[8] Realizing the possibilities that newly available spectrum offers, then FCC Chairman Michael Powell has said, "All consumers . . . deserve a new spectrum policy paradigm that is rooted in modern-day technologies and markets. We are living in a

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1. Association of Public Television Stations, *Benefits of Digital Television*, *at* http://www.apts.org/PTVissues/digitalTV/benefits.cfm (last visited Jan. 15, 2005).

2. For example, the monthly rate for a Comcast Digital Platinum package is currently $98.42 per month. Comcast, *Select A Package*, *at* http://www.comcast.com (last visited Mar. 15, 2005) (providing price quotes for digital packages).

3. Consumer Elecs. Ass'n v. FCC, 347 F.3d 291, 294 (D.C. Cir. 2003).

4. The federal statute mandating the digital transition has a loophole: it only allows the transition if 85% of households have televisions capable of receiving digital television signals. 47 U.S.C. § 309(j)(14)(B)(iii) (2000).

5. Susan P. Crawford, *The Biology of the Broadcast Flag*, 25 HASTINGS COMM. & ENT. L.J. 603, 604 (2003).

6. "Spectrum encompasses the entire range of electromagnetic radio frequencies used in the transmission of sound, data, and video." Fed. Communications Comm'n, *FCC Strategic Goals: Spectrum*, *at* http://www.fcc.gov/spectrum (last updated Jan. 3, 2005).

7. In fact, because there is a finite amount of spectrum and a growing demand for it, effectively managing the available spectrum is one of the FCC's main purposes. *Id.*

8. Digital television uses as little as a quarter of the electromagnetic spectrum compared to analog television. *See infra* Part I.

world where demand for spectrum is driven by an explosion of wireless technology and the ever-increasing popularity of wireless services."[9]

Broadcasters, however, who are the content providers of free television, have been reluctant to provide programming for digital television, for fear that consumer piracy will disrupt economically vital secondary, international, and webcast markets.[10] More specifically, they are concerned about protecting their intellectual property rights—a content provider's predominant source of revenue in existing economic structures—in DTV programming. Digital television amplifies vulnerabilities in broadcasters' copyrighted, open-air transmissions because, technologically speaking, it is easier to make high-quality copies of digital broadcasts than of analog broadcasts, and many consumers do not buy what they can copy for free, even if copying is illegal. The concerns of these content providers have a profound impact on the viability of the digital transition because broadcasters are reluctant to produce and distribute programs if it is not profitable to do so. As the sole regulator of broadcast communications and the entity responsible for the digital transition,[11] the FCC intervened to assist broadcasters and implemented a broadcast flag regulation that will limit the extent to which a viewer can copy a television program. The FCC be-

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9. FCC Chairman Michael K. Powell, *Broadband Migration III: New Directions in Wireless Policy*, Remarks at the Silicon Flatirons Telecommunications Program, University of Colorado at Boulder (October 30, 2002), *available at* http://www.fcc.gov/Speeches/Powell/2002/spmkp212.html.

10. The Motion Picture Association of America states, for example:

> [F]our out of ten movies never recoup the original investment. In 2000, the average major studio film cost $55 million to produce with an extra $27 million to advertise and market, a total cost of over $80 million per film. . . .
>
> To recoup such enormous investments, the industry relies upon a carefully planned sequential release of movies, first releasing feature films in cinemas, then to home video, and then to other media. This release sequence not only provides the best financial return for studios, but also provides consumers with choices as to how they wish to view movies, and when. This carefully planned release sequence, which includes intervals for each specific media known as "distribution windows", are vital to the health of the industry. When piracy of a film occurs at any point in the release sequence, all subsequent markets are negatively affected.

Motion Picture Association of America, *Anti-Piracy*, *at* http://www.mpaa.org/anti-piracy (last visited Mar. 15, 2005).

11. Congress has recognized the FCC's authority over the digital television transition. *See, e.g.*, 47 U.S.C. §§ 308-309 (2000) (conferring responsibility for modifications of electromagnetic spectrum allocation on the FCC).

lieves that this is a necessary step to eliminate barriers facing the digital transition.

Unfortunately, the FCC promulgated its broadcast flag regulation in a climate where tensions are high between entertainment media consumers and content providers. As a result, there is strong opposition to FCC regulation. The Electronic Frontier Foundation (EFF) dubs the FCC's mandate an "ineffective solution to a non-existent problem."[12] The EFF further claims that the broadcast flag stifles the "public's rights to receive and manipulate DTV broadcasts with technologies they choose."[13] Many critics, consumer groups, and at least one legal commentator claim that the broadcast flag will stifle innovation by foreclosing experimentation and adaptation.[14] Further, beyond these substantive concerns is the question of whether the FCC even has jurisdiction to implement this broadcast flag regulation.

This Note asserts that the FCC has jurisdiction to implement the broadcast flag regulation. Part I describes broadcast flag technology and the rationale behind its implementation. Part II explains the general concept of ancillary jurisdiction, as well as how the United States Supreme Court has articulated the FCC's ancillary jurisdiction in particular. In order to support the FCC's jurisdiction to impose the broadcast flag regulation, Part III discusses the scope of the FCC's traditional rulemaking authority and its relationship to ancillary jurisdiction. Parts III.A and III.B address how FCC ancillary jurisdiction over the broadcast flag regulation is consistent with both the FCC's prior valid assertions of jurisdiction and the purposes for which the FCC exists. Part III.C discusses the practical effects of the broadcast flag in addition to the policies and wisdom behind it. The Part further explains that the broadcast flag regulation causes no need for concern because it does not limit the rights of consumers beyond current copyright law in its practical application. Finally, Part IV con-

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12. ELEC. FRONTIER FOUND., IN THE MATTER OF DIGITAL BROADCAST COPY PROTECTION: COMMENTS OF ELECTRONIC FRONTIER FOUNDATION 2 (Dec. 6, 2002), *available at* http://www.eff.org/IP/Video/HDTV/20021206-eff-fcc-comments.pdf.

13. Elec. Frontier Found., *Join the Digital Liberation Television Front!*, *at* http://www.eff.org/broadcastflag (last visited Mar. 8, 2005).

14. Crawford, *supra* note 5, at 605-06; Mike Magee, *EFF Blasts Hollywood Over Digital TV Broadcast Flag*, INQUIRER, Dec. 9, 2002, *at* http://www.theinquirer.net/?article=6626; Matthew Fordahl, Computer Crime Research Center, *Critics Fear Broadcast Flag Would Stomp on Consumer Rights*, *at* http://www.crime-research.org/news/2002/12/Mess2802.htm (last visited Mar. 9, 2005) ("[C]ritics worry that building in a single, government-mandated type of security could stifle innovation, especially if the approved technology is proprietary and secret.").

cludes that the FCC is in the best position to determine that broadcast flags are in the public interest.

I. DETAILS OF THE DIGITAL TELEVISION TRANSITION AND THE BASICS OF THE BROADCAST FLAG

In 2003, the FCC adopted anti-piracy protection for digital television.[15] This anti-piracy mechanism, known as a "broadcast flag" because it will signal that compliant recording devices should limit the digital output of certain over-the-air broadcasts,[16] prevents mass distribution of digital media over the Internet through data encryption.[17] The broadcast flag, at the discretion of a content owner,[18] enables any device that receives digital television content to, upon reception,[19] encrypt that content and protect it against unauthorized distribution.[20] The FCC rule requires manufacturers to furnish all equipment capable of receiving DTV signals[21] with broad-

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15. Press Release, Federal Communications Commission, FCC Adopts Anti-Piracy Protection for Digital TV (Nov. 4, 2003), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-240759A1.pdf.

16. The flag, which was developed to prevent unauthorized redistribution of digital programming, has two values, true and false; if the flag in a signal is set to true, a compliant recording device will prevent digital output. . . . The encoding would only be included in broadcast signals; neither cable nor satellite transmissions would be directly affected, although those services could be legally obligated to protect rebroadcasts of digital transmissions.

Broadcast Flag, WHATIS.COM, *at* http://whatis.techtarget.com/definition/0,,sid9_gci959980,00.html (last updated Apr. 16, 2004).

17. *See id.* Federal regulation 47 C.F.R. § 73.9000(d) (2004) describes a broadcast flag as a redistribution control descriptor comporting with ATSC standard 65B. This standard is explained in ADVANCED TELEVISION SYSTEMS COMMITTEE, ATSC STANDARD: PROGRAM AND SYSTEM INFORMATION PROTOCOL FOR TERRESTRIAL BROADCAST AND CABLE (REVISION B), Doc. A/65B, § 6.9.13, tbl. 6.37 (Mar. 18, 2003), *available at* http://www.atsc.org/standards/a_65b.pdf. The broadcast flag's existence within the ATSC stream signals "technological control of consumer redistribution." *Id.*

18. The broadcast flag scheme is entirely discretionary in the sense that a copyright owner can choose not to use it; it can be turned on and off. *See supra* note 16.

19. This encryption takes place at the demodulation phase; the data remains unencrypted during transmission.

20. Crawford, *supra* note 5, at 609-15 (providing an overview of the broadcast flag).

21. This could potentially include digital television sets, digital cable set-top boxes, direct broadcast satellite receivers, personal video recorders (PVRs), DVD recorders, D-VHS recorders, and computers with tuner cards. *See* Larry Borsato, *What Is the FCC Trying to Protect?*, Nov. 14, 2004, *at* http://www.larryborsato.com/blog/archives/000239.html; Susan Crawford, *Susan Crawford Blog, Copyright Office Talk*, Apr. 1, 2004, *at* http://scrawford.blogware.com/blog/_archives/2004/4/1/31347.html; David S. Isenberg,

cast flag technology by July 1, 2005.[22] The FCC believes that the broadcast flag mechanism will "foster the transition to digital TV and forestall potential harm to the viability of free, over-the-air broadcasting in the digital age."[23]

According to the FCC, the need for a universal anti-piracy mechanism stems from the transition from analog television broadcasting to digital television broadcasting.[24] In 1997, the FCC "adopted a standard for DTV transmissions [and] committed itself to the goal of abandoning analog broadcasts and switching all television broadcasts to DTV by the end of 2006."[25] This transition is exceedingly beneficial because it will allow more efficient utilization of the electromagnetic spectrum.[26] More efficient use of the electromagnetic spectrum in turn makes bandwidth available to new and emerging technologies such as digital cellular phones.[27] Additionally, by sending digital signals, broadcasters will be able to transmit information more concisely than they could with analog signals. For example, an analog broadcaster can fit only one video and two or three audio signals into a 6 MHz broadcast channel; a DTV station can transmit up to four times the information while increasing signal quality.[28] However, the FCC concluded that content owners would not make high value digital content available absent some protection from mass indiscriminate redistribution.[29] In other words, the problem arises due to the nature of the

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isen.blog, FCC Seeks Legitimization of HUGELY Expanded Charter, Nov. 13, 2004, *at* http://www.isen.com/blog/2004/11/fcc-seeks-legitimization-of-hugely.html.

22. 47 C.F.R. §§ 73.9002 to .9004.

23. Press Release, *supra* note 15, at 1.

24. This is particularly true in light of new developments such as the Internet2. Recently, Internet2 "researchers successfully sent data from Switzerland to Tokyo at speeds of 7.21 gigabits per second. That was enough speed to transfer a full-length DVD anywhere in the world in less than five seconds." John Borland, *Hollywood Seeks Internet2 Tests, P2P Oversight*, CNET NEWS.COM, Nov. 18, 2004, *at* http://news.com.com/2100-1026_35458537.html.

25. Consumer Elecs. Ass'n. v. FCC, 347 F.3d 291, 294 (D.C. Cir. 2003).

26. *Id.*

27. *Id.* ("The FCC can then reallocate the spectrum no longer needed by broadcasters for other uses, such as emergency and wireless communications.").

28. *Id.* at 293. Increased quality means CD-quality audio, for example. *Id.* Additional benefits of terminating analog broadcasting in favor of digital broadcasting include the ability to broadcast in high definition format, a more limited dependence on signal strength, and a higher resistance to interference. *In re* Review of the Commission's Rules and Policies Affecting the Conversion to Digital Television, 15 F.C.C.R. 5257, 5266 para. 28 (2000).

29. *In re* Digital Broadcast Content Protection, MB Docket 02-230, at 3 (Fed. Communications Comm'n Nov. 4, 2003) [hereinafter FCC Digital Broadcast Order], *available at* http://www.eff.org/IP/Video/HDTV/20031104_fcc_order.pdf.

technology; the old protection systems, which prevented disruption of secondary markets due to piracy, no longer work.[30]

Users can more easily pirate high quality copies of digital broadcasts than of analog broadcasts.[31] The problem is one of degree, rather than kind. A consumer can copy an analog broadcast, for example by making a VCR recording, just as easily as she can copy a digital broadcast; the key difference is that in order to mass distribute a copy of an analog broadcast, a consumer must first convert the file into digital format, whereas with digital broadcasts, such a conversion is not required.[32] This is important because data is lost in each analog-to-digital conversion, and the quality of the resulting copy will be lower than a file originating in digital format that does not need to be converted. Therefore, eliminating even a single analog-to-digital conversion significantly improves program quality.[33]

However, once a movie or television program is digitized as a computer file, a user can distribute the program just as she would any other data.[34] With this file, making a perfect copy is a click away. She can make copies on CD-R, Zip® drives, USB drives, or any other storage media,

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30. This Note accepts the FCC's determination that the broadcast flag protects content providers and therefore promotes creation of copyrightable works. The extent to which intellectual property protection promotes innovation is not addressed here. *See, e.g.*, Paul D. Marquardt & Mark Leddy, *The Essential Facilities Doctrine and Intellectual Property Rights*, 70 ANTITRUST L.J. 847, 868 (2003) (discussing the relationship between copyright's statutory monopoly and antitrust law). *See generally* Peter S. Menell, *Envisioning Copyright Law's Digital Future*, 46 N.Y.L. SCH. L. REV. 63 (2002-2003) (discussing copyright and digital media).

31. Digital Diversity, *Digital Diversity: Selecting the Right Video Solution*, *at* http://www.digitaldiversity.com.au/whichvideo.htm (last visited Feb. 5, 2005) ("[D]igital video recordings are always 100% correct and offer around twice the quality of VHS (Analogue). . . . Another major benefit of digital video is that you may copy it to another digital device (like a PC or Digital Camera) with absolutely no quality loss.").

32. A user accomplishes this through an analog-to-digital conversion:

> [T]he process of changing continuously varying data, such as voltage, current, or shaft rotation, into discrete digital quantities that represent the magnitude of the data compared to a standard or reference at the moment the conversion is made. . . . The most common use is to change analog signals into a form that can be manipulated by a digital computer.

Analog-to-Digital or A/D Conversion, INFOPLEASE, *at* http://www.infoplease.com/ce6/sci/A0803863.html (last visited Mar. 8, 2005).

33. *See* E-MELD, *E-Meld School of Best Practice: Conversion Homepage*, *at* http://www.emeld.org/school/classroom/conversion (last visited Jan. 15, 2005).

34. Microsoft Corporation, *Key Concepts in Windows Media Technologies*, Dec. 2000, *at* http://msdn.microsoft.com/library/default.asp?url=/library/en-us/dnwmt/html/introwmt7-2.asp.

then send them in the mail or distribute the data file over a network, such as the Internet.[35] When the user then plays the digitized file with a media player,[36] the signal is converted from the digitized data—zeroes and ones—back to an analog form.[37]

As a result of this technological reality, content providers' concerns over the advent of VCRs, which first allowed consumers to record and copy analog television broadcasts, are reemerging, but with greater force and with much more at stake.[38] When the FCC required all broadcasts to be digital broadcasts, it essentially mandated a high quality format that was Internet-ready. Thus, the FCC inadvertently threatened content providers economically at dramatically heightened levels. The FCC's broadcast flag regulation directly addresses the threat of mass distribution of high quality programming by consumers.[39] This threat is very real and is restricted by technology limitations to a lessening degree. BitTorrent and eDonkey, for example, are technologies designed specifically to facilitate a user's fast download of very large files. Each service has grown rapidly over the past two years and has been used widely to distribute full-length movies, computer games, and software.[40]

The FCC designed the broadcast flag to prevent consumer mass distribution because that type of unlimited copying jeopardizes the economic viability of broadcast television. More specifically, consumer mass distribution significantly limits television broadcast's secondary, international,

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35. *Id.*

36. For example, Windows Media Player.

37. "The final step is accessing and then converting the bits—the digital instructions—back to analog form so the movie can be viewed." Microsoft Corporation, *supra* note 34.

38. *See* Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417 (1984) (rejecting a copyright owner's claim that consumer video tape recording constituted copyright infringement).

39. Content providers are not off-base here. The MPAA "intends to file as many as 230 lawsuits in coming weeks against individuals who have illegally shared copyrighted movie files over the Internet." Laura M. Holson, *Film Group Said to Plan Suits Aimed at Illegal File Sharing*, N.Y. TIMES, Nov. 4, 2004 (reporting the MPAA's intent to file as many as 230 lawsuits against individuals who had illegally shared copyrighted movie files over the Internet), *available at* http://www.nytimes.com/2004/11/04/technology/04 pirate.html.

40. John Borland, *MPAA Targets Core BitTorrent, eDonkey Users*, Dec. 14, 2004, CNET NEWS.COM *at* http://news.com.com/MPAA+targets+core+BitTorrent%2C+eDonk ey+users/21001025_3-5490804.html?tag=nefd.top; *see also supra* note 24.

and webcast markets.[41] These markets provide essential opportunities for content providers to recoup their costs.[42]

II. THE TEST FOR ANCILLARY JURISDICTION

As an administrative agency, the FCC can typically act only pursuant to a congressional grant of authority.[43] The Communications Act of 1934[44] (the Act) governs regulation of telecommunications in the United States;[45] this Act established the Federal Communications Commission as an administrative body now responsible for regulating all aspects of the telecommunications industry.[46] Notably, unlike its predecessors, the Act extended jurisdiction over telecommunications to a single expert agency, the FCC.[47] Titles II through IV of the Act give the FCC specific jurisdiction over individual types of communication technologies.[48] Title II of the Act[49] governs common carriers and contains the principal set of provisions pertaining to telephony.[50] Title III of the Act[51] establishes the regulatory regime for broadcast services.[52] Finally, Title IV[53] governs the regulation of cable television.[54]

In addition to these explicit congressional grants of jurisdiction, in certain circumstances, the FCC has "ancillary jurisdiction" under Title I of

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41. FCC Digital Broadcast Order, *supra* note 29, at 4.

42. *Id.*

43. 5 U.S.C. §§ 551-559, 571-584, 701-706 (2000). "The Administrative Procedures Act governs the way in which independent agencies of the United States Federal government may propose and establish regulations. It also sets up a process of direct review for agency decisions by federal courts." *Administrative Procedures Act*, WIKIPEDIA: THE FREE DICTIONARY, *at* http://en.wikipedia.org/wiki/Administrative_Procedures_Act (last visited Mar. 8, 2005).

44. 47 U.S.C. §§ 151-614.

45. STUART MINOR BENJAMIN ET AL., TELECOMMUNICATIONS LAW AND POLICY 3 (2001).

46. *Id.*

47. *Id.* ("The 1934 Act was not the first communications statute passed in the United States. It was, however, the first statute to bring different areas of the telecommunications industry under one statutory title and one administrative agency. Before 1934, telegraph, telephone, and radio were governed by separate laws and separate governmental bodies.").

48. *See* Norman M. Sinel et al., *Recent Developments in Cable Law*, 777 PLI/PAT 341, 348 (2003).

49. 47 U.S.C. §§ 201-276.

50. BENJAMIN ET AL., *supra* note 45, at 6.

51. 47 U.S.C. §§ 301-399.

52. BENJAMIN ET AL., *supra* note 45, at 6.

53. 47 U.S.C. §§ 401-416.

