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FOREWORD

Vivian I. Kim† & Stephen M. Ullmer‡

The Annual Review is a yearly publication of the Berkeley Technology Law Journal that provides a summary of many of the major developments at the intersection of law and technology. Our aim is to provide a valuable resource for judges, policymakers, practitioners, students, and scholars. Each Note provides a primer into a particular area of law, a development in that area of law, and commentary on that development.

The twenty-two Notes in this issue continue a tradition of covering a wide range of topics. The Notes address developments in traditional intellectual property areas—patent, copyright, and trademark law—along with developments in cyberlaw and privacy. Following the Notes in each area of law, we have included Additional Developments which are brief descriptions of important developments not addressed in the Notes.

I. PATENT LAW

This year’s Annual Review covers a wide range of developments in the area of patent law. Our first Note discusses the obvious to try test in the context of gene patents after KSR International Co. v. Teleflex Inc.¹ The KSR Court indicated that an invention may be obvious if it is obvious to try. The Note focuses on a post-KSR case, In re Kubin,² that the obvious to try test applies to the unpredictable art of biotechnology, which arguably lowers the obviousness bar for gene patents. The Note concludes that Kubin does not apply an appropriate obviousness standard that accounts for the complexity, unpredictability, and costly nature of biotechnology innovations.

The second Note in the patent law section addresses the use of opinion letters after In re Seagate.³ Even after Seagate, opinion letters lack the credibility and utility that Seagate sought to restore. The Note concludes by suggesting that the value of opinion letters can be restored through widespread adoption of the Northern District of California model jury instructions.

† Senior Annual Review Editor, Berkeley Technology Law Journal; J.D. Candidate, 2010, University of California, Berkeley School of Law.
‡‡ Senior Annual Review Editor, Berkeley Technology Law Journal; J.D. Candidate, 2010, University of California, Berkeley School of Law.

2. 561 F.3d 1351 (Fed. Cir. 2009).
3. 497 F.3d 1360 (Fed. Cir. 2007) (en banc).
The next Note surveys forum shopping and venue transfer issues in patent infringement lawsuits. Although recent developments allow defendants to more easily transfer cases out of unfavorable venues, courts struggle to clearly define their cases. The Note concludes by suggesting that proposed Congressional bills would codify a clear framework for the courts to use when analyzing venue transfer motions.

The fourth Note discusses the effects of patent licensing on efforts to combat the spread of HIV and AIDS. The Note focuses on the intersection of scientific progress in the mid-1990s that vastly improved the treatment of HIV and AIDS and the emergence of patent protection in India during that same period time. Because patent protection delays the availability of affordable generic drugs in the developing world, the areas that need effective treatment options only receive highly toxic and largely ineffective treatments. The Note concludes that public aid organizations should procure safer and more effective drugs, even if fewer people have access to the treatments.

The next Note focuses on follow-on biologics and the extension of the Hatch-Waxman Act to such innovations. Modern science cannot reliably determine whether a follow-on biologic is bioequivalent to an innovator biologic, which creates potentially higher developments costs and suggests that changes must be made to the Hatch-Waxman framework for follow-on biologics. The Note concludes that the FDA faces a difficult challenge in setting the bar for clinical trials, and questions whether Congress should delegate the FDA the power to effectively create or stifle the entire follow-on biologics industry.

The final patent Note discusses patent intermediaries and their emerging importance in business strategy. Although patents are intangible, many companies now value their patent portfolios highly and patent assets have emerged as part of a valuable marketplace. The Note discusses the emerging categories of patent intermediaries and their long-term significance, concluding that creative and innovative intermediaries will likely profit from relatively untapped patent marketplace.

II. COPYRIGHT LAW

Technological advances, such as the smartphone, are constantly pushing the boundaries of copyright law. Our first Note in the copyright section of the Annual Review discusses the practice of jailbreaking these phones from lock-ins which are implemented through technical protection measures (TPMs). The Note applies the limited case law on section 1201 of the Digital
Millennium Copyright Act (DMCA) to the Apple iPhone App Store. The Note argues for the adoption of a functionalist approach to anti-circumvention instead of a formalistic approach which does not further the goal of the DMCA, the protection of works in the digital age, because it turns on arbitrary idiosyncrasies of software design and circumvention method. The Note proposes a two-step functionalist analysis to analyze liability under section 1201 in cases involving aftermarket goods or services in order to be consistent with the drafter’s intent.

The second Note in the copyright section explores emerging media technologies in relation to entitlement theories and intellectual property rights. The Note evaluates the structure and history of the digital performance right in the context of non-interactive webcasting and tests it against two articles by entitlement theorists. The Note concludes that reducing the number of bargaining parties through collective rights organizations can produce some degree of exchange and thus they should be supported in both liability rule and property rule entitlement schemes.

The third Note in the Annual Review examines the World Trade Organization’s decision regarding Chinese market access for U.S. content industries. The decision was issued as a resolution to a formal challenge by the United States in April of 2007 of China’s official policies, practices, and enforcement measures related to protection of Intellectual Property Rights. The Note argues that although the United States won a significant victory in the Panel’s decision, the victory is not without controversy. The Note concludes that the decision supports the idea that China is moving towards a polity with greater respect for cultural goods and the Intellectual Property Rights embedded therein.

Following ten years of rapid growth, online copyright infringement still represents a significant challenge to modern copyright owners. The fourth Note examines the two litigation campaigns of the Recording Industry Association of America (RIAA), focusing on the two cases that reached the jury: Capitol Records, Inc. v. Thomas-Rasset and Sony BMG Music Entertainment v. Tenenbaum. The Note concludes that an alternate dispute resolution process based on Professors Mark A. Lemley and R. Anthony Reese’s proposal would give copyright holders and Internet users a more effective and efficient means of conflict resolution.

The fifth Note also discusses the problem of copyright infringement, brought about by the rise of user generated content. The Note analyzes the conflicting approaches to the section 512(c) safe harbor of the DMCA, which requires that the service provider not directly benefit from infringing activity that it has the right and ability to control.\(^8\) Although the defendant won summary judgment under the safe harbor in both \textit{Io Group, Inc. v. Veoh Networks, Inc.}\(^9\) and \textit{UMG Recordings, Inc. v. Veoh Networks, Inc.},\(^10\) the courts in both cases expressed incompatible understandings of section 512(c). The Note concludes that the \textit{UMG} court’s understanding, that a service provider’s “right and ability” to control is connected to its level of involvement with the infringing activity, was superior because of its consistency with Congressional intent.

Our last copyright Note explores the problems technological advances can have on traditional content providers such as newspapers. It discusses the tort of “hot news” misappropriation, in the context of the Associated Press suit against online news-aggregator All Headline News,\(^11\) and its effects on online journalism. The Note concludes that the \textit{All Headline News} case serves as an indication of the evolving customary practices between newspapers and aggregators that, in combination with other newspaper-saving methods, will help create a sustainable equilibrium of newsgathering and dissemination.