54. *Id.*

the Act. Title I grants the FCC power to regulate "communication by wire and radio" and charges it with the duty to "execute and enforce the provisions of this Act."[55] Moreover, Title I confers upon the FCC ancillary jurisdiction over matters that are not expressly within the scope of a specific statutory mandate but are nevertheless reasonably necessary to the FCC's execution of its statutorily prescribed functions.[56]

This articulation of the FCC's ancillary jurisdiction is analogous to the well-known ancillary jurisdiction of Article III courts, as well as the ancillary jurisdiction of other federal agencies.[57] Ancillary jurisdiction dictates that it would be unwise to force two independent proceedings when they are related to and dependent upon one another. In *Reconstruction Finance Corp. v. Bankers Trust Co.*,[58] the Supreme Court allowed a federal agency jurisdiction to adjudicate a state law claim, over which it would ordinarily lack jurisdiction to hear, when that claim was sufficiently related to a federal law dispute that the agency had statutory jurisdiction to adjudicate. Similarly, in *Katchen v. Landy*,[59] the Court upheld a bankruptcy referee's power to hear and decide state law counterclaims when those counterclaims arose out of the same transaction as the bankruptcy proceeding. The Court reasoned that, "as a practical matter, requiring the trustee to commence a plenary action to recover on its counterclaim would be a 'meaningless gesture.'"[60] Ancillary jurisdiction may also apply in Article I tribunals, agencies, and adjunct courts.[61] The broadcast flag regulation is one of these instances: the FCC is leading the digital transition, so jurisdiction over the broadcast flag regulation follows, because the two are inextricably intertwined.

The Court has based the concept of ancillary jurisdiction on the idea that it is efficient to allow one expert decisionmaker to have jurisdiction over all substantially related matters, especially where it would be counterproductive to do otherwise.[62] The FCC is no exception. In *United States*

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55. *Id.* §§ 151-161.

56. *See* Floersheimer Center for Constitutional Democracy, *Bellhead/Nethead: The FCC Takes On The Internet, Panel 2: Ancillary Jurisdiction*, *at* http://www.cardozobellhead.net/jurisdiction.html (last updated Aug. 2004).

57. *See, e.g.*, Commodity Future Trading Comm'n v. Schor, 478 U.S. 833, 851-53 (1986) (holding the CFTC's assumption of jurisdiction over common-law counterclaims proper); Reconstruction Fin. Corp. v. Banker's Trust Co., 318 U.S. 163, 169-71 (1943) (allowing Interstate Commerce Commission to assert jurisdiction over state claim).

58. 318 U.S. 163.

59. 382 U.S. 323 (1966).

60. *Id.* at 334; *see Schor*, 478 U.S. at 852.

61. *Schor*, 478 U.S. at 851-53 (upholding the ancillary jurisdiction of the CFTC).

62. In practice, federal bankruptcy jurisdiction provides good examples of this idea.

v. Southwestern Cable Co.,[63] the Court upheld FCC cable television regulations before the FCC received any express congressional grant of regulatory authority over cable television.[64] It did so under the theory of ancillary jurisdiction.[65] Then, in *United States v. Midwest Video Corp.*,[66] the Supreme Court explained ancillary jurisdiction in the context of broadcast television as a test of whether the rule in question will "further the achievement of long-established regulatory goals in the field of television broadcasting by increasing the number of outlets for community self-expression and augmenting the public's choice of programs and types of services."[67]

Although the courts have traditionally defined the FCC's Title I ancillary jurisdiction as less expansive than the FCC's regulatory authority arising under the other titles within the Act,[68] precedent recognizes the necessity of the doctrine's application when appropriately implemented. In *Southwestern Cable*, the Court articulated the test for when the FCC may assert ancillary jurisdiction. Under *Southwestern Cable*'s two-part test, the FCC may employ ancillary jurisdiction where: (1) "[T]he Commission's general jurisdiction grant in Title I of the Communications Act covers the subject of the regulation,"[69] and (2) the assertion of jurisdiction is "reasonably ancillary to the effective performance of [its] various responsibilities."[70]

III. A PARADIGMATIC USE OF ANCILLARY JURISDICTION: THE FCC'S JURISDICTION OVER BROADCAST FLAG REGULATION

With the advent of new technologies, the reach of the FCC's ancillary jurisdiction is dynamic and subject to controversy. Much of this controversy is a variation of familiar "slippery-slope" arguments. For example, one scholar argues, "[I]f the FCC has the power to act on anything that has

63. 392 U.S. 157, 177-78 (1968).

64. Congress later explicitly granted the FCC authority to regulate cable television in what is now Title IV of the Communications Act as amended by the Telecommunications Act of 1996. Pub. L. No. 104-104, §§ 401-403, 110 Stat. 56, 128-32 (1996) (codified as amended in scattered sections of 47 U.S.C.).

65. *Southwestern Cable*, 392 U.S. at 178.

66. 406 U.S. 649 (1972).

67. *Id.* at 667-68.

68. Sinel, *supra* note 48, at 348.

69. *See Southwestern Cable*, 392 U.S. at 172-75; FCC Digital Broadcast Order, *supra* note 29, at 14.

70. *Southwestern Cable*, 392 U.S. at 178.

something to do with communication, we have only the FCC's self-restraint to rely on when it comes to all [I]nternet communications."[71] In that vein, the American Library Association and other consumer groups are currently challenging the FCC's authority to issue the broadcast flag regulation.[72] A panel of judges on the United States Court of Appeals for the District of Columbia heard oral arguments on February 22, 2005.[73]

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71. Susan Crawford, *Susan Crawford Blog: Does the White House Know?*, Nov. 11, 2004, *at* http://scrawford.blogware.com/blog/_archives/2004/11/11/180969.html (emphasis added).

72. *See* Opening Brief of Petitioners, Am. Library Ass'n v. FCC (D.C. Cir. filed Oct. 4, 2004) (No. 04-1037) [hereinafter Opening Brief of Petitioners], *available at* http://www.eff.org/IP/Video/HDTV/BflagInitialbrf100404.pdf.

73. *Id.* at Cover Page; *see also* Public Knowledge, *Broadcast Flag Court Challenge*, *at* http://www.publicknowledge.org/issues/bfcase (last visited Mar. 16, 2005). The three-judge panel consisted of Judge Harry T. Edwards, Judge David B. Sentelle, and Judge Judith W. Rogers. *See* Kevin J. Heller, *Induce Act Blog (Copyright Blawg)*, Feb. 19, 2005, *at* http://techlawadvisor.com/induce/2005/02/broadcast-flag.html. During oral argument, Judge Edwards questioned whether the FCC had "crossed the line" by requiring manufacturers to incorporate the broadcast flag technology in television devices. SiliconValley.com, *U.S. Appeals Court Debates Anti-Piracy TV Technology*, Feb. 22, 2005, *at* http://www.siliconvalley.com/mld/siliconvalley/news/editorial/10963551.htm. The FCC's attorney, Jacob M. Lewis, argued that the FCC had not crossed the line because lawmakers have not specifically outlawed the FCC's actions. *Id.* This Note, however, takes quite a different perspective. It suggests that the FCC's actions have not crossed the line because the broadcast flag regulation falls within the FCC's sufficiently limited ancillary jurisdiction. Judge Edwards expressed some concern regarding a more expansive view of the FCC's ancillary jurisdiction by comparing the broadcast flag regulation to the FCC attempting to regulate washing machines. Declan McCullagh, *Court Questions FCC's Broadcast Flag Rules*, CNET NEWS.COM, Feb. 22, 2005, *at* http://news.com.com/2100-1030_3-5585533.html. However, the requirements that a regulation must fall within the FCC's Title I jurisdictional grant and align with historically prescribed functions, in order to fit within the FCC's ancillary jurisdiction, to some extent, serves to ameliorate this concern. *See infra* notes 85-88 and accompanying text. As this Note considers, the FCC cannot regulate washing machines for the same reason it cannot regulate the Sears Tower. *Id.*

On a slightly different note, during oral argument, Judge Sentelle suggested that the library and consumer groups might lack standing to challenge the broadcast flag regulation because those groups may not suffer an injury in fact. *See* McCullagh, *supra*. Indeed, on March 15, 2005, the panel issued an opinion requesting supplemental submissions to clarify the petitioners' standing. Am. Library Ass'n v. FCC, No. 04-1037, slip op. at 3 (D.C. Cir. Mar. 15, 2005) ("[W]e have concluded that more is required in order for the court to determine conclusively whether petitioners have Article III standing."). The court found that "in order to establish injury in fact, petitioners must show there is a substantial probability that the FCC's order will harm the concrete and particularized interests of at least one of their members." *Id.* at 7. More specifically, the court requested that the "petitioners . . . explain whether there is a substantial probability that the [FCC's] broadcast flag regime will hinder the ability of any of petitioners' members to engage in

However, such concerns regarding the FCC's alleged ballooning jurisdiction are misplaced. The FCC's ancillary jurisdiction is bounded by the strict guidelines of ancillary jurisdiction generally, and more specifically by *Southwestern Cable*'s two-part test. This Part applies the *Southwestern Cable* test to the FCC's broadcast flag regulation and concludes that FCC jurisdiction is appropriate. Section A addresses the first step of the *Southwestern Cable* test; and Section B addresses the second step. Section C addresses the policies, realities, and implications of the broadcast flag regulation in the relevant industries. This Part ultimately concludes that the FCC has jurisdiction over the broadcast flag.

A. The FCC's General Jurisdictional Grant in Title I of the Communications Act Covers the Subject of the Broadcast Flag Regulation

Due to the nature of the subject matter the FCC regulates, the FCC must constantly respond to new technology. Congress entrusted the FCC with the dual purpose of protecting free broadcast communications and furthering the digital television transition. In pursuit of that duty, the FCC has responded to threats of various origins, most notably new technologies that jeopardize the viability of broadcast television. Whatever the nature of the threat, the FCC defends its territory in the interest of the public good. The FCC's broadcast flag regulation is the FCC's most recent defense of broadcast television, crafted to ensure the viability of broadcast television in the digital transition.

In order for ancillary jurisdiction to apply, the subject of the regulation at issue must fall within the FCC's general jurisdictional grant in Title I of the Communications Act of 1934. Broadcast television and broadcast tele-

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otherwise permissible copying and distribution of television broadcasts to distant locations and, if so, in precisely what way such hindrance is likely to occur." *Id.* at 12. While the court did point out that "the administrative record provide[d] examples of legitimate uses of information technologies made by libraries that could be adversely affected by the flag rule," it appears such references were not sufficiently persuasive to allow Article III standing. *Id.* at 5. In fact, Judge Sentelle stated in his dissent, "[T]he majority's opinion appears to me not to ask the petitioner to clarify its standing, but to offer us a further record to create standing where none is present on the record before us." *Id.* at 1 (Sentelle, J., dissenting). Indeed, this Note argues that, as of yet, there is no indication that the broadcast flag will substantially hinder legitimate copying and distribution of television broadcasts. Apparently, this fact has not escaped the court, or, at least, the panel is questioning how much harm the broadcast flag will actually do.

For an enlightening discussion of federal court standing doctrine, see William A. Fletcher, *The Structure of Standing*, 98 YALE L.J. 221 (1988).

vision receivers,[74] the subjects of the broadcast flag regulation, fall within the statutory grant. The FCC has general jurisdiction over "all interstate and foreign communication by wire or radio,"[75] "including all instrumentalities, facilities, apparatus, and services (among other things, the *receipt, forwarding, and delivery* of communications) incidental to such transmission."[76] Many opponents of FCC jurisdiction contend that since a broadcast flag receiver is not necessary to receiving a digital television broadcast, FCC jurisdiction is inappropriate.[77]

Contrary to this assertion, the statutory language of Title I contemplates conferring the FCC province over apparatus "incidental" to transmissions. The plain, ordinary meaning of incidental is "[o]ccuring . . . in fortuitous or subordinate conjunction with something else *of which it forms no essential part*."[78] Broadcast flag receivers are related and, at a minimum, incidental to the receipt of television broadcast. While it is by no means definitive that the broadcast flag regulation falls within the FCC's authority, Title I is certainly open to that interpretation; it is a meaning the words will bear. Moreover, under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,[79] "if [a] statute is silent or ambiguous with respect to [a] specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute."[80] Title I does not explicitly say anything about a broadcast flag, and it is apparent that the FCC interprets Title I under a plain, ordinary meaning.[81] Thus, a textual analysis implies that the broadcast flag regulation falls within the FCC's general jurisdictional grant.

However, this is not the end of the inquiry; the scope of the FCC's general jurisdictional grant is bounded by the FCC's historical functions. Although the FCC has never regulated the recording or copying of broadcasts before, it has regulated television hardware involved in the reception of television signals, as the broadcast flag regulation requires. The FCC

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74. FCC Digital Broadcast Order, *supra* note 29, at 14-15 ("[W]e find that television receivers . . . come within the scope of the Commission's general authority.").

75. 47 U.S.C. § 152(a) (2000).

76. *Id.* § 153(33) (emphasis added).

77. Opening Brief of Petitioners, *supra* note 72, at 26-8 ("[A] DTV set does not need to include a flag to improve reception or avoid electrical interference from other devices.").

78. 7 THE OXFORD ENGLISH DICTIONARY 794 (J.A. Simpson & E.S.C. Weiner eds., 2d ed. 1989) (emphasis added).

79. 467 U.S. 837 (1984).

80. *Id.* at 843.

81. Brief for Respondents at 30-31, American Library Ass'n v. FCC (D.C. Cir. filed Nov. 3, 2004) (No. 04-1037).

sets standards for all kinds of devices in order to prevent interference or misuse of communications systems falling within its Title III jurisdiction. The FCC has regulated devices that receive black-and-white television signals, color television signals,[82] ultra high frequency (UHF) signals,[83] and digital television signals.[84] Because the broadcast flag regulation is not particularly unique compared to other FCC regulations, the FCC's historical functions dictate that the presumption should be in favor of allowing the FCC jurisdiction.

Furthermore, the broadcast flag requirements are not unusual in terms of the television components that they regulate. The broadcast flag regulation would require that a television receiver have a "software demodulation product."[85] Per prior, undisputed FCC regulations, this same receiver component, when used in a television set, must already comply with certain construction requirements[86] and include a closed-captioning decoder.[87] Thus, it is no extension of authority to allow the FCC to regulate a television component that it already regulates. This is in sharp contrast to situations where courts have declined to extend the FCC's jurisdiction, which often occurs when the FCC's attempted assertion of jurisdiction strays from its historically prescribed functions. For example, in *Illinois Citizens Committee for Broadcasting v. FCC*, the United States Court of Appeals for the Seventh Circuit held that the FCC lacked jurisdiction over the construction of the Sears Tower.[88] Unlike its dominion over television receivers, the FCC does not regulate building construction, despite the fact that tall buildings can block television signals.

In addition, Title I confers authority on the FCC to address broadcast misuse, for example, the inefficient use of broadcast spectrum. Like regulations of the past, the broadcast flag regulation addresses a broadcast

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82. Fed. Communications Comm'n, *Historical Periods in Television Technology: 1930-1959*, *at* www.fcc.gov/omd/history/tv/1930-1959.html (last updated June 27, 2003).

83. 47 U.S.C. § 303(s) (2000) (granting the FCC authority to require that apparatus designed to receive television signals be capable of adequately receiving all frequencies).

84. *In re* Matter of Review of the Commission's Rules and Policies Affecting the Conversion to Digital Television, 17 F.C.C.R. 15,978, 15,978-79 (2002) [hereinafter FCC Digital Tuner Order].

85. Comments of the Motion Picture Association of America, Inc. et al. at 15, *In re* Digital Broadcast Content Protection, MB Docket No. 02-230 (Fed. Communications Comm'n Feb. 13, 2004).

86. 47 C.F.R. § 15.101 (2004).

87. *Id.* § 15.122.

88. 467 F.2d 1397 (7th Cir. 1972).

misuse, namely unauthorized copying,[89] and it is well established that preventative measures designed to curb broadcast misuse sit squarely in the FCC's Title I domain. As early as 1962, Congress adopted legislation to allow the FCC to require that all television receivers "for sale or resale to the public be capable of receiving both UHF and VHF [very high frequency] frequencies."[90] Congress passed legislation "[t]o amend the Communications Act of 1934 in order to give the Federal Communications Commission certain regulatory authority over television receiving apparatus."[91] Prior to this receiver requirement, most television sets could receive only VHF signals, thus stunting the growth of UHF broadcasting.[92] But because the availability of UHF broadcasting increased the available spectrum, the FCC found it was in the public interest to promote UHF television.[93] The broadcast flag regulation over television receiving apparatus prevents the misuse of DTV and protects the public interest in the same way that the FCC's regulation over television receivers protected UHF broadcasting in the twentieth century.

Today, both Congress and the FCC have determined that digital television is in the public interest because it too increases the available spectrum. Congress and the courts have recognized the FCC's authority to further the DTV transition. In 2003, the D.C. Circuit affirmed the FCC's authority to require manufacturers to equip televisions with digital receiv-

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89. *See* Broadcast Services; Radio Stations, Television Stations, 66 Fed. Reg. 9973-02, 9983 (Feb. 13, 2001) (related provisions codified at 47 C.F.R. pt. 73) ("[U]nlike in the analog context, digital technology enables users to make an unlimited number of virtually perfect copies of digital content. However, digital technology also can enable copyright holders of digital content to prevent misuse of copy protected material through methods not previously available."); Bentley J. Olive, *Anti-Circumvention and Copyright Management Information: Analysis of New Chapter 12 of the Copyright Act*, 1 N.C. J.L & TECH. 2, para. 6 (2000) (discussing the anti-circumvention provision of the Digital Millennium Copyright Act) ("[C]opyrighted works made available in digital form are extremely vulnerable to unauthorized copying and distribution and . . . authors will increasingly use means, such as encryption, scrambling and passwords, in an effort to prevent misuse of their works.").

90. United States v. Southwestern Cable, 392 U.S. 157, 175 n.42 (1968).

91. Pub. L. No. 87-529, 48 Stat. 1082 (1962).

92. Although Congress gave the FCC explicit authority here, this argument should be read in conjunction with Part III.B *infra*. The UHF regulations are significant precedent towards establishing the traditional scope of the FCC's authority.

93. *Southwestern Cable*, 392 U.S. at 174 n.40 ("[A]n adequate national television system can be achieved only if more of the available UHF channels are utilized.") (internal citation omitted).

ers.[94] Despite the benefits of DTV, there was reluctance among the public to buy televisions with DTV receivers.[95] This was due to

> a logjam [that] was blocking the development of DTV: broadcasters [were] unwilling to provide more DTV programming because most viewers [did] not own DTV equipment, and the lack of attractive DTV programming [made] consumers reluctant to invest more in DTV equipment, which, in turn, reinforces the broadcasters' decision not to invest more in DTV programming.[96]

In its *Digital Tuner Order*, the FCC pointed out that this "logjam" was similar in nature to the market failure surrounding the adoption of UHF broadcasting.[97] In other words, the lack of DTV receivers threatened the viability of digital television broadcasting, something both Congress[98] and the FCC[99] recognized as important to the efficient utilization of the electromagnetic spectrum. Thus, the court held that "the Commission reasonably determined to take action to bring digital tuners to the market in quantity and at reasonable prices, so that the DTV transition may move at the pace required by Congress."[100]

As with UHF broadcasts, the FCC is legitimately regulating to ensure that free broadcast DTV does not fail in its infancy.[101] The reasoning behind the UHF receiver regulation stemmed from the FCC's desire to anticipate and prevent "characteristically serious financial difficulties of UHF and educational television broadcasters."[102] It was acceptable for the FCC to "plan in advance of foreseeable events, instead of waiting to react to them,"[103] and act before the UHF stations failed in their infancy. Similarly, regarding the broadcast flag regulation, the FCC stated: "We con-

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94. Consumer Elecs. Ass'n v. FCC, 347 F.3d 291 (D.C. Cir. 2003).