\section*{III. TRADEMARK LAW}

The first Note in the trademark section discusses the likelihood of confusion as it pertains to keyword advertising. The Note suggests that the likelihood of confusion in \textit{Rescuecom v. Google Inc.} should turn on consumer sophistication. The Note concludes by suggesting that out of court settlements often prevent courts from deciding likelihood of confusion cases on their merits, and that clear standards for trademark infringement in keyword advertising are largely unavailable.

The second Note discusses the use of architectural works in video games. Because the current law in this area is not well settled, the video game industry has shied away from the use of trademarks in their games. The Note concludes that such shyness detracts from the realism in video games and unnecessarily diminishes a player’s experience, and the Note suggests that courts should establish strong precedents that support a game developers

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\(^9\) 586 F. Supp. 2d 1132 (N.D. Cal. 2008).
right to use trademarked and copyrighted architecture for the purpose of creating virtual worlds.

The final trademark Note focuses on domain name speculation. Although legal tools have emerged to fight the domain name speculation problem, the business model has persisted and continues to thrive in many respects. The Note concludes by suggesting that trademark law should not be the preferred method for combating domain name speculation. Instead, the Note advocates policy changes, technological solutions, and social engineering to combat the problem.

IV. CYBERLAW

The first Note in the cyberlaw section of the Annual Review is a survey of recent state legislative efforts to promote internet safety, exploring the legal ramifications of their implementation. The Note discusses regulations addressing sex offenders and cyberbullying online, and evaluates proposed solutions to online safety issues and finds them problematic because of constitutional concerns. The Note concludes that comprehensive education is the best available solution to the problems of social networking safety and cyberbullying.

The next cyberlaw Note explores recent developments in the law regarding internet gambling. The Note argues that federal and state laws from both before and after the conception of the Internet have created an un navigable patchwork of regulation. The Note argues that the lack of effective regulation not only hurts American bettors who have little recourse against unfair internet gambling, but also results in federal tax losses of up to $62.7 billion over the next decade. The Note concludes that as the political mood becomes more amenable to internet gambling, nationwide legalization could be a possibility.

The third cyberlaw Note addresses the growing problem of sexting among teens, the digital exchange of sexually explicit images using text messaging services on camera-equipped cell phones. The Note attempts to strike a balance between competing policy objectives, such as teenage privacy and the state’s interest in preventing child sexual abuse and child pornography, while respecting the extent to which the digital revolution changed how teenagers communicate and interact in social spaces. It suggests several legislative components that could help authorities discipline the harms of sexting without resorting to ill-suited child pornography statutes. The Note concludes by offering a framework for developing a more balanced response appropriate to the injuries at stake and the underlying policy issues implicated by the behavior.
The last cyberlaw Note continues the Annual Review’s discussion of section 230 of the Communication Decency Act (CDA), a statute designed to shield online service providers from liability for content posted by users. The Note addresses the issue in the context of the recent crimes involving Craigslist, a popular website that enables users to post classified ads and interact in forums. The Note concludes that section 230 should no longer be considered a source of blanket immunity for interactive service providers.

V. PRIVACY LAW

The first privacy law Note addresses the emerging issue of cloud computing and stored communications and focuses on privacy issues raised by *Quon v. Arch Wireless Operating Co.* The Note analyzes the interplay between the Fourth Amendment and the privacy issues involved in cloud computing technologies, and suggests that the Supreme Court will likely recognize a reasonable expectation of privacy communications such as text messages and emails. The Note concludes by advocating that the Court bring the Fourth Amendment into the twenty-first century and protect information that will inevitably involve cloud computing technologies.

The second Note focuses on *IMS Health v. Ayotte*, which implicates significant privacy concerns associated with pharmaceutical advertising. The Note discusses commercial speech jurisprudence and recent cases that discuss commercial speech in New Hampshire, Maine, and Vermont. The Note concludes by predicting that the first circuit’s unique approach to commercial speech in *IMS Health* will not be adopted elsewhere.

The final Note discusses deceptive business practices and the requirements that companies must follow in order to avoid liability. The Note describes the Federal Trade Commission’s authority to address privacy violations and explains the relevant legal test for establishing liability. The Note concludes by recommending appropriate privacy disclosure measures that should enable companies to avoid engaging in deceptive business practices, in particular those deceptive practices involving information tracking.

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13. 529 F.3d 892 (9th Cir. 2008).
14. 550 F.3d 42 (1st Cir. 2008).
A NAIL IN THE COFFIN FOR GENE PATENTS

Joanne Kwan

In 2007, the Supreme Court in KSR International Co. v. Teleflex Inc. substantively addressed the obviousness standard for the first time since Graham v. John Deere Co., which was decided over forty years ago. In a unanimous opinion, the Court rejected the Federal Circuit’s rigid employment of the teaching, suggestion, or motivation (“TSM”) test, which had narrowed the scope of the obviousness inquiry. Instead, the Court favored a flexible approach to the obviousness question and held that the obviousness inquiry should encompass a broader scope of prior art with allowances for common sense and creative inferences. Furthermore, the Court appeared to ease the obviousness standard by stating that an invention might be obvious if it would have been “obvious to try” to a person of ordinary skill in the art.

Federal Circuit precedent in the 1990s foreclosed use of the obvious to try test to invalidate gene sequence claims. In In re Deuel, the Federal Circuit explicitly rejected obvious to try as the obviousness standard for gene patents. The court held that the existence of general methods for isolating genes was “essentially irrelevant” for determining their obviousness in the absence of prior art suggesting the actual sequences.

In In re Kubin, the Federal Circuit revisited the obvious to try test as applied to gene sequences under the post-KSR obviousness standard. The court relied on KSR and one of its own decisions—In re O’Farrell, which predated KSR—to reject as obvious claims directed to the isolation and sequencing of a human gene encoding the protein Natural Killer Cell Activation Inducing Ligand (NAIL). The court found that a prior art

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4. Id. at 418, 421.
5. Id. at 421.
6. In re Deuel, 51 F.3d 1552, 1559 (Fed. Cir. 1995) (“Obvious to try’ has long been held not to constitute obviousness.”); see In re Bell, 991 F.2d 781, 785 (Fed. Cir. 1993) (holding that focusing on the methods of making the claimed sequences is misplaced).
7. 51 F.3d at 1559.
8. Id.
9. 561 F.3d 1351, 1352 (Fed. Cir. 2009).
10. Id. at 1361.
reference disclosing the existence of the NAIL protein, a prophetic method for isolating the gene encoding NAIL, and a probe for performing that isolation, along with a manual disclosing general methods for isolating a gene, rendered the cloning of the gene “reasonably expected in light of the prior art and ‘obvious to try.’” The court further interpreted KSR as overruling Deuel and held that the obvious to try test can apply to the “unpredictable art” of biotechnology.

Part I of this Note introduces the law of obviousness, focusing on the development of the obvious to try test and key Federal Circuit decisions rejecting that approach for gene patents. It also includes a biotechnology primer describing the relationship between gene and protein sequences, and scientific methods for gene cloning. Part II describes the Kubin decision. Part III discusses Kubin’s probable implications and concludes that the decision represents a major change in the law that will lower the bar for finding biotechnology patents obvious.