95. *Id.* at 300.

96. *Id.*

97. FCC Digital Tuner Order, *supra* note 84, at 15,990 para. 27.

98. 47 U.S.C. § 309(j)(14)(A) (2000) (mandating analog broadcast licenses not be renewed).

99. *In re* Advanced Television Systems and their Impact Upon the Existing Television Broadcast Service, 12 F.C.C.R. 12,809, 12,850 para. 99 (1997).

100. *Consumer Elecs. Ass'n,* 347 F.3d. at 301 (internal citations omitted).

101. It is true that the television and movie industries are attempting to protect its intellectual property rights through individual lawsuits. But the viability of this type of judicial protection alone is uncertain, as the music industry cases suggest. *See, e.g.*, Metro-Goldwyn-Mayer Studios, Inc. v. Grokster Ltd., 380 F.3d 1154 (9th Cir.), *cert. granted*, 124 S. Ct. 686 (2004). This is especially true considering feasibility issues and consumer "backlash" reactions to lawsuits. Holson, *supra* note 39.

102. *Southwestern Cable,* 392 U.S. at 176.

103. *Id.* at 177.

clude that by taking preventative action today, we can forestall the development of a problem in the future similar to that currently being experienced by the music industry. . . . [This] will ensure the continued availability of high value DTV content to consumers through broadcast outlets."[104] Contrary to critics' claims,[105] timing may be crucial with respect to the fate of digital television.[106]

Just as the FCC's DTV and UHF receiver regulations were administrative responses by an expert agency designed to protect broadcast television, so is broadcast flag regulation. Therefore, given the historical trend, the FCC's general grant in Title I covers the subject of the regulation, broadcast flag receivers. This does not imply, however, that the FCC has jurisdiction to regulate every aspect of television receivers. The FCC has jurisdiction to regulate broadcast flag receivers only if the assertion of jurisdiction is "reasonably ancillary to the effective performance of the [FCC's] responsibilities."[107]

B. The FCC's Assertion of Jurisdiction over Broadcast Flag Receivers Is Reasonably Ancillary to the Effective Performance of Its Responsibilities

Congress has determined that the digital transition is necessary to ensure efficient and nationwide communication service to all.[108] The FCC has authority to implement the transition under 47 U.S.C. § 309(j)(14).[109] Such a role is conducive to the FCC's longtime protective function to act "consistent[ly] with the public interest . . . [in] the establishment and healthy maintenance of television broadcast service."[110] However, despite the numerous benefits the digital transition will bring,[111] the 2006 dead-

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104. FCC Digital Broadcast Order, *supra* note 29, at 5-6.

105. *See, e.g.*, Declan McCullagh, *FCC Pushes Digital TV Adoption*, CNET NEWS.COM, Aug. 8, 2002 (indicating that consumer groups believe the FCC should wait for specific authorization from Congress), *at* http://news.com.com/FCC+pushes+digital+TV+adoption/2100-1023_3-948956.html.

106. FCC Commissioner Michael Copps noted that "[e]ach time a consumer goes out and purchases an analog set, we move farther and farther away from the congressional objective." *Id.* The FCC believes that inaction itself could contribute to the failure of broadcast DTV: broadcasters would go out of business and manufacturers would stop selling DTV receivers for lack of demand.

107. FCC Digital Broadcast Order, *supra* note 29, at 14.

108. *See* Consumer Elecs. Ass'n v. FCC, 347 F.3d 291, 294 (D.C. Cir. 2003) (noting that DTV "promises more efficient use of scarce electromagnetic spectrum.").

109. 47 U.S.C. § 309(j)(14) (2000); *Consumer Elecs. Ass'n*, 347 F.3d at 294.

110. United States v. Southwestern Cable Co., 392 U.S. 157, 167 (1968).

111. *See supra* notes 5-9 and accompanying text.

line[112] does not seem realistic at present. Under the Act, the transition will be delayed unless a minimum of 85% of households in the market have televisions capable of receiving digital signals.[113] The broadcast flag is a proactive move on the part of the FCC to avoid this delay. This initiative promotes the core communications function of the FCC as well as its specific role in the DTV transition.[114]

From the agency's early roots,[115] Congress molded the FCC to ensure that communications over the airwaves served "public interest, convenience, or necessity."[116] Furthermore, the Act's "terms purposes and history"[117] all indicate that Congress envisioned a "comprehensive regulatory system for the [broadcasting] industry."[118] Thus, the FCC is charged not only with regulating broadcast communications over the airwaves, but also with ensuring viability of the industry. The FCC is required to make available "to all the people of the United States . . . a rapid, efficient, Nationwide, and world-wide wire and radio communication service."[119]

Because the broadcast flag regulation directly affects the viability of digital broadcast television, the regulation falls within the FCC's ancillary jurisdiction. In *Southwestern Cable*, the Supreme Court addressed whether the FCC had authority to regulate cable television (CATV) before Congress explicitly passed legislation to that effect. The court reasoned that CATV created "substantial competition" for local broadcasting.[120] The possibility that CATV could have a "substantial negative effect upon station audience[s] and revenues" was enough to allow the FCC to regulate the area under Title I.[121] This was because the CATV restrictions were "reasonably ancillary to the effective performance of the Commission's various responsibilities for the regulation of television broadcasting."[122] Furthermore, the Court made clear that "[n]othing in the language of [42 U.S.C.] §152(a) . . . limits the Commission's authority to those activities and forms of communication that are specifically described by the Act's

112. 47 U.S.C. § 309(j)(14).

113. *Id.* § 309(j)(14)(B)(iii)(II).

114. *See generally Consumer Elecs. Ass'n*, 347 F.3d at 291 (discussing why the FCC has authority over the DTV transition).

115. *See* Radio Act of 1927, 47 U.S.C. §§ 81-119 (repealed 1934). The Radio Act of 1927 was a predecessor to the Communications Act.

116. BENJAMIN ET AL., *supra* note 45, at 4 (citations omitted).

117. United States v. Southwestern Cable Co., 392 U.S. 157, 168 (1968).

118. FCC v. Pottsville Broad. Co., 309 U.S. 134, 137 (1940).

119. 47 U.S.C. § 151 (2000).

120. *Southwestern Cable*, 392 U.S. at 165.

121. *Id.*

122. *Id.* at 178.

other provisions."[123] The explosive growth of the Internet and file sharing threatens broadcast television today, just as CATV threatened broadcast television in the 1960s.

Opponents of the broadcast flag argue that the FCC is acting too early, implying that the FCC does not have jurisdiction unless DTV has already been harmed in some way. However, *Southwestern Cable* demonstrates that possible harm is enough to confer ancillary jurisdiction. Opponents of the broadcast flag further claim that the regulation is not necessary to the digital transition or sufficiently related to it, or they characterize the FCC's actions as an illicit attempt to regulate copyright. However, content providers' expected response to consumer piracy, the root cause of the broadcast flag regulation,[124] directly threatens broadcast television in the same manner that CATV threatened broadcast television in the 1960s. This threat is particularly problematic because "there is a substantial governmental interest in promoting the continued availability of such free television programming."[125] In fact, this substantial governmental interest was compelling enough to prompt Justice Kennedy, one of the Court's stronger advocates of First Amendment rights,[126] to write for the Court upholding a rule compelling cable operators to carry broadcast station signals, despite the resulting restriction on free speech.[127]

As a practical matter, content providers are not distinct from broadcasters, and the FCC has jurisdiction over television broadcasters.[128] With the broadcast flag, the FCC is regulating broadcast affiliates of networks like ABC, NBC, CBS, or Fox, who today either create their own programming or buy the copyrights to the programming they broadcast. Like CATV, consumer piracy directly threatens broadcast television because broadcasters, as the content providers and copyright holders, are unwilling to broadcast in light of the threat of consumer piracy.[129] Even opponents of the broadcast flag admit, "[I]t is beyond question that the digital world poses special threats to businesses that live or die on their ability to control

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123. *Id.* at 172.

124. FCC Digital Broadcast Order, *supra* note 29, at 2 ("As the digital television . . . transition progresses, the issue of content protection has become increasingly important and contentious.").

125. Turner Broad. Sys., Inc. v. FCC, 512 U.S. 622, 646 (1994) (citation and internal quotations omitted).

126. *See* David L. Hudson, *Reflecting on the Virtual Child Porn Decision*, 36 J. MARSHALL L. REV. 211, 218 (2002).

127. *See* Turner Broad. Sys., Inc. v. FCC, 520 U.S. 180 (1997).

128. *See* 47 U.S.C. § 303 (2000).

129. *See* FCC Digital Broadcast Order, *supra* note 29, at 3 para. 4.

the distribution of content."[130] Furthermore, unlike cable and satellite television content providers, these public broadcasters are in need of the broadcast flag regulation because: (1) they are unable to encrypt their broadcast signals at the modulation phase;[131] (2) they cannot raise their prices, as broadcast television is free; and (3) they are dependent on advertisers who will withdraw their support should mass consumer redistribution without advertising become commonplace.[132]

Like UHF receivers and DTV receivers, a broadcast flag receiver requirement is an appropriate solution, especially given the expertise and experience of the FCC.[133] Ordinarily the FCC has no jurisdiction over copyright, and it is not trying to regulate copyright per se. Instead the FCC is trying to accomplish its institutional goals. In fact, in the Consumer Broadband and Digital Television Promotion Act (Hollings Bill), the Senate attempted to delegate responsibility over broadcast flag regulation to the FCC,[134] illustrating Congress's insecurity over regulating such technologically dense subject matter and relative willingness to defer such matters to FCC regulation.[135] Appropriate deference should be given to pre-

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130. Crawford, *supra* note 5, at 605.

131. Open broadcasts, or Free-To-Air broadcasts, by definition are not encrypted.

132. *See, e.g.*, Michael Rappa, *Managing the Digital Enterprise: Business Models on the Web*, at http://www.digitalenterprise.org/models/models.html (last modified Jan. 6, 2005). Professor Michael Rappa writes:

> A company produces a good or service and sells it to customers. If all goes well, the revenues from sales exceed the cost of operation and the company realizes a profit. Other models can be more intricately woven. Broadcasting is a good example. Radio, and later television, programming has been broadcast over the airwaves free to anyone with a receiver for much of the past century. The broadcaster is part of a complex network of distributors, content creators, advertisers (and their agencies), and listeners or viewers.

Id.; *see also* Don Peppers & Martha Rogers, *The Resurrection of Broadcast Advertising*, DARWIN MAG., May 2002 ("[C]hanges will require broadcasters, other carriers and programming owners to adjust their business strategies in a major way. . . . Broadcasters will prefer live events not just for the size of the audience, but also because live-event viewers will not find it nearly so convenient to zap the accompanying advertising."), *at* http://www.darwinmag.com/read/0502/headfirst_advertising_content.html?action=print.

133. *See* Consumer Elecs. Ass'n v. FCC, 347 F.3d 291, 301 (D.C. Cir. 2003) ("[A] shifting of the benefits and burdens of a regulation is well within the authority of the responsible agency.).

134. S. 2048, 107th Cong. (Mar. 21, 2002).

135. The Senate did not vote on the Hollings Bill because it was returned to committee. However, due to the nature of the legislative process, the Supreme Court has been unwilling to put much weight on Congress' failure to act with regard to FCC jurisdiction. In *Southwestern Cable*, the court recognized the FCC's jurisdiction over CATV despite

dictive judgments resulting from the FCC's "reasoned decisionmaking."[136] Here, the FCC determined that in the absence of protection mechanisms content providers would only air programming on more secure platforms like cable or satellite television.[137] Thus, although with broadcast flags consumers are to some extent losing out to media companies who are gaining increasing control over what users can do with content,[138] the broadcast flag regulation is one way to ensure that content providers/broadcasters transmit the programming to begin with, particularly after analog broadcasts are no longer an option.[139] It is true that broadcast flag regulation is not the only way to approach the problem;[140] in fact there are many alternatives.[141] However, the FCC, in its judgment, chose the broadcast flag as the best method, and such a decision is the FCC's to make.

Any jurisdictional extension that the FCC's broadcast flag regulation represents is within acceptable limits due to the inherent nature of the FCC's technological expertise. The FCC's broadcast flag regulation may represent an extension of the FCC's authority, raising slippery slope concerns. Specifically, consumer advocate groups deeply criticize the FCC's actions as attempting to assert authority over manufacturers of equipment ranging from personal computers to PDAs—anything capable of receiving a digital broadcast signal. However, the FCC is only regulating communication broadcasts the same way it always has done, and any extension of the FCC's authority is consistent with the boundaries of ancillary jurisdiction. Such an extension naturally occurs with the evolution of technology, especially with respect to an agency whose expertise necessarily deals with the forefront of technology. Thus, the broadcast flag regulation is reasonably ancillary to the digital transition, satisfying the second step of the *Southwestern Cable* test.

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the FCC's "inability to obtain amendatory legislation." United States v. Southwestern Cable Co., 392 U.S. 157, 165 (1968).

136. *See Consumer Elecs. Ass'n*, 347 F.3d at 299-300. Under the Administrative Procedure Act, a court may vacate an order only if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A) (2000). This Note argues that the broadcast flag regulation is within the law and the FCC's jurisdiction, as well as in accordance with law.

137. FCC Digital Broadcast Order, *supra* note 29, at 4.

138. SiliconValley.com, *FCC OKs 'Broadcast Flag' for Digital TV*, Nov. 4, 2003, *at* http://www.siliconvalley.com/mld/siliconvalley/7182028.htm.

139. Congress mandated that "[a] television broadcast license that authorizes analog television service may not be renewed . . . . for a period that extends beyond December 31, 2006." 47 U.S.C. § 309(j)(14)(A) (2000).

140. *See infra* Part III.C.

141. FCC Digital Broadcast Order, *supra* note 29, at 11-13 (noting alternatives such as encryption at the source, watermarking and fingerprinting).

C. The Practical Effects of a Broadcast Flag: What Will It Really Do?

The FCC's broadcast flag regulation has met a great deal of hostility from various consumer groups.[142] The EFF incites its readers, "Join the Digital Television Liberation Front!"[143] and the Consumer Federation of America asserts that "[t]he Commission has no business attempting to define a personal-digital-network-environment (PDNE) in which to confine the interoperability of electronic devices."[144] The EFF explains its concerns:

> Want to burn that recording digitally to a DVD to save hard drive space? Sorry, the [digital rights management (DRM)] lockbox won't allow it. How about sending it over your home network to another TV? Not unless you rip out your existing network and replace it with DRMd routers. Kind of defeats the purpose of getting a high definition digital signal, doesn't it?[145]

While there is truth in the EFF's response to the broadcast flag regulation, the response is something of an overreaction. The broadcast flag will not preclude burning DVDs; manufacturers will just have to equip DVD recorders with special software that can read the flag's signals.[146] Unfortunately, this requirement likely leads to an interoperability problem. A content recorder, equipped with the broadcast flag software, will be able to read the flag's signals while recording TV programs. That recorded copy will then play an infinite number of times on that new content recorder/player, but it will not play on an older DVD player purchased before the advent of the flag. Old DVD players will only play original store-bought or rented DVDs.[147] Plus, consumers will also need to replace existing routers. While this is certainly a valid issue, it is not a new problem in the world of electronics. For example, recall the Betamax video tape play-

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142. Most notably, those groups challenging the FCC's regulation in the D.C. Circuit: the American Association of Law Libraries, American Library Association, Association of Research Libraries, Consumer Federation of America, Consumers Union, Electronic Frontier Foundation, Medical Library Association, and Special Libraries Association.

143. Elec. Frontier Found., *supra* note 13.

144. Opposition to the Petitions for Reconsideration Reply Comments of the Consumer Federation of America at 1, *In re* Digital Broadcast Content Protection, MB Docket No. 02-030 (Fed. Communications Comm'n Mar. 15, 2004).

145. Elec. Frontier Found., *supra* note 13.

146. Jane Black, *Why Hollywood Is Winning Its War*, BUSINESS WEEK ONLINE, Dec. 9, 2003, *at* http://www.businessweek.com/technology/content/dec2003/tc2003129_3825_tc137.htm.

147. *Id.*

ers or record players. The average consumer is not particularly distraught that she cannot play records on DVD players or that Betamax videos will not play on VHS tape players.[148] Even if that were not the case, the decision to sacrifice interoperability for content protection is a decision well within the FCC's authority to make. It is important to recognize that the FCC is the best decisionmaking body to balance these concerns. In the FCC's expert opinion, the net benefits of the broadcast flag, namely preserving free broadcast television, exceed this cost—especially given the pace at which technology evolves to render old equipment obsolete.

Consumers will benefit from the broadcast flag because content providers will continue to create programming. In practice the FCC's broadcast flag regulation addresses only the threat of mass distribution of high-quality programming by consumers. Mass distribution is currently illegal under the Copyright Act, which grants the exclusive right to reproduce a copyrighted work to the copyright owner, subject to various fair uses,[149] including time and space shifting.[150] The flags make enforcement of the Copyright Act possible when it would otherwise be unfeasible[151] or exceedingly difficult. Painstaking alternatives include bringing suit against individuals operating servers that index illegal copies of movies and TV programs used on computer networks[152] or suing individual file sharers.

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148. It was not until the late 1970s, when European and Japanese companies developed more technically advanced machines with more accurate electronic timers and greater tape duration, that the VCR started to become a mass market consumer product. By 1980 there were three competing technical standards, with different, physically incompatible tape cassettes. . . . The two major standards were Sony's Betamax (also known as Betacord or just Beta), and JVC's VHS. Betamax was generally reckoned to make and play slightly better quality recordings, but VHS rapidly overtook it in sales. As more VHS recorders came into use, and more VHS films became available . . . eventually Betamax was squeezed out of the consumer market; though a related system called Betacam still remains in use for high quality professional recording equipment.

Filmbug, *Video and VHS*, *at* http://www.filmbug.co.uk/dictionary/vhs.php (last visited Jan. 15, 2005).

149. *See* 17 U.S.C. § 107 (2000).

150. *See, e.g.*, Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 423-27 (1984).

151. At the time of the broadcast flag regulations in 2003, the FCC did not see watermarking or fingerprinting as a viable option. FCC Digital Broadcast Order, *supra* note 29, at 13.

152. Press Release, Rich Taylor, MPAA Studios Take Actions Against Major P2P Server Operators to Stem Global Movie Piracy (Dec. 14, 2004), *at* http://www.mpaa.org/CurrentReleases/2004_12_14_WwdeP2PActions.pdf.

However, the latter approach may no longer even be an option due to procedural difficulties.[153] These enforcement methods are time consuming, expensive, and often ineffective, and the broadcast flag provides a practical alternative. Broadcast flags ensure the continued viability of broadcast television in the face of revenue losses due to the disappearance of traditionally cost-recouping markets. While protecting those markets, the broadcast flag will not stop a consumer from doing anything she cannot already legally do.

The broadcast flag will not remove any "fair use" of a copyrighted material. The fair use doctrine is a privilege that allows someone other than the owner of a copyright to use the copyrighted material in a reasonable manner without the copyright owner's consent.[154] A television content recorder that permitted copying for personal use (such as a program obtained by recording a show on a home television) but prevented mass copying would be perfectly viable under a broadcast flag regime. For instance, a consumer could record programs on a TiVo system to view at a later time even if the TiVo system has a broadcast flag receiver. In fact, the FCC recently approved a TiVo system that, within a broadcast flag regime, would allow consumers to view recorded programs from nine different devices.[155]

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153. *See, e.g.*, Order, Twentieth Century Fox Film v. Does 1-12 (N.D. Cal. 2004) (No. C 04-04862 WHA) (ruling that Fox Film could not join multiple defendants into one action and implying that Fox would have to bring actions against one person at a time), *available at* http://www.eff.org/IP/P2P/MPAA_v_ThePeople/20041123_20thv12_order_severing_cases.pdf; *see also* John Borland, *Judge Slows MPAA File-Trading Suits*, CNET NEWS.COM, Nov. 24, 2004 ("[T]he MPAA had not shown good reason to bundle together 12 separate cases. [The judge] allowed the first of the suits to go ahead to a discovery process, in which the identity of the alleged file swapper will be requested from Internet service provider Pacific Bell, but he put the other 11 cases on hold."), *at* http://news.com.com/Judge+slows+MPAA+file-trading+suits/2100-1025_3-5466215.html?tag=nefd.top.

154. *Fair Use Doctrine*, LEGAL DATABASE, *at* http://www.legal-database.com/fair-use-doctrine.htm (last visited Mar. 9, 2005).

> The reasonableness of a use is determined on a case-by-case basis applying an equitable rule of reason analysis. There are four factors in determining whether the use was a "fair use": 1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; 2) the nature of the copyrighted work; 3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and 4) the effect of the use upon the potential market for or value of the copyrighted work.

Id. (citing 17 U.S.C. § 107 (2000)).

155. Ctr. for Democracy & Tech., *FCC Approves Content Protection Systems*, Aug. 4, 2004, *at* http://www.cdt.org/copyright/broadcastflag.

Manufacturers can be very specific about the type of copying they limit and the type of copying they allow through the use of advanced technology. Copyright law's fair use, competition among electronics manufacturers, and the discretion of copyright owners will minimize the ability of the broadcast flag to limit functionality. The fact that the FCC approves technologies like TiVo reinforces the agency's promise that its broadcast flag regulation "in no way limits or prevents consumers from making copies of digital broadcast television content" for personal use.[156] The FCC decision does not "alter the defenses and penalties applicable in cases of copyright infringement, circumvention, or other applicable laws."[157] Its goal is simply to foster the digital transition, a task assigned to the FCC by Congress.

While special interests were present in the FCC's considerations, that does not detract from the integrity of the FCC's determination. Hollywood and consumer electronics makers' interests have never been aligned. In the 1920s, vaudeville players sued Marconi, claiming the radio undermined the live performance business.[158] In the first half of the twentieth century, movie studios feared that television would undercut cinema ticket sales. In the 1980s, Hollywood tried to stop Sony from selling VCRs.[159] The same is true of the broadcast flag; it is a much-needed compromise in a battle of this ongoing war. Part of its elegance is that it is a solution that does not stifle new technology[160] or extend copyright law beyond its current reach. In fact, the FCC encourages manufacturers to continue to develop new technologies and better methods of copyright protection, such as watermarking[161] and fingerprinting.[162] And although Professor Lawrence Lessig

156. FCC Digital Broadcast Order, *supra* note 29, at 6.

157. *Id.*

158. Black, *supra* note 146.

159. *See* Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417 (1984).

160. *Contra* Crawford, *supra* note 5, at 605 (claiming that the broadcast flag will keep new machines from appearing).

161. For example, Teletrax is the world's first global video broadcast monitoring and video asset management service. "Teletrax's technology embeds an imperceptible and indelible digital watermark into video whenever it is edited, transmitted, broadcast or duplicated. A global network of decoders or 'detectors,' then captures all occurrences of the embedded video being transmitted via satellite, cable or terrestrially and generates tracking reports for the content owners." Press Release, Medialink Worldwide, Inc., Medialink Secures $5 Million Investment for Teletrax Growth (Nov. 9, 2004), *available at* http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=MDLK&script=410&layout=0&item_id=642112. This is potentially a superior copyright protection technology to the broadcast flag because it eliminates the "analog hole" without causing interoperability problems.

162. FCC Digital Broadcast Order, *supra* note 29, at 12-13.

suggests that by "imposing a requirement (effectively) in the middle of the network, the broadcast flag will break all sorts of innovative new applications,"[163] this is slightly misleading. The broadcast flag does not require a content provider or software developer to actually mark its content with the flag. The broadcast flag only impedes unwanted mass copying. It will not affect computer programmers and engineering innovators who want to share their ideas, software and programs, nor will the broadcast flag act as a barrier to communications over the Internet.

IV. CONCLUSION

The broadcast flag regulation is a valid, even desirable, exercise of the FCC's ancillary jurisdiction, as the flag is closely related to the digital transition. The FCC implemented the broadcast flag regulation as a means to protect broadcast television, and this goal comports with the FCC's Title I statutory grant and its historical function. The FCC's rule strikes a balance between the protection of the property rights of the content providers and the development of new technologies. This framework, in the expert opinion of the FCC, allows for the development of new technologies that respect the existing rights of digital providers in order to preserve current economic models. As a general matter, new technologies create a greater possibility for the theft of intellectual property. Content providers will only create new programming if their property is properly protected. In the area of broadcast television, the FCC must balance the property rights of all parties—content providers, the government, and consumers—against one another.

The broadcast flag reaches such a balance. The flag will not keep purchasers from copying, modifying, or inventing; they will just have to do so subject to existing rules. The FCC has demonstrated the willingness and competency to fashion rules that all can live by. Thus, not only does the case law support the conclusion that the FCC has jurisdiction over broadcast flag regulation, but it is also in the public interest for the FCC to implement the broadcast flag regulation.

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163. Lawrence Lessig, *Lessig Blog, (Broadcast) Flag Burning*, *at* http://www.lessig.org/blog/archives/001528.shtml (last visited Mar. 16, 2005).

BERKELEY TECHNOLOGY LAW JOURNAL
ANNUAL REVIEW OF LAW AND TECHNOLOGY

REPRESENTING TALENT

CALIFORNIA'S RECORDING INDUSTRY ACCOUNTING PRACTICES ACT, SB 1034: NEW AUDITING RIGHTS FOR ARTISTS

By Lon Sorensen

As home to both the entertainment industry and an unpredictable political climate, California is fertile land for novel ideas to take root in its state legal code. Nowhere was this phenomenon more evident than at Governor Arnold Schwarzenegger's signing of Senate Bill 1034 ("SB 1034")[1] on July 16, 2004.[2] Officially dubbed The Recording Industry Accounting Practices Act,[3] the bill was a response to the continuing outcry against royalty accounting practices in the music business. Artists had long bemoaned the power exercised by labels through recording contracts that gave the companies near complete control over a musician's royalty statements and financial freedom. By granting recording artists a statutory right to audit their record labels,[4] the law was the first of its kind in the nation and endowed artists with more access to information and greater control over their careers.[5]

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1. 2004 Cal. Legis. Serv. 150 (West). SB 1034 modifies California Civil Code §§ 2500, 2501 and is filed under the heading "Recording Artist Contracts." CAL. CIV. CODE §§ 2500, 2501 (West Supp. 2005). For purposes of this Note, however, I will be using the citation to SB 1034 before it was officially codified into state law.

2. Press Release, Office of the Governor, Legislative Update 7/16/2004 (July 16, 2004), *at* http://www.schwarzenegger.com/en/news/uptotheminute/news_upto_en_LegisUpdate12.asp?sec=news&subsec=uptotheminute. Although the governor signed the bill in July 2004, SB 1034 did not take effect until January 1, 2005.

3. *Assembly Committee on Arts, Entertainment, Sports, Tourism, and Internet Media*, 2002-2003 Leg., 1 (Cal. 2003) (presenting a bill analysis for SB 1034), *available at* http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1001-1050/sb_1034_cfa_20040607_152304_asm_comm.html.

4. 2004 Cal. Legis. Serv. 150 (West).

5. Highlighting the pervasive suspicion held by government officials about the recording industry at the time, the California law was passed almost concurrently with New York State Attorney General Eliot Spitzer's investigations into the industry in New York. In May 2004, Spitzer announced that the five major record labels had signed a pact

The legislation was largely the result of an impassioned state legislator responding to a high-profile issue that had both a personal and professional draw.[6] In 2002, after a cluster of news accounts exposed the myriad of problems surrounding royalty calculations in the music industry, State Senator Kevin Murray (D-Culver City) held a series of Senate hearings to allow both sides of the business—the recording artists and the record labels—to articulate their concerns before lawmakers.[7] What came to light was shocking to those outside of the entertainment world: an industry where artists had little idea where their earnings came from and little control over their financial futures.[8]

While most artists' contracts contained a provision allowing them to audit their record labels' royalty statements, several formidable barriers made that provision historically more cosmetic than substantive. First, throughout the life of the contract, the onus was on the artist to prove that the label was underreporting sales and thereby underpaying royalties.[9] Audits could easily verify suspicions of underpayment, but this was an expensive venture for a new artist and also an unreliable one as the audit was not certain to uncover royalty discrepancies. Costing anywhere from $10,000 to $100,000,[10] an audit was also a luxury only established recouped artists could afford. Furthermore, audits often took several years to complete and the documents available for review were usually contractually limited, a provision that shielded the labels from unwanted scrutiny.[11] Artists that did find instances of royalty underpayment were contractually

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with his office agreeing to pay back royalties totaling $50 million owed to former recording artists. Though the California law deals with current or future royalties and the New York pact deals with former back royalties, the two actions are significantly similar with their focus on accounting discrepancies and their proximity in time to each other. Jeff Leeds, *Music Giants Pay Back Royalties*, L.A. TIMES, May 4, 2004, at C1.

6. Chuck Philips, *Artists Put Pressure on for Benefits, Pensions*, L.A. TIMES, June. 3, 2002, at C1 [hereinafter Philips, *Artists Put Pressure*]; Chuck Philips, *The Nation Auditors Put New Spin on Revolt over Royalties Music*, L.A. TIMES, Feb. 26, 2002, at A15 [hereinafter Philips, *Nation Auditors Spin*].

7. Chuck Philips, *State Senate to Examine Music Firms Royalties: A Second Hearing on Recording Industry Accounting is Planned to Probe Allegations that Artists are Being Cheated*, L.A. TIMES, Aug. 26, 2002, at C1.

8. Chuck Philips, *Music Labels Urged to Revise Royalties: A State Senate Panel Criticizes Record Firms' Accounting and Threatens to Take Action*, L.A. TIMES, Dec. 3, 2002.

9. *See* Philips, *supra* note 6, at A15.

10. *Record Label Accounting Practices: J. Hearing of the Cal. State Senate Comm. on the Judiciary and State Senate Select Comm. on the Entm't Indus.*, 2001-2002 Leg., 3 (Cal. 2002) [hereinafter *Record Label Accounting Practices Hearing*] (overview by Sen. Martha M. Escutia, Chair).

11. *See* Philips, *supra* note 6, atA15.

limited to only receiving what should have been paid to them under the terms of the original agreement,[12] leaving the artist at a financial disadvantage since she would personally have to pay for the services of an auditor or attorney. Finally, artists rarely chose to litigate over royalties under a breach-of-contract claim since an amiable relationship was preferred with the company that exercised such control over their careers.[13] Generally, artists just opted for a negotiated settlement to receive their money.[14]

Based on these realities, State Senator Murray proposed potent legislation that established a fiduciary relationship between artist and label and that mandated punitive damages payable by labels in cases of breach. Yet the bill signed into law by the governor in 2004 was a far cry from the original bill envisioned by the senator in 2002. Gone was any language mentioning a fiduciary duty, punitive damages, or an artist's right to be released from a recording contract in cases of royalty underreporting. Instead, the bill established a simple set of statutory auditing rights that attached to every record contract.[15]

This new law is significant not only in its novelty as a section in a state legal code, but also in its measured benefit to artists. At a minimum, the new law will help dissipate artists' suspicion about royalty underreporting in the state of California. And through an enumerated set of basic auditing rights, the law will help balance the scales of power long bemoaned by recording artists. This is all done without the heavy hand of government oversight and the uncertainties of a fiduciary relationship in the music industry setting. Thus, while SB 1034 is more limited in scope than the original bill, it is decidedly more sensible and pragmatic.

But aside from its merits, perhaps SB 1034's greatest impact can best be seen when viewed against the backdrop of other recent developments in the music industry. Accordingly, this Note examines the major changes left in the wake of SB 1034's passage. Part I tracks the history of the recording industry and the recent forces that are posing a challenge to its traditional structure. Part II details the major milestones leading up to the governor's signature on SB 1034, from recent California case law to the acrimonious hearings in the state capitol. Finally, Part III evaluates the lingering questions left by SB 1034's passage, namely (1) how the legislation interfaces with a recent California court ruling that shifted the burden of proof to record labels in litigation surrounding royalty payments; (2) whether the bill has unintended consequences that could toll the death

12. *Id.*
13. *Record Label Accounting Practices Hearing*, *supra* note 10, at 44.
14. *Id.*
15. *See* 2004 Cal. Legis. Serv. 150 (2004).

knell for an already embattled industry; and (3) how the ominous legislation as originally proposed—which would have thrust a fiduciary duty on record labels and allowed for increased liability—may have prodded the industry toward the desirable path of self-reform. This Note concludes that SB 1034, with its limited approach to accounting reform, is superior to the sweeping law originally proposed by State Senator Murray due to its small but important role in the current evolution of the music industry.

I. BACKGROUND

A. Players in the Recording Industry

The cornerstone of the music industry, past and present, is the much-maligned recording artist contract.[16] To recording artists, it is the essential bridge between raw talent and the promised lands of future celebrity. To record labels, it is a proven conduit to the creative resources necessary to run a profitable enterprise. Called the hub around which nearly every aspect of the music industry revolves,[17] the central role of the recording contract has never been disturbed, despite profound technological changes in the world of music. New players and modes of distribution define the current state of the business, but artists are still bound to the terms of a written document that has changed very little since its inception.

1. Shifting Roles for Artist and Label

The music recording industry owes its rise to technological innovation.[18] This technology was historically expensive and unavailable for private use, with record companies positioned as the only entities capable of making the significant investment in new machinery to make and record music. These companies invested significant resources in building more recording studios and in developing their artists and repertoire (A&R) departments to scout new talent. This A&R staff was responsible not only for locating talent, but also for writing and arranging the artist's music. Thus, A&R served a vital role in the hegemony exercised by the record labels over nearly every aspect of the music business, from fostering creativity to managing finances.[19]

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16. Lynn Morrow, *The Recording Artist Agreement: Does it Empower of Enslave?*, 3 VAND. J. ENT. L. & PRAC. 40, 42 (2001).

17. ENTERTAINMENT INDUSTRY CONTRACTS § 159.01 (Donald C. Farber ed., 2002).

18. *See* GEOFFREY P. HULL, THE RECORDING INDUSTRY 17 (2d ed. 2004).

19. *See generally* RICHARD BUSKIN, INSIDE TRACKS (1999) (compiling firsthand accounts from famous record producers about the evolution of the music business).

However, the 1960s marked the gradual demise of the label's A&R staff as a musical contributor and the ascension of the record producer as a central participant in the creative process.[20] Originally the record companies employed the producer, but as they continued to play a central role in the marking of sound recordings, and as artists wanted more creative control over their music, producers left the employ of record labels to start their own production companies.[21] By the 1970s, producers functioned almost entirely separate from labels, thereby removing the creative aspect of music making from the record companies' control and confining the labels' A&R departments to simply identifying talent and managing the books.[22] This division of labor—with labels focused on finances and artists/producers focused on music—appeared to result in a healthy balance between making music and distributing the finished product.[23] But despite this new construct and the shifting responsibilities of the various players, the one entity that remained unchanged was the recording contract.

The financial success of the industry in the late 1970s attracted outside investment to the labels, beginning a series of mergers that resulted in record companies functioning as one branch of a bureaucratic conglomerate that was largely removed from the idiosyncrasies of the music business.[24] As the record labels became more corporate, the division of labor between artist and label only served to widen the growing gap in philosophies between them. The omnipresent recording contract began to be viewed by artists as a means of corporate control and manipulation—a tool to tie artists to a life of professional indentured servitude.[25]

2. *The Contemporary Milieu*

Today, only four major record companies control over 90 percent of the recording contracts.[26] These companies—Universal Music Group, Sony BMG,[27] EMI Record Group, and Warner Music Group—funnel the

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20. *Id.* at 49.

21. *See* M. WILLIAM KRASILOVSKY & SIDNEY SHEMEL, THIS BUSINESS OF MUSIC 37 (8th ed. 2000).

22. *Id.*

23. *See* Senator Kevin Murray, *Recording Industry Practices*, 24 ENT. L. REP. 4 (2002). This structure aligned with the artists' perception of themselves as creative talent and not as business people.

24. *See* REEBEE GAROFALO, ROCKIN' OUT: POPULAR MUSIC IN THE USA 200-02 (2d ed. 2002).

25. Morrow, *supra* note 16, at 41.

26. Murray, *supra* note 23, at 6.

27. Until August 2004, there had been five major record labels dominating music distribution. However, in the fall of 2004, Sony Music Entertainment and Bertelsmann Music Group completed the merger of their operations. This new venture has created the

music industry through the terms of a monolithic contract that has changed little over the past seventy years and has grown to over eighty pages in length.[28]

Adding to the dominance of labels in the industry is their familiarity with the contracting process. Armed with experienced attorneys and oblique contracts, record labels have been able to ensure a deal that guarantees maximum income and considerable leverage for themselves. To labels, this is simple economics since they are corporations that must turn a profit in order to survive.[29] In line with this image, record labels portray themselves as "risk distributors, in the same vein as banks, oil wildcatters, and venture capital companies[,]"[30] who invest in artists they think will be successful despite the fact only a small percentage ever will be. As seen by industry representatives, record labels simply spread risk and hope for a return.[31]

Not surprisingly, artists take an entirely different view of the industry, largely seeing themselves as victims of a detached corporate giant and a hard bottom line. Invoking metaphors of slavery and servitude,[32] they view the record companies as conspiring to keep them perpetually indebted to a plantation that also owns the product of their labor.[33] According to artists, nowhere else is this manipulation more evident than in the royalty accounting scheme established by the record contract. "Of the thousands of royalty compliance audits I've conducted over the past 30 years," reported one prominent accountant for recording artists, "I can recall only one instance where the artist owed money to the company,"[34]

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world's second-largest music company, just after Universal Music Group, and highlights the state of flux afflicting the traditional music industry establishment. Media Brief, *Sony Corp.: Deal Creating Music Company with Bertelsmann is Completed*, WALL ST. J., Aug. 6, 2004, at B6.

28. Murray, *supra* note 23, at 9.

29. XAVIER M. FRASCOGNA, JR. & H. LEE HETHERINGTON, THIS BUSINESS OF ARTIST MANAGEMENT 130 (1997).

30. *Record Label Accounting Practices Hearing*, *supra* note 10, at 71 (statement by Steve Marks, Senior Vice President of Business and Legal Affairs, Recording Industry Association of America (RIAA)).

31. *Id.* For every 100 artists signed, a label can expect to have only five release a hit album. Also, labels commit an average of $450,000 per contract for advances and production just to launch an artist's first album. *Id.* at 69.

32. *Id.*

33. *Id.*

34. Philips, *Nation Auditors Spin*, *supra* note 6, at A15 (quoting Wayne Coleman, an accountant whose St. Louis firm has recovered more than $100 million in unpaid royalties for clients).

directly implying that labels generally always owe royalty money to artists.

B. Portents of Change

If the history of the music industry is defined by a static recording contract binding together label and artist, then the contemporary music industry is largely defined by forces that put this historical structure in doubt. The current era has witnessed better representation of artists, the rise of digital distribution, and the formation of groups to advocate on behalf of artists—trends that may or may not lead to the eventual marginalization of the recording contract.