I. BACKGROUND ON THE LAW OF OBVIOUSNESS

A. OBVIOUSNESS AND THE GRAHAM FRAMEWORK

The U.S. patent system aims to promote the progress of science and technology. A patentable invention must be new, useful, and nonobvious. The nonobviousness requirement codified in § 103 bars the grant of a patent if “the differences between the [invention] 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.”

In Graham, the Supreme Court articulated a framework to evaluate obviousness. That framework considers several factual inquiries, including the scope and content of the prior art, the differences between the prior art and the claims at issue, and the level of ordinary skill in the pertinent art. In this analysis, courts may also evaluate secondary considerations, e.g., commercial success, long felt but unsolved needs, and the failure of others to solve the problem.

11. Id.
12. Id. at 1358, 1360.
17. Id.
18. Id.
To fulfill the nonobviousness requirement, an invention must evidence more ingenuity and skill than that “possessed by an ordinary mechanic acquainted with the business.”19 *Graham* dealt with an invention that combined known mechanical elements in a different arrangement to create an improved device for absorbing shock from plow shanks.20 The Court held that the invention was unpatentable because the differences between the claims and the prior art would have been obvious to a person reasonably skilled in the art at the time of the invention.21

The invention, however, need not evince a “flash of creative genius,” a standard promulgated by the Supreme Court in *Cuno Engineering Corp. v. Automatic Devices Corp.*22 The Court found that Congress had abolished the *Cuno* standard by adding “[p]atentability shall not be negatived by the manner in which the invention was made” to § 103.23

The Court also recognized the importance of the nonobviousness requirement in ensuring that the patent system awards patents for “innovation, advancement, and things which add to the sum of useful knowledge.”24 In contrast, an invention that merely adds trivial or incremental modifications to the prior art essentially exists in the public domain and fails to satisfy the nonobviousness requirement.

**B. KSR AFFIRMS THE GRAHAM FRAMEWORK FOR EVALUATING OBVIOUSNESS**

In the years following *Graham*, the Court of Customs and Patent Appeals (CCPA) and the Federal Circuit25 developed and employed the TSM test to evaluate the obviousness of an invention.26 Obviousness requires the factfinder to step back in time to evaluate the state of the art at the time of invention. Hindsight bias complicates these judgments. Awareness of the invention can distort the challenges facing inventors at the time of discovery, and a revolutionary invention may seem obvious with the passage of time. The TSM test carefully guarded against hindsight bias by requiring that the prior art, the nature of the problem, or the knowledge of a person of

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19. *Id.* at 11 (citing Hotchkiss v. Greenwood, 52 U.S. 248, 267 (1850)).
20. *Id.* at 19–20.
22. *Id.* at 15 (citing Cuno Eng’g Corp. v. Automatic Devices Corp., 314 U.S. 84 (1941)).
25. In 1982, the CCPA and the US Court of Claims were combined to form the Federal Circuit.
ordinary skill in the art provide some motivation or suggestion to combine prior art teachings.27

In *KSR*, the Supreme Court criticized rigid application of the TSM test.28 The case concerned a mechanical combination of an adjustable automobile gas pedal and an electronic sensor.29 Although the prior art disclosed both elements,30 the Federal Circuit refused to invalidate the patent because the prior art did not provide explicit motivation for a person of skill in the art to combine those elements.31 The Supreme Court reversed and found that rigid reliance on the TSM test deviated from the flexible *Graham* framework.32 The Court explained that the prior art encompassed more than references to the problem the patentee was trying to solve or elements designed to solve it.33 Under the correct analysis, the prior art can consider “any need or problem known in the field or endeavor”34 and include elements that a person of ordinary skill or creativity could fit together like “pieces of a puzzle.”35 Although the Court acknowledged that the use of hindsight remained a risk, the rigid TSM test overestimated its threat and denied “factfinders recourse to common sense.”36

The Court further expanded the types of evidence that a court may consider by revitalizing the obvious to try test—previously rejected by the Federal Circuit.37 According to the Court, the Federal Circuit incorrectly concluded that “a patent claim cannot be proved obvious merely by showing that the combination of elements was ‘obvious to try.’”38 The Court elaborated that what is obvious to try might be obvious when “there is a design need or market pressure to solve a problem,” “a finite number of identified, predictable solutions” exists, and pursuit of known options leads to “anticipated success.”39

*KSR* generated uncertainty concerning the way in which lower courts would interpret and apply the expanded obviousness standard. In particular,

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27. *See id.* at 407 (quoting Al-Site Corp. v. VSI Int'l, Inc., 174 F.3d 1308, 1323–24 (Fed. Cir. 1999)).
28. *Id.* at 415.
29. *Id.* at 410.
30. *Id.* at 407–09.
31. *Id.* at 414.
32. *See id.* at 415.
33. *Id.* at 420.
34. *Id.*
35. *Id.* at 420–21.
36. *Id.* at 421.
37. *Id.*
38. *Id.*
39. *Id.*
revitalizing the obvious to try test could dictate the viability of biotechnology patents going forward.

C. THE OBVIOUS TO TRY TEST

The concept of obvious to try originated in CCPA decisions preceding codification of the nonobviousness requirement in the 1952 Patent Act.40 For example, in *In re Leum*, the CCPA employed the test to invalidate methods of producing toluene under superatmospheric pressure in closed chambers.41 The prior art disclosed similar starting materials and overlapping temperature ranges but not closed systems.42 The CCPA rejected the claims as obvious because “[w]hether or not the [prior art] systems were open or closed, it surely would [have been] obvious to try either in a reaction of the character defined by the patent.”43 The court further explained that “[i]f such is within the skill of the art, there can be no invention even though the results obtained by the claimed process are better than those shown by such art.”44

In *In re Ruscetta*, the CCPA similarly held a method for electrolytically etching metals and alloys unpatentable in light of prior art disclosing the same method for etching the metal tantalum and a related method disclosing the claimed metals.45 The court reasoned that because the claimed method was designed to etch a metal such as tantalum, “one would not be surprised if it etched the others.”46 The court concluded that “[c]ertainly it would [have been] obvious to try it.”47 Although the prior art may not have specifically pointed to the claimed invention, the obvious to try test developed in *Leum* and *Ruscetta* enabled courts to draw inferences from the prior art to invalidate patent claims.