The rise of the corporate record label also saw the concomitant ascension of the sophisticated talent lawyer. With an understanding of the labyrinthine record contract and the salient issues affecting an artist, modern talent lawyers ensure the best contracts possible for their clients by matching the sophistication of record label negotiators. As such, labels claim that recording contracts have become increasingly favorable to artists over the years.[35] If an album does gain success, labels are quick to highlight that artists—through their savvy management—almost always renegotiate their contracts for improved financial terms.[36]

Digital distribution and the rise of the home computer have also ushered in profound changes to the business. The online music store is now a staple in music distribution and is fast becoming the preferred means of purchasing music for many consumers.[37] While these online stores are built on the traditional artist-label relationship defined by a recording contract, the ease of this Internet distribution is encouraging some artists to bypass this historical construct altogether.

The Magnificent Union of Digitally Downloading Artists ("MUDDA") is the most notable group advocating the abandonment of the recording contract. Formed in January 2004 by rock veteran Peter Gabriel, MUDDA strives to completely remove record labels from the music business by letting artists directly sell their music online.[38] It is difficult to

35. *Record Label Accounting Practices Hearing*, *supra* note 10, at 67.

36. *Id.* at 70.

37. Perhaps no other company is more symbolic of this digital revolution than Apple Computer's iTunes. Steve Jobs, Apple's prodigious CEO, has explained his vision of the future of music: "[T]he personal computer has become the epicenter of the music-listening experience. People keep their music collections on their computers. They want to burn CDs and to put their music on portable players. Why shop at a record store?" Chuck Philips, *Apple's Jobs Unveils Song Service*, L.A. TIMES, Apr. 29, 2003, at C1.

38. Associated Press, *Rock Singers Plan Online Venture*, L.A. TIMES, Jan. 27, 2004, at C6; *see also* MUDDA, *at* http://www.mudda.org (last visited Mar. 10, 2005).

predict the ability of MUDDA and other similar groups to change the traditional power structures in the music industry, but the groups' efforts are notable in that they represent the most extreme reaction to the current music industry by envisioning a business model free of labels and recording contracts.

Finally, once loosely affiliated artists are now coming together to combat shared obstacles and present a unified message to the world. Groups like the Recording Artists' Coalition[39] and the Future of Music Coalition[40] have served as rallying points for disparate musicians in search of a collective voice. From lobbying Congress to educating the public to helping mold public opinion, the groups have had measured success in counteracting the powerful and seasoned Recording Industry Association of America (RIAA).

II. EVOLUTION OF SB 1034

The history of the recording industry formed the foundation for State Senator Murray's eventual legislation in the recording industry. But several pivotal events occurred before the state legislator proposed his sweeping changes to the industry and its players. These events—a decision from a California state court and enhanced media attention surrounding the music business—proved a powerful impetus for the senator to take legislative action.

A. Impact of *Wolf v. Superior Court*

The ideas that would eventually take shape in SB 1034 owe at least some of their beginnings to a California state court. Kevin Murray, the former talent agent-turned state senator from the Los Angeles area,[41] was troubled by the California Court of Appeal ruling in *Wolf v. Superior Court*,[42] which held there was no fiduciary duty between an author who had assigned his intellectual property rights to a distributor in exchange for contingent compensation from the exploitation of those rights. The dispute in *Wolf* arose when an author transferred the rights to his novel

39. *See* Recording Artists' Coalition, *at* http://www.recordingartistscoalition.com (last visited Mar. 10, 2005).

40. *See* Future of Music Coalition, *at* http://www.futureofmusic.org (last visited Mar. 10, 2005).

41. Senate Democratic Caucus, *Biography of Senator Kevin Murray*, *at* http://democrats.sen.ca.gov/templates/SDCTemplate.asp?pg=senbiography&cp=MemberPage&sln=Murray&sdn=26&zrn=Zone (last visited Feb. 16, 2005).

42. 130 Cal. Rptr. 2d 860 (Ct. App. 2003).

and its cast of characters to the Walt Disney Corporation.[43] In exchange for acquiring these rights, Disney agreed to pay the author a fixed royalty of the receipts it earned from merchandising and other exploitation of the author's characters.[44] The agreement between Disney and the author further stated that Disney was not obliged to perform any of the rights granted to it under the contract and could freely assign or license all of the rights.[45] After Disney developed and co-produced a motion picture based upon Wolf's novel, Disney and the author entered into another agreement that not only confirmed the author's entitlement to the contingent compensation from the original agreement, but also empowered the author with specific audit rights.[46] Each time the author attempted to exercise these rights, however, Disney allegedly refused him access to the pertinent records. In his suit, the author claimed breach of the auditing contract and further accused Disney of underreporting revenues it received in connection with the characters.[47] Pointing to the exclusive control Disney exercised over information concerning the exploitation of the characters and the revenue received therein, the author argued that Disney's conduct not only amounted to a breach of contract, but also to a breach of fiduciary duty.[48]

The *Wolf* court held that the "contractual right to contingent compensation in the control of another has never, by itself, been sufficient to create a fiduciary relationship where one would not otherwise exist."[49] The court also struck down the author's claim that a fiduciary relationship existed because he "reposed 'trust and confidence' in Disney to perform its contractual obligation."[50] While every contract requires one party to place at least some trust and confidence in the other, the court reasoned, by no means does this establish the elements giving rise to a fiduciary duty.[51] Trust imbues every contract with the implied covenant of good faith and fair dealing, but public policy mandates it not create a fiduciary relationship since every contract would thus be prone to the heightened duties sur-

43. *Id.* at 862-63. The motion picture that was eventually produced by Walt Disney, with Steven Spielberg's Ambin Entertainment, was *Who Framed Roger Rabbit* (1988). *Id.* at 862.

44. *Id.* at 862-63.

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.* at 863.

49. *Id.* at 864.

50. *Id.*

51. *Id.*

rounding agency.[52] The court also rebuffed the author's claim that the profit-sharing nature of the agreement gave rise to a fiduciary relationship.[53] Citing the absence of a joint venture between the author and Disney, and the fact that Disney was under no obligation to maximize profits from the author's characters, the court stated that no fiduciary duty existed between the two. "The contract plainly allowed an opportunity for nonmutual profit that is absent in fiduciary relationships."[54]

The court next considered whether the author's contractual auditing rights created a fiduciary duty. The court determined that a relationship is either fiduciary in character or it is not; the remedy sought is irrelevant in defining the nature of the relationship.[55] Therefore, the presence of auditing rights "does itself not convert an arm's length transaction into a fiduciary relationship."[56]

The *Wolf* court did, however, establish an important new presumption for artists suing over royalties in California courts. The author's final argument for a fiduciary duty centered around whether shifting the burden of proof to a party in exclusive control of financial records transformed the contractual relationship into a fiduciary one.[57] The author claimed, and the court agreed, that in contingent compensation cases where essential financial records are in the exclusive control of the defendant who would benefit from any incompleteness, public policy would best be served by shifting the burden of proof onto the defendant. The court ruled, however, that this burden shifting did not create a fiduciary duty since the nature of a contractual relationship is separate and distinct from the burden of proof.[58]

The *Wolf* ruling prompted State Senator Murray to seek legislation that would directly counter the decision by expressly establishing a fiduciary duty between recording artist and record label. Seeing the two entities more as spouses than as business unions,[59] Murray believed a fiduciary duty between the two was not only appropriate, but entirely necessary. He felt a fiduciary relationship was a sure way to prevent opportunism in a situation where the company is often in the position to benefit itself rather than the artist through either negligent recordkeeping or intentional

52. *Id.*
53. *Id.* at 865.
54. *Id.* at 866.
55. *Id.* at 867.
56. *Id.*
57. *Id.*
58. *Id.* at 868.
59. Murray, *supra* note 23, at 5.

fraud.[60] The salient quality present in each form of fiduciary relationship is a level of profound inequality between the parties,[61] which State Senator Murray reasoned was true of artist-label agreements. A fiduciary duty in the context of recording contracts would be significant in that it would give the artists not only a contractual right, but also an empowering moral right to receive fair and accurate royalty statements.[62] The label would be "duty bound to act with the utmost good faith for the benefit" of the artist[63] and would be required to disclose all relevant information regarding royalties—a potent remedy that would dramatically increase the power of artists vis-à-vis labels.

B. SB 1034

In addition to *Wolf*, two articles in the *Los Angeles Times* further prodded State Senator Murray to introduce SB 1034. In one story, the paper detailed famous recording artists forced to rely on public assistance or denied a pension and health insurance because record labels underreported their royalty earnings—all outcomes that cost the public money in the form of state services.[64] The second article told how recording artists were forced to sue their labels just to secure a proper accounting of their royalty earnings.[65] Due to this media focus and the problems he perceived stemming from *Wolf*, State Senator Murray organized two hearings in the state capital to galvanize support for possible legislative action. These hearings were jointly chaired by the Senate Judiciary Committee and the Senate

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60. Robert Flannigan, *Commercial Fiduciary Obligation*, 36 ALBERTA L. REV. 905, 906 (1998). Flannigan explains in his article that "[f]iduciary responsibility, like all forms of legal responsibility, is a product of social policy. In the fiduciary context, the operative social norm is the desire to inhibit opportunism." *Id.*

61. 37 AM. JUR. 2D *Fraud and Deceit* § 32 (2004).

62. RESTATEMENT (SECOND) OF AGENCY § 13 (2004); Murray, *supra* note 23.

63. Barbara A. v. John G., 193 Cal. Rptr. 422, 431 (Ct. App. 1983) (citation omitted).

64. *See* Philips, *Artists Put Pressure*, *supra* note 6, at C1 (describing how Motown diva Mary Wells was so destitute at the end of her life that the "First Lady of Motown" was forced to check into a charity ward of the country medical hospital to receive treatment).

65. *See* Philips, *Nation Auditors Spin*, *supra* note 6, at A15 (stating that singer Peggy Lee and 300 other performers obtained a $4.75-million settlement in a class-action suit that accused their record company of cheating them out of royalties from back to the 1940s and describing recent efforts by the Recording Artists Coalition to raise funds and lobby lawmakers for fairer record contracts).

Select Committee on the Entertainment Industry and set the tone for the eventual legislation authored by the senator.[66]

As originally drafted, SB 1034 proposed sweeping changes to the artist-label relationship. The bedrock of the original bill was a call for a fiduciary duty on recording companies to accurately account for royalties earned under a recording contract.[67] Moreover, the bill empowered artists with a statutory right that existed above and beyond the specific terms of each ad hoc contract to audit the accounting records for their royalties. Finally, the bill stipulated specific remedies for artists in cases of breach of that fiduciary duty: requiring a label to pay an artist's costs of an audit, legal fees, and interest if an audit revealed an underpayment of royalties greater than ten percent; requiring a label to pay an artist three times any amount of underpayment if the amount was greater than ten percent; permitting an artist to rescind her recording contract if the audit revealed an underpayment greater than twenty percent; and submitting any disputes concerning the payment of royalties arising from the audit to binding arbitration.[68]

This proposed legislation would have profoundly transformed the recording industry in California by granting artists unprecedented contractual and remedial power. The current state of the law required an artist who suspected royalty underpayment to bring a lawsuit based on a violation of the duty of good faith and fair dealing—an unappealing and expensive route for most musicians.[69] Because there were no penalties against labels for the negligent underpayment of royalties, damages would generally be limited to expectation damages, or what was originally due under the terms of the contract. California law did provide penalties for the un-

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66. According to Senator Martha Escutia, Chair of the Senate Judiciary Committee, the Judiciary Committee co-chaired the hearings due to reports that past recording artists had to rely on public assistance because they were shortchanged their royalty earnings during their careers. Senator Escutia explained that "if public tax dollars are being spent to support artists who were cheated out of their royalty earnings, we need to shift the burden back to where it belongs: to the record labels that failed to pay the artists their rightful earnings." *Record Label Accounting Practices Hearing*, *supra* note 10, at 1 (overview by Sen. Martha M. Escutia, Chair).

67. *Assembly Committee on Arts, Entertainment, Sports, Tourism, and Internet Media*, 2002-2003 Leg., 1 (Cal. 2003) (presenting a bill analysis for SB 1034), *available at* http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1001-1050/sb_1034_cfa_20040607_152304_asm_comm.html.

68. *Assembly Committee on Arts, Entertainment, Sports, Tourism, and Internet Media*, 2003-2004 Leg., 1-2 (Cal. 2004), *available at* http://www.leginfo.ca.gov/pub/03-04/bill/sen/sb_1001-1050/sb_1034_cfa_20040607_152304_asm_comm.html.

69. Murray, *supra* note 23, at 6.

derpayment of royalties in cases of outright fraud,[70] but the artist had to prove a specific intent by the record label to fraudulently underpay.[71] Because specific intent was extremely difficult to prove in court and the artist could rarely afford to litigate, the record company was largely perceived as free to act negligently in its royalty accounting without penalty.[72] As stated by one industry accountant:

> The [recording] companies play this 'catch-us-if-you-can' game with artist royalties. It's not like they sit down and scheme how to take advantage of everybody. But the systems are designed to impede. They're archaic and the royalty staffs are lean. Only artists with muscle really have the ability to get their money.[73]

Yet State Senator Murray's threatened seismic shift to the recording industry never took place. Whittled away by the legislative process and intense lobbying by the RIAA, SB 1034 as signed by Governor Schwarzenegger was significantly diluted and far less severe—a compromise package palatable to the recording industry conglomerates and legislators leery of government intervention in private contracting. While the bill creates a statutory right for artists to audit royalty statements issued by recording companies, it falls far short of establishing the fiduciary relationship originally advanced by State Senator Murray.[74] Artists may now only audit their labels once a year, and the artist must request this audit within three years after the end of a royalty earnings period as defined by the contract.[75] While artists can choose their own auditor and hire him on a contingency fee basis, they can only audit a particular royalty earnings period once. Auditors can audit a label on behalf of several artists at once, but if impropriety is found, artists are limited to the contractual remedies found in their individual contracts, with no enhanced right to punitive damages.[76] Thus, one of the seminal issues that gave birth to SB 1034—the lack of a fiduciary duty between artist and label as defined in *Wolf*—ultimately failed to appear in the final passage of State Senator Murray's bill.[77]

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70. CAL. CIV. CODE § 3294(a) (West 2004); 23 CAL. JUR. 3D *Damages* § 137.

71. Murray, *supra* note 23, at 7.

72. *Id.*

73. *See* Philips, *Nation Auditors Spin*, *supra* note 6, at A15 (statement by veteran music accountant Fred Wolinsky of Sherman Oaks, CA).

74. 2004 Cal. Legis. Serv. 150 (West).

75. *Id.*

76. *Id.*

77. Murray, *supra* note 23, at 7.

III. ANALYSIS

Despite the differences between State Senator Murray's first draft and the bill as passed, SB 1034 provides artists a very tangible tool in their quest for equity in bargaining power and accuracy in royalty payments—audit rights with defined metes and bounds that attach regardless of contractual terms. Furthermore, when viewing the law in the context of recent reform in the industry, the legislation points to a larger shift towards artist information that invariably results in a balanced and more trusting environment in the music business, an environment that would be overwhelmed by the enormous weight of a fiduciary duty as originally envisioned by the senator.

A. SB 1034 and *Wolf*: Empowering Artists Both Before and After Litigation

The burden-shifting scheme outlined in *Wolf* empowers artists with information only *after* litigation has commenced, while SB 1034 grants artists the right to audit throughout the normal course of the artist-label relationship. Thus, State Senator Murray's bill is arguably more forward thinking and proactive, assuaging concerns before they grow. *Wolf*'s evidentiary ruling is decidedly more reactive, gaining potency only after the start of formal legal proceedings.

At a cursory glance, the California court of appeal ruling in *Wolf* seemed to affirm the limited the rights of an artist who had assigned her intellectual property to a distributor. With the court refusing to impose a fiduciary duty on a company bound to a contingency compensation agreement with an artist, the distributors of assigned intellectual property rights appeared to score a major victory in the ruling. Record labels were able to maintain the status quo and confine artists' remedies to the terms of the contract and the implied covenant of good faith that included no heightened obligation of disclosure, no moral obligation to accurately account to an artist, and no elevated standard of diligence when managing an artist's royalties,

But the end of the *Wolf* opinion was capped with a brief discussion that quietly reshaped the contours of lawsuits between the two sides. Noting that an artist litigating against a corporate distributor faced an uphill battle without access to the all-important accounting records, the court ruled that the burden of proof in a royalty underpayment claim should be shifted away from the plaintiff artist and on to the defendant distributor:

> [I]n contingent compensation and other profit-sharing cases where essential financial records are in the exclusive control of

> the defendant who would benefit from any incompleteness, public policy is best served by shifting the burden of proof to the defendant, thereby imposing the risk of any incompleteness in the records on the party obligated to maintain them.[78]

While this shifting of the evidentiary burden does not transform the nature of the parties' relationship from contractual to fiduciary,[79] it is significant nonetheless. By placing the burden on the distributors to open their accounting books and prove that royalties are being paid correctly, the *Wolf* court granted artists a powerful right to access and knowledge. Although not the fiduciary duty State Senator Murray hoped to impose on labels, it is a notable victory for artists and a large step towards bringing transparency to the shrouded world of royalty accounting. Recording artists who now choose to file suit against their label alleging royalty underpayment have the luxury of having the label carry the burden of proof that the artist has been paid her fair share.

But the victory for artists that the *Wolf* ruling represents must be tempered by the practical difficulties of suing record companies. The steps leading up to this point are formidable: the artist must first hire an auditor to ascertain whether royalty underpayment has occurred, retain counsel for a lawsuit against the label, and then file a suit in court. This course of action is not only extremely expensive for an unrecouped artist struggling to break into the music industry, but it is also a hostile action against an entity without which most artists traditionally cannot live. Despite recent trends to the contrary, record labels and recording contracts are still a significant force in the music industry and the primary means by which artists gain a foothold in the business. Pushing a royalty underpayment contention to the point of litigation poisons the well between artist and label and stands as a harbinger of a future bumpy ride together.[80]

But all is not lost, because it appears SB 1034 will serve as a preliminary safety valve by providing an artist with the right to audit *before* filing a lawsuit. State Senator Murray's legislation empowers artists with a discrete set of auditing rights that apply throughout the life of a recording contract and that transcend any stipulated terms in ad hoc negotiations. The bill also removes barriers to hiring an auditor, thus enabling an artist to address royalty concerns before resorting to litigation. Taken together, *Wolf* and SB 1034 vest artists with more rights and more information,

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78. Wolf v. Superior Court, 130 Cal. Rptr. 2d 860, 867-68 (Ct. App. 2003).

79. *Id.* at 868.

80. *Record Label Accounting Practices Hearing*, *supra* note 10, at 44 (statement by Mr. Londell McMillan, General Counsel, Artist Empowerment Coalition).

thereby increasing artists' collective knowledge and ensuring that they reap the benefit of their album sales.

B. Possible Limitations and Ramifications of SB 1034

During the legislative hearings leading up to SB 1034's passage, some state lawmakers expressed open reticence about the effectiveness of a Sacramento-crafted law in the esoteric world of recording contracts. One state senator bluntly admitted that "I truly don't understand any of this."[81] Referring to the recording artists and record labels, he went on to say that

> I understand in any business negotiation both sides try to protect themselves, but how do we get in the middle of this and not mess it up so badly, because trust me on this one, if we do get in the middle of this, we will mess it up. That is the nature of the legislative process.[82]

With its skeletal set of mandated auditing rights, it seems unlikely SB 1034 is going to "mess up" too much in the music industry, but it is worth highlighting at least some of its possible side effects, namely the potential for thinner record deals for artists, the flight of labels from California, and lawyer-driven acrimony in the industry.

1. Diminished Record Contracts for New Acts

With its specific list of accounting rights and its prescribed methods for conducting royalty audits, SB 1034 is likely to bring some degree of healthy transparency to the recording industry. This transparency may come at a cost, however, and that cost could be less generous deals for new recording artists. Facing the financial pressure of online piracy and copyright infringement,[83] record labels are stretched thin in their struggle to maintain the traditional market structure. Being brittle and bruised from their war with technology, record labels could react to elevated auditing responsibilities by simply tightening the noose around new artists' necks and offering them a lower royalty rate that includes more latitude for the label but less for the artist. As recording contracts have been the backbone of the music business and virtually every new artist must go through a recording deal at some point, SB 1034 may signal a more difficult time for emerging talent ahead. New artists often must take what they are offered since they have no track record of musical success and little leverage at the negotiating table. After SB 1034, what they get from a label may be

81. *Id.* at 45 (statement by Sen. Ray Haynes).
82. *Id.* at 45-46.
83. *Id.* at 3.

more rights to accounting sheets but less money and maneuvering power under the contract.

2. *Flight of the Labels from California*

Geography may be another factor limiting the effectiveness of SB 1034. Along with California, New York and Tennessee serve as ground zero for the music industry. SB 1034 may set the stage for the exit of major record labels from California in an effort to escape its requirements. While this scenario seems unlikely given the long-standing history of the recording industry in the Golden State and the significant pool of talent that emerges from the region, it is not outlandish to envision major operations for labels moving entirely to some other jurisdiction more friendly to record companies. This could feasibly be accompanied with the labels inserting a contract provision detailing that this new jurisdiction would be the proper venue for any and all litigation arising under the terms of the contract.

3. *A Boon for Lawyers and Accountants*

Finally, aside from recording artists, SB 1034 will make at least two other groups of professionals happy: accountants and lawyers. With the enhanced power to audit and the ability to investigate suspected royalty underpayments, artists will be calling on the services of accountants to do the financial probing—and in instances of gross royalty underpayment, on an attorney to commence litigation against the label to either break the contract or demand payment. Such intrusions by two little-loved professional groups seem likely to deepen the growing divide between artist and label who have historically functioned in a symbiotic relationship. Once compared to a marriage[84] by State Senator Murray, this relationship could be reduced to a hostile war zone defined by legions of lawyers and accountants fighting their counterparts on the other side.

However, when viewed against the backdrop of other recent changes in the industry, it is unlikely SB 1034 will be a cash cow to the legal and accounting worlds or that California will see the en masse migration of record labels from its borders. Rather, the legislation is one part of the much larger evolution that is transforming the industry of music.

C. SB 1034 Prodding Industry Self-Reform

The recording companies voluntarily implemented much of the spirit of the original SB 1034 before its diluted counterpart ever passed—one more sign of increasing pressures on the industry to change. For over two

84. Murray, *supra* note 23, at 5.

years, State Senator Murray had been threatening to impose change on the recording business through legislative fiat. After the 2002 legislative hearings, the senator sent this warning to record labels in a law review article: "I urge the record companies to consider the structural and accounting changes on their own to avoid legislation that would mandate contract terms, and to engage in discussions with State Legislatures and Congress about enacting those suggestions that require legislative action."[85] While opening the door for self-regulation and organic reform, State Senator Murray also made clear he would not be coy about using the blunt force of legislative action to remedy a pervasive problem in the recording industry.

Three of the label conglomerates moved quickly toward internal self-reform. Bertelsmann Music Group (BMG)[86] was the first to break ranks with industry rivals by proposing a "fairer, more transparent" accounting system for royalty payments.[87] At the end of 2002, BMG announced its sweeping changes to the way it did business with artists: it would simplify royalty computations; reduce the number of pages in a standard recording contract from 100 to 12; introduce a new contract model that would restrict the number of years an artist would be bound to the label while also opening up a new stream of shared revenue; and compute royalties based on the wholesale price of a CD rather than the suggested retail price.[88] As explained by a music industry accountant, "It's exactly what artists are crying out for. In theory, if it became a universal practice, there would be little reason for artists to ever conduct audits."[89]

Feeling both peer pressure from BMG and the threat of legislative action, Universal Music Group, the largest of the record labels, next followed suit. Among other reforms, Universal announced in 2002 that it too would revamp its royalty accounting process by giving artists access to

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85. *Id.* at 9-10.

86. This announcement from BMG came nearly one year before its merger in late 2004 with Sony Music Group. The newly merged label, Sony BMG, is owned equally by the two media giants and it remains to be seen what type of lasting reform will endure in this new corporate structure. *See* Media Brief, *supra* note 27, at B6.

87. Chuck Philips, *BMG to Roll Out Royalty Plan: The Move Could Help Ease the Controversy Over the Industry's Accounting Practices*, L.A. TIMES, Nov. 20, 2003, at C1.

88. *Id.* Royalties based on wholesale prices or suggested retail prices will likely be the same, but the benefit for artists will be in the form of simplified royalty statements. "For instance, an artist with a 12% royalty based on the suggested retail price of $17.98 per CD typically earns about $1—after the company extracts a bevy of deductions. Under BMG's plan, the same artist will receive a 9% royalty based on the wholesale price of $11.41 per CD, with no deduction, still receiving about $1." *Id.*

89. *Id.* (statement by Phil Ames, a music industry accountant who has performed countless audits for recording artists).

manufacturing documents that it had previously withheld.[90] Also significant was Universal's plan to double the size of its audit staff to enable the company to be more responsive to royalty inquiries from artists.[91] Finally, in a move to educate artists about industry accounting practices and to alleviate their suspicions, Universal announced it would hold royalty workshops twice a year.[92]

In the most significant accounting reform, Warner Music Group announced in 2003 that not only would it simplify royalty calculations across the board, but it would also subject itself to self-imposed penalties in the advent of royalty underpayment. By promising to pay interest in prime rates to artists on unpaid royalties found in an audit and to reimburse acts for the costs of any audit that revealed royalty underpayment exceeding ten percent,[93] Warner Music became the first and only record company to expose itself to monetary damages for its own negligence.

Exactly what prompted the record labels to voluntarily reform their royalty accounting practices is unknown. Considering the extended length of the law's passage and the high profile senate hearings held in the state capital, SB 1034 packed a media punch that was felt throughout the entertainment industry. State Senator Murray was able to marshal considerable momentum in his call to empower artists by catering to a national media audience with an issue that made headlines but also appealed to people's inner sense of fairness. Whether it was the negative press emanating from the senate hearings about the antiquated practices of the recording industry, or the specter of government oversight manifest through a statute which would have imposed a fiduciary duty, the bill as signed by Governor Schwarzenegger was much more narrow in its approach to industry reform. Receiving the final blessing of the RIAA, the recording artists, and the Sacramento political establishment, SB 1034 was largely able to accomplish the overly ambitious goals of the original bill sans governmental intrusion into private contracting.

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90. Contracts require labels to compensate artists on records sold, not manufactured. Therefore, labels historically only provided artists with records of sales during audits. The fact that the manufacturing records were withheld from auditors caused suspicion among artists who accused labels of selling albums manufactured overseas without accounting for them in royalty statements. *See* Chuck Philips, *California Universal Music to Redo Royalties: Firm Becomes Second to Respond to Concerns About the Industry's Accounting Practices*, L.A. TIMES, Nov. 28, 2002, at C2.

91. *Id.*

92. *Id.*

93. Chuck Philips, *Warner Rolls Out Royalty Reforms: Record Company Says Move Will Make it Easier for Acts to Determine What They are Owed*, L.A. TIMES, Mar. 20, 2003, at C1.

IV. CONCLUSION

By all accounts, the artist-label relationship was ripe for change, and recent events have done much to address a number of glaring problems in the recording industry. Viewed as a whole, these changes have significantly emboldened artists through more information and greater access to documents once held exclusively by the labels. The accounting self-reform enacted by three major record companies alleviates the misinformation and the suspicion an artist may have about proper royalty recording, feasibly removing the need for an audit in the first place. However, if an artist did choose to audit, SB 1034 grants her discrete audit rights and a means to defray the formidable ensuing costs. Finally, if the artist chose to sue for royalty underpayment, the *Wolf* decision places the burden on the record label to prove that the artist was being paid correctly. These recent actions are all incremental but decidedly prudent, as they allow the music industry to organically adapt itself to the expectations of talent and the financial realities facing labels in an uncharted digital age. Legislative actions that would impose artificial relationships and stipulate damages, such as the original bill proposed by State Senator Murray, overreach and threaten to bring enmity, rather than cooperation, to the industry. The music business has adapted to the technical innovations and evolving musical tastes of the last 100 years, and there is every reason to believe that it will continue to do so in the years to come through self-adaptation, minimal government intrusion, and cooperation between artist and label.

BERKELEY TECHNOLOGY LAW JOURNAL
ANNUAL REVIEW OF LAW AND TECHNOLOGY

FOREIGN & INTERNATIONAL LAW

BMG CANADA, INC. V. DOE & SOCIETY OF COMPOSERS, AUTHORS & MUSIC PUBLISHERS OF CANADA V. CANADIAN ASS'N OF INTERNET PROVIDERS: WHY THE CANADIAN MUSIC COMPENSATION SYSTEM MAY NOT WORK IN THE UNITED STATES

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Canada and the United States rely on similar copyright schemes. When it comes to crafting and enforcing copyright law for and on the Internet, however, the solutions and outcomes in the two countries significantly differ. Recent Canadian court decisions *BMG Canada, Inc. v. Doe* ("*Doe*")[1] and *Society of Composers, Authors & Music Publishers of Canada v. Canadian Ass'n of Internet Providers* ("*SOCAN*")[2] confirm that in Canada, copying or downloading music from the Internet for personal noncommercial use does not constitute infringement. Consequently, Internet service providers (ISPs) are not liable for contributory infringement or related royalty payments. In light of the marked departure these cases represent from U.S. law and norms, and larger problems with Canada's levy-based copyright regime, *Doe* and *SOCAN* demonstrate that it may not be feasible or desirable to adopt recent suggestions that the United States implement a Canadian-style system.

This Note analyzes how Canada's copyright laws operate in relation to the Internet and considers the concerns pertinent to adopting a similar system in the United States. Part I summarizes Canadian copyright law in general, and the levy/tariff system in particular, as they operate in the Internet environment. Part II briefly describes the *Doe* and *SOCAN* decisions and what they say about user, ISP, and P2P file-sharing liability in Canada. Part III reviews the current state of file-sharing copyright

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1. BMG Can., Inc. v. Doe, [2004] F.C. 488 (Can.).

2. Soc'y of Composers, Authors & Music Publishers of Can. v. Can. Ass'n. of Internet Providers, [2004] S.C.R. 427, 2004 Can. Sup. Ct. LEXIS 46.

jurisprudence on the Internet in the United States. Finally, Part IV analyzes how *Doe* and *SOCAN* heighten existing problems with the Canadian levy/tariff system, and concludes that these shortcomings would render it unwise to adopt a similar system in the United States.

I. THE CANADIAN COPYRIGHT SYSTEM

Canadian copyright law is a statutory scheme that protects rights similar to those protected in the United States.[3] Unlike the United States, however, Canada utilizes a compensatory scheme consisting of tariffs and levies on goods and services related to consumption of copyrighted works.

A. THE CANADIAN COPYRIGHT ACT

The Canadian Copyright Act protects five general categories of creative works: literary, dramatic, artistic, and musical works, and sound recordings.[4] A recorded musical work is typically protected by several different copyrights, including those in the musical composition, the lyrics, and the performance.[5] The Act grants a copyright holder the exclusive rights to produce, publicly perform, publish in the original language or translation, make a sound recording or cinematographic film of, reproduce, communicate by telecommunication, and rent or authorize renting of the work.[6] Direct infringement occurs when an individual exercises one of the copyright owners' rights without the consent of the copyright owner.[7] The statute also defines secondary infringement, which

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3. *See generally* Sheldon Burshtein, *Surfing the Internet: Copyright Issues in Canada*, 13 SANTA CLARA COMPUTER & HIGH TECH. L.J. 385, 395-408 (1997) (discussing Canadian copyright law in general and Internet issues in particular); Alex Colangelo, *Copyright Infringement in the Internet Era: The Challenge of MP3s*, 39 ALBERTA L. REV. 891, 902-03 (2002) (discussing challenges Canada faces in applying its copyright laws on the Internet); Daniel J. Gervais, *Transmissions of Music on the Internet: An Analysis of the Copyright Laws in Canada, France, Germany, Japan, the United Kingdom, and the United States*, 34 VAND. J. TRANSNAT'L L. 1363, 1367-72 (2001) (comparing Canadian copyright law to that of other countries).

4. *See* Copyright Act, R.S.C., ch. C-42, § 2 (1985) (Can.).

5. Musical works include any work of music or musical composition, with or without words, and compilations of musical works. *Id.* Song lyrics are classified as literary works. *Id.* The Canadian Copyright Act also protects performance of musical works. *Id.* § 15.

6. *Id.* § 3. The scope of the performance right depends on whether the work is fixed or not. If the performance is not fixed, the copyright owner can communicate the work by telecommunication, perform it publicly, and fix the performance. *Id.* § 15(a). If the performance is fixed the rights-holder can reproduce, authorize fixation, reproduce reproductions, and rent the performance. *Id.* § 15(b)-(c).

7. *Id.* § 27(1).

is constituted by the sale, lease, distribution for the purposes of trade, exhibition in public by the way of trade, or importation of infringing works when the actor "knows or should have known [that she] infringes the copyright or would infringe the copyright if [the action] had been made in Canada by the person who made it."[8]

Certain types of activities that involve the reproduction or performance of copyright-protected works are exempted from copyright infringement in Canada. The most notable exception is for reproduction of a sound recording "for the private use of the person who makes the copy."[9] This private personal use exemption for music, which was introduced in 1998 as an amendment to the Canadian Copyright Act,[10] is balanced by a levy that consumers pay on blank media in order to compensate rights holders for such copying.[11] This is one of the most significant differences between the copyright laws of Canada and the United States.[12] While prior to the advent of the Internet the meaning of "private personal use" was relatively clear, the *Doe* and *SOCAN* cases reveal that the Internet's capabilities have rendered the scope of the exemption one of the most contentious and economically significant issues in Canadian copyright law.

B. THE CANADIAN LEVY SYSTEM

In deciding how to enforce the Canadian Copyright Act in the Internet age, the Canadian Parliament determined that "it was difficult to detect infringements, and adequate enforcement of the law was a somewhat distant hope that would, in effect, only serve to clog the [Canadian] judicial system."[13] Thus, the Parliament decided to compensate artists by

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8. *Id.* § 27(2)-(5).

9. *Id.* § 27(2). In addition to the private personal use exemption discussed here, the "fair dealing" doctrine allows other exemptions such as copying for private research, and performance under certain circumstances. *Id.* The fair dealing doctrine belongs to Canadian common law and is not legislatively defined; hence, the court interprets the facts of each case. Canadian fair dealing differs from the United States' "fair use" doctrine, as the latter is broader in scope. *See* Burshtein, *supra* note 3, at 405.

10. *See* Canadian Copyright Board, *Fact Sheet*, Dec. 12, 2003, *at* http://www.cb-cda.gc.ca/news/c20032004fs-e.html.

11. *See* R.S.C., ch. C-42, § 80.

12. Although the Audio Home Recording Act provides a similar exemption for copies made onto digital audio tape (DAT), likewise subsidized by a levy on blank recordable compact discs, limited consumer adoption of the DAT format has rendered the provision largely irrelevant. 17 U.S.C. § 1001 (2000).

13. Mark K.J. Rushton & Virginia H.L. Jones, *The Tortoise and the Hare: Canadian Legislative Copyright Reforms Race Against Copyright Infringement Over Kazaa and Other New Generation Peer-to-Peer Networks*, 32 AIPLA Q.J. 197, 245 (2004).

implementing a levy on blank media.[14] Seeking additional compensation, SOCAN applied to the Canadian Copyright Board for an Internet tariff known as "Tariff 22."[15]

1. *The Levy System*

While § 80 of the Canadian Copyright Act allows private personal copying of sound recordings, it also restricts such copying to a form of recording media that is subject to a consumer levy: domestically produced or imported blank media including analog audio cassette tapes, compact discs, MiniDiscs, and various forms of memory permanently embedded in a digital audio recorder (such as an MP3 player).[16] As new copying media appear, the Canadian legislature modifies the levy system to include them.[17] The Copyright Board then determines the levy amount in consultation with all interested parties.[18] The levies aim to compensate artists for lost royalties due to consumers' home copying.[19] Whether the levy sufficiently compensates artists, however, is widely disputed.[20]

Under the levy system,[21] the Canadian Private Copying Collective (CPCC)[22]—an umbrella organization consisting of five Canadian music collective societies, of which SOCAN[23] is one—collects the fee on blank

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14. *See* R.S.C., ch. C-42, § 80.

15. Statute SOCAN, *Web Licensing*, *available at* http://www.socan.ca/jsp/en/music_users/web_licensing.jsp (last visisted Feb. 28, 2005).

16. *See* R.S.C., ch. C-42, § 80; *see also* Canadian Copyright Board, *supra* note 10 (discussing what the media categories from which levies are collected include and exclude).

17. Rushton & Jones, *supra* note 13, at 248.

18. R.S.C., ch. C-42, § 83(1)-(9).

19. W. Victor Tuomi, *Music, Copyrights, and the Internet: The Copyright Board Chimes In*, 18 CAN. INTELL. PROP. REV. 69, 171 (2001).

20. *See, e.g.*, Rushton & Jones, *supra* note 13, at 249 ("[A] blank media levy masked in the price of consumer goods is not sufficient to compensate for all varieties of copyright infringement."); Tuomi, *supra* note 19, at 77-80 (criticizing the levy system as a form of tax).

21. *See* Kimberly Hancock, *Canadian Copyright Act Revision*, 13 BERKELEY TECH. L.J. 517, 525-26 (1998).

22. *See generally* Canadian Private Copying Collective, http://cpcc.ca (last visited Feb. 28, 2005).

23. *See generally* SOCAN, http://www.socan.ca (last visited Feb. 28, 2005). SOCAN is a not-for-profit corporation representing composers, songwriters, and lyricists. Membership is not compulsory. "SOCAN is part of a worldwide network of similar societies administering similar repertoires. . . . SOCAN has filed and continues to file numerous [requests for] tariffs." JOHN S. MCKEOWN, CANADIAN LAW OF COPYRIGHT AND INDUSTRIAL DESIGNS 709-10 (3d ed. 2000). There are twelve such collective societies in Canada. *Id.*; *see also* Hancock, *supra* note 21, at 525-26 (discussing the levy system). Other member collectives are the Canadian Mechanical Reproduction Rights

media. The CPCC then distributes the collected fees to its constituent societies, which, in turn, distribute the fees to artists.[24] In general, a collective society licenses[25] the right to perform its members' copyrighted works publicly "by [members'] assignment, grant of license, appointment of it as their agent or otherwise, authoriz[ing] it to act on their behalf in relation to that collective administration."[26] The collective societies also pursue copyright enforcement actions on their members' behalf.[27]

Agency (CMRRA), the Neighboring Rights Collective of Canada (NRCC), the Societe de gestion des droits des artistes-musiciens (SOGEDAM), and the Societe du droit de reproductiondes auteurs, compositeurs, et editeurs au Canada (SODRAC). Canadian Copyright Board, *supra* note 10.

24. Artists can join any society for which they qualify for some nominal annual or one-time membership fee; any one artist can qualify for more than one society. *See* SOCAN, *How Membership Works*, *available at* http://www.socan.ca/jsp/en/music_creators/how_it_works.jsp (discussing one time membership fees and royalties distribution process and timetable in SOCAN) (last visited Feb. 28, 2005); SOCAN, *Membership Criteria*, *available at* http://www.socan.ca/jsp/en/music_creators/criteria.jsp (last visited Feb. 28, 2005) (discussing the membership criteria for music creators and music publishers).