Following the enactment of § 103 in the 1952 Patent Act, courts began to criticize the obvious to try test.48 In *In re Huellmantel*, the CCPA addressed the obviousness of anti-inflammatory compositions that combined salicylate with either prednisone or prednisolone.49 The solicitor asserted that because prednisone, prednisolone, or the combination of salicylate and cortisone was

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41. *Leum*, 158 F.2d at 311–12.
42. *Id.*
43. *Id.* at 312.
44. *Id.* (citing *In re Kepler*, 132 F.2d 130 (C.C.P.A. 1942)).
45. 255 F.2d at 692.
46. *Id.*
47. *Id.*
49. *Huellmantel*, 324 F.2d at 1000.
known to treat inflammation, it was “obvious to at least try” to substitute prednisone or prednisolone for cortisone. The court affirmed the rejection of the claims based on a different rationale, finding instead that the prior art suggested positive results from such combinations. But the CCPA criticized the obvious to try test “insofar as it negates consideration of properties in determining obviousness under section 103, [it] flies in the face of the plain language of the statute.” The court continued: “Nothing is said about ‘obvious to try.’”

In In re Tomlinson, the CCPA echoed its skepticism in Huellmantel, further discrediting the obvious to try test. Responding to an obvious to try argument, the CCPA held that obviousness under § 103 should be directed to compositions and methods, “not of the direction to be taken in making efforts or attempts.” Furthermore, the CCPA noted that “there is usually an element of ‘obviousness to try’ in any research endeavor” and the obvious to try test “would not only be contrary to statute but result in a marked deterioration of the entire patent system as an incentive to invest in those efforts and attempts which go by the name of ‘research.’”

The Federal Circuit confronted the obvious to try test in In re O’Farrell. The case concerned the validity of a biotechnology invention directed to producing a particular cloned gene in bacteria. The prior art disclosed a method for producing a different gene in bacteria. The court affirmed the obviousness rejection of the Board of Patent Appeals and Interferences (Board) because the claimed invention was obvious to try and the prior art suggested a “reasonable expectation of success.” The court explained that “[the prior art] contained detailed enabling methodology for practicing the claimed invention, a suggestion to modify the prior art to practice the claimed invention, and evidence suggesting that it would be successful.”

But the Federal Circuit, like the CCPA in Huellmantel and Tomlinson, recognized the danger of the obvious to try test and advocated a narrow,
limited, and cautious use of the approach. The O’Farrell opinion emphasized that some inventions may be obvious to try, yet legally nonobvious, by describing two situations where courts misapplied the obvious to try test. First, the court prohibited the use of the obvious to try test where success depends on trying many parameters or choices and the prior art does not indicate a preference for a particular parameter or choice. Second, the obvious to try test is inappropriate where the prior art provides only general guidance for a particular approach or technology. Furthermore, even if an invention is obvious to try, obviousness requires that the prior art provide a “reasonable expectation of success.” Obviousness, however, “does not require absolute predictability of success.”

1. A Biotechnology Primer

In the 1990s, the Federal Circuit, in two key decisions of In re Bell and Deuel, effectively shielded claims to the isolation and sequencing of genes from the obvious to try test. Before turning to those cases, this section provides a basic primer on gene cloning and biotechnology.

Proteins carry out essential cellular functions necessary for life, and protein deficiencies or aberrant activities cause many disorders. For example, proteins catalyze chemical reactions, transduce signals to coordinate biological processes, and provide components required for cellular architecture and movement. Therapeutic proteins are a particular class of biopharmaceuticals. They can function as replacement therapies to treat protein deficiencies or as compositions designed to target a molecule or cell population that mediates a disease. Examples of such therapeutics include Epogen®, which treats erythropoietin deficiency in anemia; Enbrel®, which blocks the inflammatory molecule Tumor Necrosis Factor (TNF) in

62. See id. at 903.
63. Id.
64. Id.
65. Id.
66. Id. at 904.
67. Id. at 903.
68. 991 F.2d 781, 781 (Fed. Cir. 1993) (holding that focusing on the methods of making the claimed sequences is misplaced).
69. 51 F.3d 1552, 1559 (Fed. Cir. 1995) (“‘Obvious to try’ has long been held to not constitute obviousness.”).
rheumatoid arthritis, and Herceptin®, which targets cancer cells expressing the receptor Human Epidermal growth factor Receptor 2 (HER2).

Understanding the relationship between protein and deoxyribonucleic acid (DNA) enables researchers to make, use, and manipulate proteins—ultimately facilitating the development of therapies. Although the genetic code dictates what protein will arise from a given sequence of DNA, knowledge of the polypeptide sequence of a protein does not conversely allow one to predict its corresponding DNA sequence. Rather, gene cloning experiments are necessary to determine the polynucleotide sequence of the gene that encodes a particular protein of interest. Scientists have developed general laboratory methods that provide guidelines for a researcher to clone genes of interest. Rarely, however, can a researcher fully adhere to such predefined methods. Biological systems are by their nature unpredictable. Conditions and procedures that were successful for cloning one gene may fail for another. Post-Kubin, a critical issue in evaluating obviousness is whether variations to established methods involve mere routine changes or require an inventive step.

Hereditary information is encoded in DNA as genes, and genes are transcribed from DNA to ribonucleic acid (RNA) and ultimately translated into a protein. DNA is a polymer of units called nucleotides, each of which includes one of four bases: adenine (A), thymine (T), cytosine (C), and guanine (G). Like DNA, RNA is a polymer of nucleotides but utilizes the base uracil (U) instead of thymine (T). The order of the bases arranged along the sugar-phosphate backbone of DNA corresponds to the polynucleotide sequence. This polynucleotide sequence directs the sequence of amino acids within a protein (its polypeptide sequence) through a two-step process. First, an RNA intermediate molecule known as messenger RNA

72. See, e.g., George Spencer-Green, Etanercept (Enbrel): Update on Therapeutic Use, 59 ANNALS RHEUMATIC DISEASE 46, 46 (2000).
73. See, e.g., Hiroji Iwata, Perspective of Trastuzumab Treatment, 14 BREAST CANCER 150, 150 (2007).
74. See, e.g., O'Farrell, 853 F.2d at 897; ALBERTS, supra note 70, at 106.
75. See infra notes 83–88 and accompanying text.
76. If a complete genomic database is available, a person of skill in the art can identify all the polynucleotide sequences within the database that can specify a particular polypeptide sequence. The complete human genome has now been sequenced. Francis S. Collins et al., A Vision for the Future of Genomics Research, 422 NATURE 835, 835–36 (2003).
77. Francis Crick, Central Dogma of Molecular Biology, 227 NATURE 561 (1970).
78. See, e.g., O'Farrell, 853 F.2d at 896; ALBERTS, supra note 70, at 4–5, 60.
79. See, e.g., O'Farrell, 853 F.2d at 897; ALBERTS, supra note 70, at 60.
80. See, e.g., O'Farrell, 853 F.2d at 896; ALBERTS, supra note 70, at 104.
(mRNA) is transcribed from the DNA template. The mRNA then acts as a template for the assembly of amino acids during protein synthesis—a process called translation.

A group of three bases, known as a codon, specifies the amino acid to be assembled into a protein during translation. Sixty-four codons or $4^3$ combinations are possible given that there are four bases and three positions within each codon, and these sixty-four codons code for the twenty natural amino acids and three stop signals. The genetic code describes the relationship between codons and amino acids. Because more than one codon can code for most amino acids, the genetic code is considered degenerate or redundant, though the genetic code has no ambiguity because each codon codes for only one amino acid. For example, in mammals, six codons, UUA, UUG, CUU, CUC, CUA, and CUG, code for the amino acid leucine (Leu) and no other amino acid.

Given a polynucleotide sequence of a gene with defined start and stop positions, one can precisely predict its corresponding polypeptide sequence by reading the codons, which map to specific amino acids. The degeneracy of the genetic code renders the reverse situation, determination of the precise polynucleotide sequence of a gene from its polypeptide sequence, impossible. For example, consider the following polynucleotide sequence, UUA UUG CUU CUC CUA CUG UUA. With knowledge from the genetic code that those codons encode Leu, it is straightforward to translate its polypeptide sequence as Leu-Leu-Leu-Leu-Leu-Leu-Leu. In contrast, consider the short polypeptide sequence: Leu-Leu-Leu-Leu-Leu-Leu-Leu. Because six codons can encode for Leu and there are seven Leu in the polypeptide, $6^7$ or 279,936 combinations of codons can encode this polypeptide sequence. Given that proteins are large molecules, the number of possible polynucleotide sequences that can encode a given polypeptide sequence can be astronomical. For example over $10^{36}$ possible polynucleotide sequences could encode insulin-like growth factor, the relatively small protein of 79 amino acids at issue in Bell. Thus, given only a polypeptide sequence of a protein, a

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81. See, e.g., O’Farrell, 853 F.2d at 897–98; Alberts, supra note 70, at 104–05.
82. See, e.g., Alberts, supra note 70, at 106–08.
83. See, e.g., O’Farrell, 853 F.2d at 897; Alberts, supra note 70, at 106.
84. See, e.g., O’Farrell, 853 F.2d at 897; Alberts, supra note 70, at 106.
85. See, e.g., O’Farrell, 853 F.2d at 897; Alberts, supra note 70, at 106.
86. See, e.g., In re Deuel, 51 F.3d 1552, 1554 (Fed. Cir. 1995); Alberts, supra note 70, at 106.
87. See, e.g., Alberts, supra note 70, at 106.
88. In re Bell, 991 F.2d 781, 784 (Fed. Cir. 1993).
scientist must successfully clone a gene in order to identify the corresponding gene sequence that encodes the protein.

Gene cloning commonly depends on screening of a complementary DNA (cDNA) library to identify the target cDNA that encodes the polypeptide in question. A cDNA library contains a mixture of cDNAs generated from mRNAs isolated from a given tissue and thus represents the expressed genes within that tissue. No library completely covers an entire genome or even all of the expressed genes within the starting tissue because genes are not ubiquitously expressed in all tissues or at all times, and conditions for creating a library vary in their ability to amplify particular targets. The choice of tissue, culturing conditions, and amplification conditions represent a few of the many parameters that will alter the content of the library. A researcher knowing the biology of the target of interest, such as its expression profile, can make educated guesses to optimize some parameters and maximize the chances for coverage of the target gene. However, the unpredictability of physiological conditions suggests that even slight variations to the general protocols for library generation may significantly affect coverage. It is not possible to determine which parameters or combination of parameters will guarantee a library that contains the target gene. Notably, cloning will fail if the library does not contain the target.

Scientists employ various methods to isolate genes from libraries. For example, one method depends on screening of a library with a gene probe. A gene probe is a DNA fragment whose sequence is designed to hybridize to a target gene sequence. Given the polypeptide sequence of a protein, a scientist can design a probe with a higher probability of binding to the desired target. Another general approach involves expression cloning and screening, in which each cDNA of a library is expressed clonally, with each clone expressing one protein. Screening leads to isolation of the clone exhibiting the property of interest. The property of interest can include a specific property possessed by the target protein, such as the ability to bind

89. See, e.g., Denel, 51 F.3d at 1554.
90. cDNAs are synthesized from mRNA in a process called reverse transcription and contain the coding sequences of a gene. See, e.g., ALBERTS, supra note 70, at 310.
91. See, e.g., J.G. Siedman, Construction of Recombinant DNA Libraries, in 68 CURRENT PROTOCOLS IN MOLECULAR BIOLOGY 5.0.1, 5.0.1–5.0.3 (Frederick M. Ausubel et al. eds., 2003).
92. See, e.g., J.G. Siedman, Screening of Recombinant DNA Libraries, in 69 CURRENT PROTOCOLS IN MOLECULAR BIOLOGY 6.0.3, 6.0.3–6.0.5 (Frederick M. Ausubel et al. eds., 1994).
93. See, e.g., id.; ALBERTS, supra note 70, at 312.
94. See, e.g., Siedman, supra note 92.
an antibody probe, which is a type of protein that binds with great affinity to one specific molecule, or to activate a transcriptional response.

Knowing the polypeptide sequence of a protein, a scientist can develop methods to clone its corresponding gene. Although general screening methodology exists for gene cloning, scientists often use methods that diverge from the general protocol because each research endeavor can raise unique considerations. Each step may involve a separate experiment to optimize parameters and lead to failed attempts. Research, by its very nature, is empirical, yet may contain an element of the routine, because new discoveries often depend on prior discoveries.

2. **The Federal Circuit Rejects the Obvious to Try Test**

The Federal Circuit decisions in *Bell*[^95] and *Deuel*[^96] prohibited consideration of whether general methodologies to isolate genes made the claimed sequences obvious to try and therefore obvious. Instead, the Federal Circuit required that the prior art teach or suggest structurally similar polynucleotide sequences to support a finding of obviousness.[^97] In *Bell*, the Federal Circuit reversed the Patent Office’s rejection of gene sequences as obvious because the prior art failed to teach or suggest the claimed sequences.[^98] The case concerned the obviousness of polynucleotides encoding human insulin-like growth factors I and II (IGF-I and IGF-II) in light of prior art disclosing the putative polypeptide sequences of IGF-I and IGF-II, and a general method for isolating a gene.[^99] The court held that knowledge of the polypeptide sequences coupled with a general method for isolating a gene did not render the corresponding gene sequences obvious.[^100] Although the court acknowledged that one could hypothesize the gene sequence based on knowledge of the protein sequence, the degeneracy of the genetic code meant that “a vast number of nucleotide sequences . . . might code for a specific protein.”[^101] Thus, “given the nearly infinite number of possibilities . . . the claimed sequences would not have been obvious.”[^102]

In *Deuel*, the Federal Circuit found claims to polynucleotide sequences encoding heparin binding growth factors (HBGFs) patentable because the