25. "The cost of a SOCAN license depends on a range of factors, from where and how the musical work is being performed, to the seating capacity, and even the kind of event . . . . In fact, there are more than 20 different tariffs set by the Copyright Board to accommodate the different uses of music." SOCAN, *How Our Licensing Works*, *available at* http://www.socan.ca/jsp/en/music_users/how_it_works.jsp (last visited Feb. 28, 2005); *see also* SOCAN, *SOCAN Tariffs*, *available at* http://www.socan.ca/jsp/en/resources/tariffs.jsp (last visited Feb. 28, 2005) (listing various kinds of tariffs). SOCAN also assists Canadians to obtain a license on foreign music as it has "reciprocal agreements with organizations similar to SOCAN, from all over the world." SOCAN, *Do You Need A License?*, *available at* http://www.socan.ca/jsp/en/music_users/do_you_need_license.jsp (last visited Feb. 28, 2005).

26. MCKEOWN, *supra* note 23, at 710 (quoting R.S.C., ch. C-42, § 2 (1985) (Can.)). Sections 67-68.2 outline the law applicable to collective societies:

> In order to come within the definition, the society must carry on the business of the collective administration of copyright and operate a licensing scheme applicable to a repertoire pursuant to which the society sets out classes of uses that it agrees to authorize under the Act and the royalties and terms and conditions relating to such use.

Id. Collective societies periodically file the lists of all musical works in current use with the Minister at the Copyright Office. *Id.* 709; *see also* MIHALY FICSOR, COLLECTIVE MANAGEMENT OF COPYRIGHT AND RELATED RIGHTS (2000); Stanley M. Besen, et al., *An Economic Analysis of Copyright Collectives*, 78 VA. L. REV. 383 (1992) (arguing that collectives centralize administration of copyrights and lower costs allowing more transactions to occur).

27. MCKEOWN, *supra* note 23, at 708 ("The rules of the societies provid[e] for the pooling of the fees and damages recovered and division of the fund among the members after the deduction of expenses.").

Obtaining a tariff in Canada is a complex and often lengthy process. A collective society such as SOCAN first must file a proposed tariff with the Copyright Board, which is then published in the *Canada Gazette*. Prospective users may file written objections within sixty days after the publication of the tariff.[28] No collective society can commence an infringement or royalty recovery action unless a proposed tariff has been filed, absent special consent from the Minister of the Copyright Board.[29] The Copyright Board must set tariffs on a "reasonable and suitable" or "rational" basis, and then publish approved tariffs in the *Canada Gazette* as soon as practicable.[30] Once the Copyright Board certifies a tariff, the defendant in an enforcement action cannot dispute its validity,[31] and the collective society cannot cancel the underlying license. Any party, however, can appeal the Copyright Board's decision in the system of Canadian federal courts.

2. *Tariff 22*

In 1995, SOCAN proposed what became known as "Tariff 22" to the Copyright Board as another way to compensate artists for Internet distribution of their works.[32] "Tariff 22 seeks to license the royalties for the public performance of musical works by means of any telecommunication service whose transmission can be independently accessed. The primary targets of this tariff are ISPs."[33] Unlike the blank media levy, Tariff 22 focuses on indirect infringements "occurring because of the content providers' authorization and communication" over the Internet.[34] While the validity of Tariff 22 has not been contested, the Canadian courts have been addressing the issue of who should be

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28. R.S.C., ch. C-42, § 67 (1)-(5); *see also id.* § 68 (outlining Copyright Board decision and objections processes).

29. *Id.* § 67(4); *see also* C.A.P.A.C. v. Maple Leaf Broad. Co., [1953] Ex. C.R. 130, 150 (Can.).

30. *See* R.S.C., ch. C-42, §§ 66.91, 68(4); Can. Assn. of Broads. v. Soc'y of Composers, Authors & Music Publishers of Can., 58 C.P.R. 3d 190 (Fed. Ct. 1994) (Can.); *see also* Can. Broad. Co. v. Can., 47 C.P.R. 3d 426 (Fed. Ct. App. 1993) (Can.) (holding that the rates do not have to be set to negotiated price in a competitive market); Can. Copyright Broad. Co. v. Can., 30 C.P.R. 3d 269 (Fed. Ct. 1990) (Can.) (holding that the Copyright Board should not "pursue consistency at the expense of the merits of individual cases"); Performing Rights Org. of Can., Ltd. v. Can. Broad. Co., 7 C.P.R. 3d 433 (Fed. Ct. 1986) (Can.).

31. *Maple Leaf Broad.*, [1953] Ex. C.R. at 130.

32. SOCAN, *Web Licensing*, *available at* http://www.socan.ca/jsp/en/music_users/web_licensing.jsp (last visited Feb. 28, 2005) [hereinafter, SOCAN, *Web Licensing*].

33. *Id.*

34. Rushton & Jones, *supra* note 13, at 246.

responsible for payment of Internet tariffs since 1995.[35] *SOCAN* is the latest development in the allocation of Tariff 22.[36]

II. *DOE* AND *SOCAN*

Two recent Canadian copyright decisions, *Doe* and *SOCAN*, liberally interpreted the Canadian Copyright Act to clarify the liability issues involved with Internet music file sharing. In *Doe*, the Federal Court held that end users are not liable for trading Internet-downloaded music files because § 80 of the Copyright Act allows private noncommercial copying by end-users.[37] In *SOCAN*, the Supreme Court of Canada held that ISPs are not required to collect Tariff 22 because they are mere intermediaries in the file transfer process.[38] Section 2.4(1)(b) of the Copyright Act states that persons who only supply "the means of telecommunication necessary for another person to so communicate" are not themselves to be considered parties to an infringing communication. Moreover, forcing ISPs to pay the tariff would hinder innovation.

A. *DOE*: DOWNLOADING SONGS FOR PERSONAL USE DOES NOT CONSTITUTE COPYRIGHT INFRINGEMENT

The plaintiffs in *Doe*, all members of Canada's recording industry (collectively referred to as "CRIA"), demanded that five Canadian ISPs disclose the identities of twenty-nine customers, each alleged to have infringed the copyrights of more than one thousand songs by anonymously using software such as Geekboy and KaZaA to install Internet-downloaded music onto their home computers and to illegally trade it.[39] The Court of Appeals held that the ISPs did not have to disclose the

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35. *See* Soc'y of Composers, Authors and Music Publishers of Can. v. Can. Assoc. of Internet Providers, [2002] F.C. 3 (Can.); Soc'y of Composers, Authors and Music Publishers of Can. v. Can. Assoc. of Internet Providers, C.P.R. 4th 417 (Copyright Bd. 1999) (Can.).

36. The Copyright Board decided to conduct hearings for Tariff 22 in two phases. Phase one, completed in the fall of 1999, dealt with the legal issues pertaining to the tariff such as who is liable and what actions are liable under the Copyright Act. Phase two will deal with the tariff structure and who specifically will be liable within the communication chain for the payment of fees and amount of those fees under the tariff. As yet, the date for the hearing of phase two has not been set.

SOCAN, *Web Licensing*, *supra* note 32.

37. BMG Can. Inc. v. Doe, [2004] F.C. 488, ¶ 25 (Can.).

38. Soc'y of Composers, Authors & Music Publishers of Can. v. Can. Ass'n of Internet Providers, [2004] S.C.R 427 (Can.), 2004 Can. Sup. Ct. LEXIS 46, at *89.

39. *Doe*, [2004] F.C. 488, ¶¶ 1-2.

identity of individual customers because CRIA failed to meet three of the five necessary criteria to compel such disclosure.[40] Specifically, CRIA failed to make a prima facie case of copyright infringement, establish that the ISPs were the only practical source for the identity of the P2P users, and establish that the public interest for disclosure outweighed privacy concerns.[41]

The court began by construing § 80 of the Copyright Act, which states:

> (1) Subject to subsection (2), the act of reproducing all or any substantial part of [a] musical work embodied in a sound recording, . . . onto an audio recording medium for the private use of the person who makes the copy does not constitute an infringement of the copyright in the musical work, the performer's performance or the sound recording.[42]

The court held that "downloading a song for personal use does not amount to infringement."[43] The court also implied that uploading does not amount to infringement: "No evidence was presented that the alleged infringers either distributed or authorized the reproduction of sound recordings [when they] merely placed personal copies into their shared directories which were accessible by other computer users via a P2P service."[44] According to the court, distribution only occurs when a defendant commits a "positive act . . . such as sending out the copies or advertising that they are available for copying."[45] Thus, "[t]he mere fact of placing a copy on a shared directory in a computer where that copy can be accessed via P2P services does not amount to distribution."[46]

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40. (a) [T]he applicant must establish a prima facie case against the unknown alleged wrongdoer; (b) the person from whom discovery is sought must be in some way involved in the matter under dispute, he must be more than an innocent bystander; (c) the person from whom discovery is sought must be the only practical source of information available to the applicant; (d) the person from whom discovery is sought must be reasonably compensated for his expenses arising out of compliance with the discovery order in addition to his legal costs; (e) the public interests in favor of disclosure must outweigh the legitimate privacy concerns.

Doe, [2004] F.C. 488, ¶¶ 13, 43 (citing Norwich Pharmacal v. Customs & Excise Comm'rs, [1974] A.C. 133 (Can.), and Glaxco Welcome PLC v. Canada, 81 C.P.R. 3d 372 (Fed. Ct. 1998)).

41. *Id.* ¶ 43.

42. R.S.C., ch. C-42, § 80 (1) (1985) (Can.).

43. *Doe*, [2004] F.C. 488, ¶ 25.

44. *Id.* ¶ 26.

45. *Id.* ¶ 28.

46. *Id.* ¶ 28.

Second, the court noted that individual privacy rights outweighed the public's interest in protecting copyrights since "the protection of privacy is of utmost importance to Canadian society"[47] and there existed a "serious possibility of an innocent account holder being identified."[48] The court observed that the Canadian Parliament had recognized the need to protect privacy on the Internet when it passed the Personal Information Protection and Electronic Document Act.[49] Accordingly, the court held that "[u]nder these circumstances, given the age of the data, its unreliability and the serious possibility of innocent account holders being identified . . . the privacy concerns outweigh the public interest concerns in favor of disclosure."[50]

B. *SOCAN*: ISPS ARE NOT REQUIRED TO COLLECT TARIFF 22 FROM INTERNET USERS

After *Doe* established that individual end users do not directly infringe copyrights file sharing when they engage in private home copying of music files through Internet file sharing, *SOCAN* held that ISPs are not secondary infringers for facilitating such file sharing. As a result, ISPs need not collect or pay Tariff 22, since tariff liability only follows from one's infringement of the communication right.

In *SOCAN*, the plaintiff sought to collect royalties under Tariff 22 from the Canadian Association of Internet Providers, a coalition of Canadian ISPs who had challenged SOCAN's contention that ISPs must pay royalties for copyrighted musical works transmitted over the Internet.[51] SOCAN argued that ISPs infringed its exclusive right to communicate the works to the public by telecommunication and the right to authorize such communication,[52] and thus must pay royalties under Tariff 22.[53] The ISPs countered that they were merely conduits, and

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47. *Id.* ¶ 36.

48. *Id.* ¶¶ 42.

49. *Id.* ¶¶ 38-40 (citing Personal Information Protection and Electronic Documents Act, R.S.C., ch. C-5, §§ 3, 7(3)(c) (2000) (Can.)).

50. *Id.* ¶ 42.

51. Soc'y of Composers, Authors & Music Publishers of Can. v. Can. Ass'n of Internet Providers, [2004] S.C.R 427 (Can), Can. Sup. Ct. LEXIS 46, *22-*25.

52. "For the purposes of this Act, [the copyright holder has] . . . the sole right . . . in case of any literary, dramatic, or artistic work, to communicate the work to the public by telecommunication . . . ." R.S.C., ch. C-42, § 3(1)(f) (1985) (Can.).

53. *See SOCAN*, [2004] S.C.R 427, Can. Sup. Ct. LEXIS at *20-*23; *see also* Rushton & Jones, *supra* note 13, at 256 (arguing that ISPs are well situated to collect tariffs from individual customers).

because they did not regulate or authorize the content of the Internet communications they transmitted, Tariff 22 did not apply.[54]

Ultimately decided by the Supreme Court of Canada, the *SOCAN* case originated in the Canadian Copyright Board in 1995, when SOCAN applied for the approval of Tariff 22 to allocate royalties due as a result of Internet file sharing.[55] The Board concluded that, unlike content providers, ISPs do not execute "a communication" under § 24(1)(b) of the Act and hence are not liable for royalties.[56] The Board further held that even where an ISP does more than act as a conduit, it should not incur copyright liability unless the communication originates from a server located in Canada.[57]

On review, the Canadian Federal Court reversed the Board's decision. Though the court agreed with the Board that copyright liability does not accrue to ISPs that perform a purely intermediary function, it held that if a Canadian ISP creates a "cache" of Internet material, even for purely technical reasons, it no longer acts as a mere intermediary.[58] Instead, the ISP becomes a participant in the copyright infringement and is thereby subject to Tariff 22.[59] One judge dissented on this point, arguing that creating a cache for the purpose of enhancing Internet economy and efficiency should not constitute infringement.[60] The court also took a broader jurisdictional approach to the Internet than the Copyright Board, finding that liability for copyright infringement may be imposed upon any

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54. *SOCAN*, [2004] S.C.R 427, Can. Sup. Ct. LEXIS at *22-*23.

55. *Id.* at *24-*25.

56. Such is the case since § 2.4(1)(b) of the Canadian Copyright Act states that persons who only supply "the means of telecommunication necessary for another person to so communicate" are not themselves to be considered parties to an infringing communication. *Id.* at *33.

57. *Id.* at *35-*36. If the content provider has "the intention to communicate [. . .] specifically to recipients in Canada," the exception may apply. *Id.*

58. *Id.* at *21-*22. The court defined "cache" to be:

> [w]hen an end user visits a Web site, the packets of data needed to transmit the requested information will come initially from the host server where the files for this site are stored. As they pass through the hands of Internet Service Providers, a temporary copy may be made and stored on its server. This is a cache copy. If another user wants to visit this page shortly thereafter, using the same Internet Service Provider, the information may be transmitted to the subsequent user either directly from the Web site or from what is kept in the cache copy. The practice of creating "caches" of data speeds up the transmission and lowers the costs.

Id. at *29.

59. *Id.* at *36-*38.

60. *Id.* at *38-*39 (Sharlow, J.A., dissenting-in-part).

telecommunication entity that has "a real and substantial connection" with Canada, and that the scope of the Canadian Copyright Act is not restricted to Internet communications originating from host servers located in Canada.[61]

The Supreme Court of Canada reversed the Federal Court, upholding the Copyright Board's decision and protecting the ability of ISPs to deploy innovative technologies, such as caching, that improves Internet efficiency without invoking royalty liability in the process.[62] As the Court reasoned, the "capacity of the Internet to disseminate 'works of the arts and intellect' is one of the great innovations of the information age. Its use should be facilitated rather than discouraged . . . ."[63] The Court further noted:

> Parliament has decided that there is a public interest in encouraging intermediaries who make telecommunications possible to expand and improve their operations without the threat of copyright infringement. To impose copyright liability on intermediaries would obviously chill that expansion and development, as the history of caching demonstrates.[64]

Therefore, ISPs acting as intermediaries should not be held liable for infringing uses of digital content since "[i]t is clear that Parliament did not want copyright disputes between creators and users to be visited on the heads of the Internet intermediaries, whose continued expansion and development is considered vital to national economic growth."[65]

The Court declined to join the fray on the jurisdictional question, observing that regardless of where the communication originates, Parliament already decided in § 2.4(1)(b) of the Copyright Act that ISPs are mere intermediaries and therefore not liable when such communications infringe.[66] The Court noted that § 2.4(1)(b) "is not a

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61. *Id.* at *36-*38.
62. *Id.* at *39.
63. *Id.*
64. *Id.* at *79.
65. *Id.* at *89.
66. *Id.* at *66.

> Section 2.4(1)(b) shields from liability the activities associated with providing the means for another to communicate by telecommunication. "The means," as the Board found, ". . . are not limited to routers and other hardware. They include all software connection equipment, connectivity services, hosting and other facilities and services without which such communications would not occur". . . . So long as an Internet intermediary does not itself engage in acts that relate to the content of the communication, *i.e.* whose participation is content neutral, but confines itself to providing "a

loophole but is an important element of the balance [between artists and consumers] struck by the statutory copyright scheme."[67] Thus, ISPs are no more liable than "the owners of the telephone wires, who are utterly ignorant of the nature of the message intended to be sent, (and) cannot be said within the meaning of the covenant to transmit a message of the purport of which they are ignorant."[68]

C. THE AFTERMATH OF *SOCAN* AND *DOE*

Taken together, *Doe* and *SOCAN* make it difficult for collective societies to compensate its member artists for Internet file-sharing activities, since they cannot collect royalties either from end users or from ISPs. The decision in *Doe* reaffirmed that end users are not liable for illegally trading Internet-downloaded music because users already pay a blank media levy. In *SOCAN*, the court reaffirmed that the Parliament made a policy decision to protect ISPs from liability when it enacted § 2.4(1)(b) of the Copyright Act.

The result of this impasse has been a raging debate between the collective societies on the one side and ISPs and users on the other. Collective societies argue that the blank media levy does not sufficiently compensate the copyright holders and that Tariff 22 has essentially been rendered moot. ISPs and end users conversely argue that the Canadian levy and tariff system works well, compensating artists while also protecting privacy and the personal noncommercial copying right codified in the Copyright Act.

III. UNITED STATES COPYRIGHT LIABILITY

The United States' copyright scheme takes a markedly different approach to Internet file sharing than that established by the Canadian Copyright Act and the decisions in *SOCAN* and *DOE*. Instead of using a levy/tariff system of compulsory licensing to compensate artists,[69] the

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> conduit" for information communicated by others, then it will fall within § 2.4(1)(*b*). The appellants support this result on a general theory of "Don't shoot the messenger!".

Id. at *68-*69.

67. *Id.* at *66.

68. *Id.* at *70-*71.

69. U.S. copyright law does deploy a levy system for personal copies made DAT, where levies collected on blank DAT tapes and DAT devices are distributed to music copyright holders and consumers are exempt from lawsuits for personal copying. Audio Home Recording Act of 1992, 17 U.S.C. § 1001 (2000). However, due to limited popularity of the DAT format the system is not widely used.

United States relies primarily on private contractual arrangements between the copyright holders and users.[70]

The United States Copyright Act does not permit noncommercial copying beyond that protected by the fair use doctrine.[71] Consequently, individual users can be held directly liable for copyright infringement when they trade copyrighted music files on the Internet.[72] The *Napster* court specifically found that file sharing over the Internet is not a fair use of copyright music, and hence end users who use P2P to copy files are direct infringers.[73] Indeed, the recording industry has filed a number of direct copyright infringement lawsuits against individual file sharers over the past two years.[74]

The state of secondary liability for file sharing is less clear. The fact that end users commit direct infringement when downloading copyrighted files in the United States exposes ISPs and P2P providers to potential secondary liability for facilitating such infringing acts.[75] With the passage of the Digital Millennium Copyright Act, ISPs received a statutory exemption and/or safe harbor from secondary liability similar to § 2.4(1)(b) of the Canadian Copyright Act.[76] P2P software providers, however, enjoy no such statutory protection and have been held

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70. For instance, user agreements in which the user promises not to use her ISP to infringe copyrights. *See* Niva Elkin-Koren, *Copyrights in Cyberspace—Rights Without Laws?*, 73 CHI.-KENT L. REV. 1155 (1998) (advocating "private ordering" on the Internet where ISPs and users engage in contractual agreements).

71. *See* 17 U.S.C. § 107.

72. *See, e.g.*, Elliot M. Zimmerman, *Entertainment, Arts, and Sport Law: P2P File Sharing: Direct and Indirect Copyright Infringement*, 78 FLA. BAR J. 40, 40-42 (2004) (discussing direct liability in the United States).