[^95]: In re Bell, 991 F.2d 781, 784–85 (Fed. Cir. 1993).
[^96]: In re Deuel, 51 F.3d 1552, 1559 (Fed. Cir. 1995).
[^97]: *Id.*
[^98]: *Bell*, 991 F.2d at 784–85.
[^99]: *Id.* at 782–83.
[^100]: *Id.* at 784–85.
[^101]: *Id.* at 784.
[^102]: *Id.*
prior art did not disclose the claimed sequences.\textsuperscript{103} The court reasoned that because polynucleotides were chemical entities, a prima facie case of obviousness required that the teachings of the prior art suggest the claimed compounds to a person of ordinary skill in the art.\textsuperscript{104} Although the prior art described a general method for isolating a gene and partial polypeptide sequences for heparin-binding brain mitogens that were identical to a portion of the applicant’s polypeptide sequences,\textsuperscript{105} the prior art failed to suggest the claimed polynucleotide sequences.\textsuperscript{106} Thus, the court found that the claims were not obvious.\textsuperscript{107}

The court also addressed the obvious to try argument and stated that “the existence of a general method of isolating cDNA or DNA molecules is essentially irrelevant to the question whether the specific molecules themselves would have been obvious.”\textsuperscript{108} Focusing on the direction of research under the obvious to try test was flawed because a “general motivation to search for some gene” did not necessarily make obvious a gene that was subsequently obtained as a result of that search.\textsuperscript{109} Furthermore, basing a rejection on what “one might have been motivated to try to do . . . amounts to speculation and an impermissible hindsight.”\textsuperscript{110} Finally, the court explicitly rejected the obvious to try test as it “has long been held not to constitute obviousness.”\textsuperscript{111}

These decisions recognized the complexity and unpredictable nature of biotechnology inventions, including those involving gene sequences, and insulated such inventions from obviousness attacks based on obvious to try. But \textit{KSR} and \textit{Kubin} have changed the patent landscape for these inventions.

II. \textit{IN RE KUBIN}

A. BACKGROUND

\textit{Kubin} concerned a patent application claiming the polynucleotide sequence of a gene encoding NAIL, a protein expressed on a class of lymphocytes important in tumor and viral immunity called Natural Killer

\begin{thebibliography}{11}
\bibitem{103} In re Deuel, 51 F.3d 1552, 1558–59 (Fed. Cir. 1995).
\bibitem{104} \textit{Id.} at 1558.
\bibitem{105} \textit{Id.} at 1556.
\bibitem{106} \textit{Id.} at 1558.
\bibitem{107} \textit{Id.} at 1560.
\bibitem{108} \textit{Id.} at 1559.
\bibitem{109} \textit{Id.} at 1558.
\bibitem{110} \textit{Id.}
\bibitem{111} \textit{Id.} at 1559.
\end{thebibliography}
(NK) cells. NAIL modulates NK cell function in part through its binding interactions with a protein called CD48. Methods of using NAIL or its gene sequence could provide therapeutic value by altering NK cell function and immune responses. The Examiner rejected the claims as obvious in light of three references: a patent disclosing a human NAIL-specific antibody and a prophetic method of screening a NK cell library with the antibody (“Valiante reference”); a general cloning manual (“Sambrook reference”); and a scientific article disclosing murine NAIL, a murine NAIL-specific antibody, and a method for cloning the gene encoding the murine NAIL (“Mathew reference”).

B. THE BOARD’S DECISION

The Board sustained the Examiner’s rejection of the claims for obviousness because a person of ordinary skill in the art had a reasonable expectation of success in cloning the NAIL polynucleotide with conventional methods. First, the Board found as a factual matter that the applicants used the same methodologies as those of the Valiante and Sambrook references to isolate the gene that encodes NAIL. Second, the Board found that the state of the art had “advanced significantly” during the period between the filing dates of the Deuel and Kubin applications. Third, the Board noted that KSR cast doubt on the viability of Deuel’s rejection of the obvious to try test. Fourth, the Valiante reference provided a “reasonable expectation of success” in obtaining the claimed polynucleotide sequence. Thus, contrary to the precedents set forth in Bell and Deuel, which held that conventional methodologies are irrelevant in an obviousness determination, the Board found that the use of conventional methodologies to isolate the NAIL polynucleotide rendered the invention obvious.

A reference that teaches away from a claimed invention may help establish nonobviousness of that invention. A reference teaches away when

112. In re Kubin, 561 F.3d 1351, 1352 (Fed. Cir. 2009).
113. See id. at 1353.
114. See id. at 1353–55.
115. Id. at 1354.
117. Id. at 1413.
118. Id.
119. Id. at 1414.
120. Id. at 1413.
121. See id. at 1414 (holding that NAIL cDNA is not patentable because it would have been obvious to isolate it).
122. See, e.g., In re Kubin, 561 F.3d 1351, 1357 (Fed. Cir. 2009) (discussing a reference that fails to support nonobviousness because it fails to teach away).
it would deter a person of ordinary skill “from following the path set out in the reference.”

The degree of teaching away depends on the particular facts. The Board found that this doctrine did not apply to the Mathew reference. Even though the Mathew reference questioned the existence of a human version of NAIL, it “merely indicate[d] that conflicting data existed” regarding the existence of human NAIL rather than teaching away.

C. **The Federal Circuit’s Decision**

On appeal, the Federal Circuit affirmed the Board’s obviousness rejection because the invention was obvious to try and the prior art provided a reasonable expectation of success. The crux of the decision addressed the viability of the holdings in *Deuel*. Under *Deuel*, the *Kubin* claims would likely be patentable because the prior art did not disclose structurally similar sequences and despite knowledge of the protein, general methods for gene cloning would not render the corresponding gene sequence obvious. Furthermore, under *Deuel*, obvious to try is an inappropriate test for obviousness.

Agreeing with the Board’s skepticism about *Deuel*’s continuing vitality, the court overruled *Deuel*, citing *KSR* for “unambiguously discredit[ing]” the holding that “the obviousness inquiry cannot consider that the combination of the claim’s constituent elements was ‘obvious to try.’”

The court then resurrected its own *O’Farrell* decision. The *O’Farrell* court had identified two situations where what is obvious to try is nonetheless not obvious. The first situation occurs when success depends on trying numerous possibilities but where the prior art failed to indicate the parameters or choices that would likely lead to success. The court explained that in this situation, courts should not succumb to hindsight since the inventor “merely throws metaphorical darts at a board filled with combinatorial prior art possibilities.” The court found support in *KSR*, which held that the inverse situation, “where a skilled artisan merely pursues

123. *Id.*
125. *Id.*
126. *In re Kubin*, 561 F.3d at 1361.
127. *Id.* at 1358 (citing *In re Deuel*, 51 F. 3d 1552, 1559 (Fed. Cir. 1995)).
128. *Id.*
129. *Id.* at 1359–60.
130. *Id.*
131. *Id.* at 1359.
132. *Id.*
‘known options’ from a ‘finite number of identified, predictable solutions,’” was obvious.133

The second situation occurs when the prior art provides only general guidance for a particular approach or technology.134 Again, the court found support for this in KSR where the Court stated that “§ 103 bars patentability unless ‘the improvement is more than the predictable use of prior art elements according to their established functions.’”135

The court held that these situations did not apply to the claims in Kubin.136 The court also held that any putative differences between the Valiante and Sambrook references and Kubin’s methods of deriving the claimed polynucleotide were irrelevant.137 The record showed that the Valiante reference’s prophetic example would “produce for any person of ordinary skill in this art the claimed polynucleotide.”138 Moreover, the court noted that appellants had in fact used the conventional techniques taught by the Valiante and Sambrook references to isolate the NAIL polynucleotide.139 The court also highlighted the appellants’ own disclosure referring to the Sambrook reference, which undermined arguments that the reference was deficient.140 Because the appellants had argued that Sambrook’s standard biochemical methods could lead to their claimed sequence, the court refused to allow them to discount the reference’s relevance to the obviousness of their claims.141

Like the Board, the court also refused to consider Mathew as a reference that teaches away.142 The court found that Mathew’s “quasi-agnostic stance”143 regarding the existence of a human version of NAIL would not have discouraged but instead “aroused a skilled artisan’s curiosity”144 to pursue cloning of NAIL.

The court concluded that because the prior art disclosed NAIL, a motivation to isolate the gene encoding NAIL, and instruction to use an antibody specific to NAIL to clone the gene, “a skilled artisan would have
had a resoundingly ‘reasonable expectation of success’ in deriving the claimed invention in light of the teachings of the prior art.” The court also refused “to cabin KSR to the ‘predictable arts’ (as opposed to the ‘unpredictable art’ of biotechnology).” The court therefore affirmed the Board’s finding of invalidity because “the claimed invention was reasonably expected in light of the prior art and ‘obvious to try.’”

III. DISCUSSION

A. A NEW OBVIOUSNESS STANDARD

In Kubin, the Federal Circuit set a new standard for obviousness—overturning its own precedent in Deuel and branding a gene sequence as unpatentable because its cloning was obvious to try and had a reasonable expectation of success. The court relied on KSR and O’Farrell to conclude that the invention was obvious to try and also rejected the Deuel standard requiring structural similarity in the prior art to show obviousness of a gene sequence. Furthermore, the court extended the obvious to try test to the unpredictable art of biotechnology.

1. Kubin Expands KSR’s Obvious to Try Test

In KSR, the Supreme Court invalidated an invention directed to a combination of elements in the mechanical arts. The Court based its reasoning primarily on three of its precedents, all of which involved combinations of prior art mechanical elements. First, the Court cited United States v. Adams, which concerned the patentability of a “wet battery.” The Court discussed Adams, a companion case to Graham, for its holding that combinations of prior art structures must do more than yield a predictable result to be patentable. Second, the Court cited Anderson’s-Black Rock, Inc. v. Pavement Salvage Co., which involved a road-paving machine attached to a patented burner. In Anderson’s-Black Rock, the Court found a combination

145. Id. at 1360.
146. Id. at 1360–61.
147. Id. at 1361.
148. Id. at 1358, 1361.
149. Id. at 1358–60.
150. Id. at 1358–59.
151. Id. at 1360–61.
153. Id. at 416 (citing United States v. Adams, 383 U.S. 39 (1966)).
154. Id.
155. Id. at 416–17 (citing Anderson’s-Black Rock, Inc. v. Pavement Salvage Co., 396 U.S. 57 (1969)).
of old elements unpatentable because it “added nothing to the nature and quality” of the prior art. 156 Third, the Court cited Sakraida v. Ag Pro, Inc., a case concerning a claim for a water flush system to remove dairy floor debris. 157 In Sakraida, the Court concluded that a rearrangement of old elements that yielded only expected results was obvious. 158 After describing the obviousness principles set forth in those mechanical cases, the Court criticized rigid application of the TSM test 159 and cited to Deuel solely to point out the Federal Circuit’s view that “[o]bvious to try’ has long been held not to constitute obviousness. 160 The Court explained that the Federal Circuit erred because an invention might be obvious if it was obvious to try. 161

It is difficult to determine whether the Court intended that obvious to try should apply to biotechnology or that the obviousness rules developed from the mechanical cases of Adams, Anderson’s-Black Rock, and Sakraida would translate to the facts in Kubin. The Court explained in KSR that its prior cases were instructive when the obviousness inquiry involves the combination of prior art elements. 162 Unlike KSR, Kubin involves a complex and unpredictable technology and did not merely combine known prior art structural elements.

In Kubin, the Federal Circuit interpreted KSR expansively to support using the obvious to try test to evaluate the obviousness of polynucleotide sequences. Under KSR, reason to pursue known options exists “when there is a design need or market pressure to solve a problem and there are a finite number of identified, predictable solutions.” 163 The Board differed, finding motivation to pursue options when “there [are] a limited number of methodologies.” 164 The Federal Circuit affirmed the reasoning of the Board’s decision. 165 KSR dealt with the combination of known structural elements in the mechanical arts, not the use of existing methods to create a new invention from known elements. By equating “solutions,” which referred to structural elements, with “methodologies” or the direction of research, the

156. Id.
157. Id. at 417 (citing Sakraida v. Ag Pro, Inc., 425 U.S. 273 (1976)).
158. Id.
159. Id. at 419–22.
160. See id. at 414 (alteration in original) (quoting Teleflex, Inc. v. KSR Int’l. Co., 119 F. App’x 282, 289 (Fed. Cir. 2005), rev’d, 550 U.S. 398 (quoting In re Deuel, 51 F.3d 1552, 1559 (Fed. Cir. 1999))).
161. Id. at 421.
162. Id. at 417.
163. Id. at 421.
Federal Circuit broadened the scope of prior art that may render a patent obvious under the obvious to try test.

2. Structural Similarity Is No Longer Required to Show Obviousness

*Kubin* also set a new standard for gene patents because structural similarity is no longer required to show obviousness of polynucleotide sequences. For new chemical compositions, “a prima facie case of obviousness is based upon structural similarity, i.e., an established structural relationship between a prior art compound and the claimed compound.”

In *Bell* and *Deuel*, the Federal Circuit applied this standard to polynucleotide sequences. But in *Kubin*, the Federal Circuit refused to require structural similarity to support obviousness of polynucleotide sequences.

Like *Bell* and *Deuel*, *Kubin* concerned the validity of gene sequences in light of prior art teaching the encoded protein and a general cloning manual. Unlike in *Bell* and *Deuel*, in *Kubin*, the prior art did not disclose either the complete or partial polypeptide sequence of the protein at issue. Instead, the prior art disclosed a probe specific for the protein and a prophetic method for isolating the gene encoding the protein. Thus, the prior art in *Kubin* provided less information on the polypeptide sequence encoded by the claimed gene than the corresponding prior art in *Bell* and *Deuel*. Furthermore, like in *Bell* and *Deuel*, the prior art in *Kubin* did not disclose structurally similar polynucleotide sequences, and under *Bell* and *Deuel*, conventional methods for gene cloning are irrelevant in the obviousness analysis. Therefore, if *Bell* and *Deuel* remained good law, the Federal Circuit should have found the *Kubin* claims nonobvious.