73. A & M Records v. Napster, 239 F.3d 1004, 1014-15 (9th Cir. 2004) (holding that Napster users are not fair users).

74. *See* Alice Kao, Note, RIAA v. Verizon*: Applying the Subpoena Provision of the DMCA*, 19 BERKELEY TECH. L.J. 405 (2004) (discussing the use of the DMCA's subpoena provision to obtain the identities of two Verizon Internet subscribers). *But see* Tim Wu, *When Code Isn't Law*, 89 VA. L. REV. 679 (2003) (noting that because of cost and unpopularity copyright owners have declined to sue consumers of infringing copyrighted works). This view that copyright owners would not risk costs and unpopulatiry to assert their rights became obsolete in August, 2003, when the RIAA filed its first lawsuits against music file sharers.

75. While bulletin boards and ISPs can also be held directly liable for copyright infringement taking place on their services, the secondary liability theories prove to be more applicable. *See* Playboy Enters., Inc. v. Frena, 839 F. Supp. 1552 (M.D. Fla. 1993) (granting summary judgment for direct copyright infringement against a bulletin board service which allegedly did not have any prior knowledge that its users uploaded and downloaded files to its server).

76. *See* 17 U.S.C. § 512.

secondarily liable under common law.[77] The federal courts have been inconsistent in the way they have interpreted and applied common law secondary liability rules to file sharing—most notably, the so-called "*Sony* Betamax" rule. In *Sony*, the United States Supreme Court outlined the substantial noninfringing use test, which states that no contributory infringement accrues to the provider of a staple article of commerce when the product is widely used for legitimate noninfringing uses.[78] Applications of *Sony* to P2P providers have yielded incongruent results, causing pervasive legal uncertainty that may be clarified by the Supreme Court's review of the *Grokster* case this year.[79]

In sum, the decisions in *SOCAN* and *Doe* mark a drastic divergence between the United States and Canada pertaining to Internet copyright law. In essence, the two countries have two different default rules: in Canada file sharing is legal, while in the United States it is not. Both approaches are widely criticized, as each is attended by its own drawbacks. Canada's problems are associated with government regulation, while many of the United States' woes stem from legal ambiguity and market failure.

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77. In the United States there are two theories of secondary liability for copyright infringement: contributory and vicarious. The elements of contributory liability are (1) knowledge of and (2) causation, inducement, or material involvement in a second party's infringing conduct. To show vicarious liability one must establish (1) the right and ability to supervise the infringing conduct, and (2) a direct financial interest in (though not necessarily direct awareness of) that conduct. *See* Elizabeth Miles, *In re* Aimster & MGM, Inc. v. Grokster, Ltd.: *Peer-to-Peer and the* Sony *Doctrine*, 19 BERKELEY TECH. L.J. 21 (2004) (summarizing and analyzing United States secondary liability law as it applies in the P2P context).

78. Sony Corp. of Am., Inc. v. Universal City Studios, Inc., 464 U.S. 417, 591 (1984).

79. *See* Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd., 380 F.3d 1154 (9th Cir.) (following precedent in *Napster* and holding that Grokster was not secondarily liable because it deployed a decentralized architecture that precluded the requisite knowledge and control and allowed for numerous noninfringing uses), *cert. granted*, 125 S. Ct. 686 (2004); A&M Records v. Napster, 239 F.3d 1004 (9th Cir. 2004) (holding Napster was secondarily infringing because it had actual knowledge of infringing activity, provided the "site and facilities" for the directly infringing conduct of its users, and benefited financially); *In re* Aimster Copyright Litig., 334 F.3d 643 (7th Cir. 2003) (holding Aimster secondarily liable as it failed to introduce *any* evidence of noninfringing uses, and had constructive knowledge of infringing activities despite specially designed encrypted technology that prevented specific knowledge). *See also generally* Brandon Michael Francavillo, *Pretzel Logic: The Ninth Circuit Approach to Contributory Infringement Mandates That the Supreme Court Revisit* Sony, 53 CATH. U. L. REV. 855, 858 (2004) (arguing that the "ambiguity of *Sony* has caused an approach to contributory infringement in the Ninth Circuit that contradicts the purpose of copyright law and undermines its effectiveness in protecting the rights of copyright holders").

IV. DISCUSSION: CANADIAN APPROACH MAY NOT WORK IN THE UNITED STATES

While their approaches to enforcing copyrights on the Internet significantly differ, both Canada and the United States suffer a similar uncertainty on the part of legislatures and courts about how to achieve the goals of copyright in the Internet context. Some argue that the Canadian levy/tariff system is superior to the American solution, as it has shifted "in the last couple of years . . . [to] a more balanced approach with a balance between creators and users"[80] than that in the United States.[81] However, the Canadian copyright compensation system poses problems unknown in the United States. While the viability of a Canadian-like system in the United States merits deeper consideration than the scope of this Note permits, the following observations encapsulate current critiques to suggest that the time is not ripe to import Canadian concepts into U.S. copyright law.

A. CRITIQUES OF THE CANADIAN COPYRIGHT COMPENSATION SYSTEM

The Canadian approach is criticized as ineffective because it undercompensates copyright holders and is unfairly crude. Furthermore, the pre-digital levy/tariff system has been ineptly adapted to the Internet context. Consequently, a Canadian-style scheme is more likely to compound existing problems with file sharing in the United States than it is to solve them.

First, the Canadian music industry argues that the current levy/tariff system is ineffective. Record companies claim that P2P sharing of music files has cost the industry $450 million since 1999.[82] The economic blow

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80. Robert Thompson, *Music Industry Can't Sue Net Freeloaders: Canadian Judge: 'Heard Around World'*, NAT'L POST, Apr. 1, 2004, at A1, *available at* 2004 WL 74108976.

81. The United States' approach has been criticized in number of respects. *See* Daniel J. Gervais, *The Price of Social Norms: Towards a Liability Regime for File Sharing* (2005), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=525083 (asserting that the U.S. law works against Internet norms); Electronic Frontier Foundation, *A Better Way Forward: Voluntary Collective Licensing of Music File Sharing*, *available at* http://www.eff.org/share/collective_lic_wp.php (pointing out that the United States' approach is ineffective and potentially dangerous to privacy, innovation, and economic growth).

82. Mark Evans, *The Music Industry Conundrum: Copyright Board, CRIA at Odds Over Downloading*, FIN. POST, Dec. 18, 2004, at FP16, *available at* 2003 WL 70272859.

caused by file sharing is compounded by low compulsory license rates.[83] Moreover, the rates for compulsory licenses "easily become outdated and unreflective of supply and demand."[84] This discrepancy between market and actual rates is probably due to the absence of actual bargaining between music producers and music consumers under the statutory scheme.[85] Moreover, the legislative "lock-in" characteristic of rates set by statute ties participants "to an outdated pricing structure."[86]

Second, critics contend that the Canadian levy system is a crude and unjust collection mechanism, as it collects revenues from every buyer of blank media even when the media can be used for purposes other than music downloading. For instance, compact disc manufacturers complain that customers must pay the levy for CDs they use for downloading digital pictures from their own cameras or backing up their computer files—that is, to make copies of their own work that do not infringe another's copyright.[87] Blank media producers correctly see the levy as a form of tax that diminishes the sale of their goods without discriminating between the media's possible uses.[88] Since the music industry periodically demands

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83. *See* Graham Rockingham, *When the Music's Over*, HAMILTON SPECTATOR, Apr. 4, 2003, at A12, *available at* 2003 WL 14603150 (asserting that many Canadian singers are "worried about the survival of the [music] industry" since CD sales have decreased dramatically and levies do not provide sufficient compensation). In addition, record companies have spent one million dollars in an unsuccessful effort to convince Canadians that downloading music for free is equivalent to stealing. *See* Evans, *supra* note 82. *But see* Michael Geist, *Law Bytes*, TORONTO STAR, Nov. 29, 2004, at D02, *available at* 2004 WL 98036495 (suggesting that music industry revenues declined due to non-file sharing reasons—for example, people spend more time playing video games and talking on cell phones).

84. Robert P. Merges, *Compulsory Licensing vs. the Three 'Golden Oldies' Property Rights, Contracts, and Markets*, POL'Y ANALYSIS 9, Jan. 15, 2004, *available at* http://www.cato.org/pubs/pas/pa508.pdf (explaining generally that the lack of increase in compulsory license rates may partially be due to legislative lock-in that replaces market negotiations).

85. *Id.* at 4, 7-9. The United States is no stranger to such problems. When Congress enacted the compulsory statute for player piano rolls, "the statutory royalty rate for covers was well below what many believed the market rate would have been. *Id.* at 4.

86. *Id.* at 4, 9-10 (speculating that legislative lock-in was the probable reason for the price stagnation for recorded compositions between the 1909 Copyright Act and the 1976 Copyright Act).

87. Evans, *supra* note 82.

88. Unless the demand curve for CDs is perfectly inelastic, which is highly unlikely, the CD producers have to share the tax burden with CD buyers. "The incidence [i.e., the tax burden to consumer and producer] of a tax in any market depends upon elasticities of supply and demand in . . . [a given] market. The more inelastic demand is relative to supply, the more the tax will impact upon consumers . . . . The more inelastic supply is

increases in the levy,[89] media manufacturers' dissatisfaction with the system can only increase with time.[90]

Third, observers have suggested that the provision of Canadian copyright law that allows private personal copying in exchange for imposing the levy/tariff[91] should be inapplicable in the Internet context.[92] This portion of the statute was enacted before the Internet era, and aimed only to compensate artists for lost sales of music from copies made for back-up, personal compilations, or use in the car.[93] The law's drafters never foresaw the infinite perfect copies and widespread distribution the Internet would enable.[94] Thus, applying the law in the Internet context is as inappropriate as it is unfair, and belies the drafters' intent. These critics contend that the Canadian legislature must amend the copyright statute in light of file sharing and other methods of digital distribution.[95]

Fourth, the Canadian system is arguably unfair to music consumers, as it often double or even triple taxes for downloading the same song more than once.[96] For example, an individual who makes two copies of the same song, one onto a CD and another one onto her iPod, has to pay a 21-cent

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relative to demand, the more the tax incidence will be upon suppliers . . . ." J. BRUCE LINDEMAN, MICROECONOMICS 140 (1992).

89. There does not appear to be an empirical study compares how the proposed levy increase relates to the rate of inflation in Canada.

90. *See* Evans, *supra* note 82; *see also* Jack Kapica, *CPCC Wins CD Levy Dispute*, BREAKING NEWS FROM GLOBEANDMAIL.COM (2004) (discussing a case in which an importer of blank CDs lost to the CPCC and had to pay immediately and on the highest scale provided in the tariffs).

91. R.S.C., ch. C-42, § 80 (1985) (Can.).

92. *See* Jeremy F. deBeer, *Canadian Copyright Law in Cyberspace: An Examination of the Copyright Act in the Context of Internet*, 63 SASK. L. REV. 503 (2000).

93. *Id.* at 536 ("[T]he [Canadian] Copyright Act is ill suited to address many complex issues [on the Internet] . . . [and] judicial interpretation has not adequately supplemented this legislation. There are very few Canadian cases that deal with the copyright on the Internet and what few exist are not comprehensive enough."); *see also We Deserve Fair Rates*, TORONTO STAR, Dec. 8, 2004, at A25, *available at* 2004 WL 101556047.

94. deBeer, *supra* note 92, at 536.

95. *See* Jane Bailey, *Of Mediums and Metaphors: How a Layered Methodology Might Contribute to Constitutional Analysis of Internet Content Regulation*, 30 MAN. L.J. 197 (2004) (offering an alternative approach to analyzing Internet problems); Craig McTaggart, *A Layered Approach to Internet Legal Analysis*, 48 MCGILL L.J. 571 (2003) (proposing a new approach to copyright law as it applies to the Internet).

96. *See* Tyler Hamilton, *What's Next: A Tax for Singing in the Shower*, TORONTO STAR, Jan. 19, 2004, at C01, *available at* 2004 WL 57233950.

tariff for the recordable CD and a 25-dollar tariff for the iPod.[97] This seems unfair, as § 80 of the Canadian Copyright Act presupposes that the user pays a levy in exchange for a general right to copy for personal private use. Paying more than once could be seen as contrary to the intent of the Act. A U.S. citizen may counter that 21 cents for a CD's worth of songs, even if paid 3 times, seems like a fine bargain compared to the dollar one pays to download a single song from iTunes.com.[98] Still, given the sophistication of current technology and tax collection systems, many Canadians believe that it is unfair to bear such an indiscriminate tax.[99] Furthermore, as the levy increases over time, many predict the emergence of a so-called "gray market" for blank media sold outside of Canada.[100] One cannot help but to see the irony of America's elderly going to Canada to buy cheaper drugs as Canadian youth cross the U.S. border to buy cheaper MP3 players, iPods, and blank CDs.[101]

B. PROPOSALS TO ADOPT A CANADIAN-LIKE SYSTEM IN THE UNITED STATES

Despite the shortcomings of the Canadian copyright compensation system, there have been numerous proposals urging the United States to adopt a compulsory licensing system similar to Canada's.[102] For example, Daniel Gervais suggests that even relying on conservative estimates, the

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97. *Certified Tariffs*, Copyright Bd. of Can., *available at* http://www.cb-cda.gc.ca/tariffs/certified/copying-e.html (last visited Mar. 19, 2005).

98. Similarly, iPods store thousands of songs and can be infinitely rerecorded, so a blank media levy of $25 may not be excessive even when duplicating songs copied onto other levied media. The CPCC recently filed an appeal with the Supreme Court of Canada on a federal court decision that overturned a levy on devices such as MP3 players. *See* Jack Kapica, *Media-Levy Supporters to Appeal Ruling*, GLOBE AND MAIL UPDATE, Jan. 13, 2005, *available at* http://www.globetechnology.com/servlet/story/RTGAM.20050113.gtcopy0113/BNStory.

99. Barbara Caplan & Kevin Evans, *Fight Music Levies, Not Downloaders*, NAT'L POST, Nov. 29, 2004, at FP15, *available at* 2004 WL 99315878.

100. Evans, *supra* note 82.

101. The leakiness inherent to intellectual property regimes compels some to argue that cross-border copyright regimes must be harmonized to avoid such gray markets. *Id.*

102. *See, e.g.*, WILLIAM W. FISHER, PROMISES TO KEEP, 173-259 (2004) (proposing a Canadian-like approach in the United States); LAWRENCE LESSIG, FREE CULTURE (2004); LAWRENCE LESSIG, THE FUTURE OF IDEAS (2001) (calling for a compulsory licensing system that allows media companies "compensation without control"); Neil Weinstock Netanel, *Impose a Noncommercial Use Levy to Allow Free Peer-to-Peer File Sharing*, 17 HARV. J.L. & TECH. 1 (2003) (proposing a levy to be imposed on the sale of any consumer product or service involved in P2P file sharing); Gervais, *supra* note 81; Electronic Frontier Foundation, *supra* note 81. *But see* Merges, *supra* note 84 (arguing generally against a compulsory licensing system).

U.S. music industry can easily replace its twelve billion dollars in annual CD sales through a modest worldwide compulsory license fee that varies based on the country's ability to pay (that is, five dollars a month per user in North America and fifty cents a month in North Africa).[103] Such a system would allow increasing investment into the music industry as investors gain confidence in the Internet distribution platform.[104] Advocates argue that "P2P is here to stay"[105] and "su[ing] millions American music fans into submission is destined to fail."[106] Gervais, however, acknowledges that the exact number of users willing to pay for even for a nominal license is hard to predict.[107]

Another argument in favor of a compulsory licensing system rests on a social norm premise: "If people can be made to act properly because of social norms, rather than because of fear of legal sanction, then the desired behavior can be obtained at less cost."[108] The proponents of this theory argue that since sharing is the norm on the Internet,[109] copyright enforcement would be less costly and more successful if the solution to current file sharing problems in the United States were consistent with such norms.[110] A levy system could leverage existing norms surrounding file sharing without forcing P2P coders to fight back "either by circumventing the legal norm or making its enforcement next to impossible."[111]

On the other side, opponents of such proposals criticize the Canadian levy-based system for distorting the market for music. "Rather than allowing musicians, artists, and other copyright owners to negotiate licensing terms for use of their work, a compulsory license forces

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103. Gervais, *supra* note 81, at 4-9 (assuming that "two thirds of its [Napster's] total potential market" would be willing to participate in the program); *see also* Electronic Frontier Foundation, *supra* note 81 (making similar five dollars a month proposal).

104. Electronic Frontier Foundation, *supra* note 81 (arguing that this will encourage a competitive market for file sharing applications and ancillary services, not merely a few authorized sources such as Apple's iTunes and Napster 2.0 as is currently the case).

105. Gervais, *supra* note 81, at 4.

106. Electronic Frontier Foundation, *supra* note 81, at 4 (suggesting that suing end users may inflict "collateral damage on privacy, innovation and music fans").

107. Gervais, *supra* note 81, at 7. It is also unclear how such a system would be implemented.

108. *Id.* at 9.

109. HOWARD RHEINGOLD, SMART MOBS: THE NEXT SOCIAL REVOLUTION (2002).

110. Gervais, *supra* note 81, at 11.

111. *Id.* at 13.

copyright owners to allow use of their works under legislatively set process and restrictions on use."[112]

Others have argued that a Canadian-like system is simply incompatible with the American way: "It is a brave proposal in a political culture that is allergic to taxes and uncomfortable with complex solutions."[113] Furthermore, in Canada, a country with far lower population density, communication may well be more important than in the United States—and thus, sharing on the Internet may hold a higher social value.[114] Indeed, Canadians may embrace their copyright scheme as a cultural icon that sets their country apart from the United States on many levels.[115] To the extent that Canadian copyright law embodies uniquely Canadian concepts of culture and social relations, it likely makes a poor fit for the United States.

V. CONCLUSION

While the Canadian approach to copyright enforcement on the Internet has its virtues, analysis of the *Doe* and *SOCAN* cases in their larger context suggests that the Canadian system poses unique challenges to both copyright holders and consumers in Canada. Though the United States' approach to enforcing copyright on the Internet is also imperfect and much

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112. Merges, *supra* note 84, at 1-2 (suggesting generally that levies artificially fix the price of a downloadable song). Price fixing is usually economically wasteful as it is almost impossible for the government to fix the price at the market rate, much less to constantly adjust it in response to supply and demand. Consequently, the government is likely to end up with a price floor (price above the market price) or price ceiling (price below the market price). A price floor essentially taxes users for song downloading and discourages some from participating in the market who otherwise would have participated. A price ceiling subsidizes users who otherwise would not participate in the market for song downloading. In either case, the government distorts the market and does not achieve the socially optimal output.

113. Robert S. Boynton, *The Tyranny of Copyright?*, N.Y. TIMES, Jan. 25, 2004, 2004 WL 4788385. Numerous political differences exist between the United States and Canada that can explain the difference in political cultures. For example, the "United States has more elections, selecting more officials for public office, than any other country on Earth. . . . A Canadian votes at most three times . . . in a four-year period, except for an occasional referendum, such as Quebec's 1995 vote for sovereignty." MORRIS P. FIORINA ET AL., AMERICA'S NEW DEMOCRACY 10-11 (2004). These political culture differences may also reflect different copyright norms in the United States and Canada.

114. *See* Jonathan L. Faber, *Culture in the Balance: Why Canada's Copyright Amendments Will Backfire on Canadian Culture by Paralyzing the Private Radio Industry*, 8 IND. INT'L & COMP. L. REV. 431, 431-59 (1998) (suggesting that Canada has struggled to develop a culture distinct from that of the United States and has historically used copyright laws to do so; thus, the Canadian-like compulsory licensing approach may not be as appropriate in the United States).

115. *Id.*

criticized, adopting Canadian copyright concepts and mechanisms in the United States may serve only to compound existing problems. Policy makers would be well served to be cautious in considering such imports from our neighbors to the north.

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