The structural similarity standard makes sense for chemical compounds where a showing of obviousness requires a motivation to modify the prior art to arrive at the new compound. Evidence that the prior art failed to disclose a compound structurally similar to the claimed compound would help establish nonobviousness. Polynucleotides are chemical compositions. Basing their obviousness on the structural similarity standard is consistent with how biotechnology research proceeds. Scientists have been characterizing proteins since well before current methods of genetic engineering existed, and even now researchers are motivated to clone a specific gene because its encoded

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166. *See, e.g.*, Takeda Chem. Indus., Ltd. v. Alphapharm Pty., Ltd., 492 F.3d 1350, 1356 (Fed. Cir. 2007) (citing *In re Deuel*, 51 F.3d 1552, 1558 (Fed. Cir. 1995)).

167. *Deuel*, 51 F.3d at 1558; *In re Bell*, 991 F.2d 781, 784 (Fed. Cir. 1993).

168. *In re Kubin*, 561 F.3d at 1354 (stating that the Valiante reference does not disclose the polypeptide sequence of NAIL).

169. *Id.* at 1354–55.

170. *Deuel*, 51 F.3d at 1559; *see Bell*, 991 F.2d at 784–85.
protein mediates a biologically important process. If mere knowledge of a protein in the prior art and a general guideline for cloning renders the corresponding gene sequence obvious, whole classes of genes would be unpatentable.

On the other hand, the structural similarity standard may be inappropriate for evaluating the obviousness of gene sequences. A researcher generally does not identify a gene sequence by looking to structurally similar compositions in the prior art as he would for standard chemical compounds. Instead, a researcher often relies upon the relationship between protein and DNA to clone the gene. Under the Deuel standard, virtually all gene patents would be valid because general methods are irrelevant to the obviousness of a polynucleotide sequence in the absence of prior art suggesting the claimed sequence. The Kubin holding that courts can consider methodologies in the obviousness inquiry significantly changes the obviousness standard for genes.

B. A REASONABLE EXPECTATION OF SUCCESS

Under KSR, an obvious to try solution must lead to “anticipated success.”171 In Kubin, the Federal Circuit interpreted “anticipated success” to mean “reasonable expectation of success.”172 Courts view this reasonable expectation of success from the perspective of an ordinary person of skill in the art, and obviousness does not require “absolute predictability of success.”173

The two impermissible obvious to try situations described in O’Farrell help determine whether an invention is reasonably expected.174 The O’Farrell exceptions protect efforts to solve problems where the prior art only suggests success among impractically large numbers of possibilities or general success in a field with many approaches. Success in those situations would clearly result from technological innovations. Thus, a patentability standard requiring that obvious to try inventions fall within the two O’Farrell exceptions rewards inventions that promote the progress of science and the useful arts. Yet, such a stringent obvious to try test may lapse back to the discredited “flash of creative genius” standard.

A pivotal question in Kubin was whether the prior art provided a reasonable expectation of success. In Kubin, the court found that the prior art taught “the protein of interest, a motivation to isolate the gene coding for that protein, and illustrative instructions to use a monoclonal antibody

172. In re Kubin, 561 F.3d at 1361.
173. Id. at 1360 (citing In re O’Farrell, 853 F.2d 894, 903–04 (Fed. Cir. 1988)).
174. Id. at 1359–60.
specific to the protein for cloning this gene.” The court also found that appellants used conventional methods. Therefore, the prior art provided teachings that would have led to a “reasonable expectation of success.”

If in fact the Kubin methods were identical to the illustrative instructions provided in the prior art or were conventional, the invention may have been obvious to try. Yet whether the Kubin technology followed a predictable path is not clear because the court ignored the differences between the prior art and the appellants’ methods. In fact, the court even stated that “any putative difference in Valiante’s/Sambrook’s and appellants’ processes does not directly address the obviousness” of the claimed gene sequences.

The court’s conclusion that there was a reasonable expectation of success provides an unsatisfying explanation for how to evaluate obviousness, because the extent to which the prior art taught or suggested the Kubin methods and to what extent the Kubin methods were conventional remains unclear. The prior art references in Kubin described general guidelines for cloning a gene and a method for isolating the gene using an antibody to screen an NK cell library. Appellants isolated the claimed gene using the same antibody and followed general guidelines in the prior art. Although the appellants’ methods and the prior art methods were similar, they differed in at least one major way. The prior art disclosed an NK cell library but failed to disclose how to make the NK cell library, the starting material for the screening process.

If the prior art taught a method of screening a library but failed to teach or suggest that library, the gene sequences might be nonobvious because there would be no reasonable expectation of success. The appellants argued that the development of their NK cell library was “remarkable” and involved isolating pooled RNAs from both resting NK cells and NK cells stimulated with various activators. If there were an impractically large number of possible ways to generate the library or the prior art provided only general guidance for the library, the O’Farrell exceptions might render the invention nonobvious. While general knowledge of how to make an NK cell library existed within the prior art, how much the appellants’ method of making the NK cell library deviated from those known methods is not discernible and

175. Id. at 1360.
176. Id.
177. Id. at 1355.
178. Id. at 1356.
179. Id. at 1354–55.
181. Id. at 16.
those deviations from the prior art determine whether a reasonable expectation of success existed.

Within the unpredictable arts, researchers often vary admittedly predictable and routine procedures. Whether these variations represent innovation or merely ordinary skill is a complex question that harkens back to the *Graham* standard of obviousness. Despite the apparent objectivity provided by the obviousness standard, the standard suffers from multiple layers of subjectivity and depends on the point of view and knowledge of the ordinary person skilled in the art. Courts will likely struggle to determine what weight should be given to the existence of unpredictability in the art when an invention results from methods that to some extent rely on conventional methods.

C. KUBIN CREATES UNCERTAINTY FOR BIOTECHNOLOGY

The potential impact of *Kubin* on the validity and patentability of gene sequence claims causes apprehension in the biotechnology field. Obviousness challenges may invalidate many gene patents if the protein was known and gene cloning depended on routine methods. Biotechnology patents often cite the Sambrook reference, likely in order to satisfy the enablement requirement, and this may, as in *Kubin*, undermine potential nonobviousness arguments. After *Kubin*, future biotechnology patent applicants should cautiously cite the Sambrook reference or other standard manuals, and balance the need for an enabling disclosure with the need to show the nonobviousness of their invention. In situations where less was known about the encoded protein, where applicants or patentees can provide evidence of failed attempts, or where non-routine methods contributed to cloning, the inventions may survive a nonobviousness challenge based on *Kubin*. One commentator, however, noted that the impact of *Kubin* might be less severe than initially feared because most of the known genes have been cloned and patented, and a substantial number of those patents are likely near the end of their patent term.

Innovation in biotechnology provides many social benefits, most notably in the area of human health. Patents play a vital role in encouraging investment in biopharmaceutical and biotechnological research. Before a

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typical investment generates significant returns, however, most biotechnology innovations undergo a lengthy development process that incurs significant financial costs. 185 During preclinical development, researchers evaluate candidate therapies for suitability for human testing in clinical trials. Clinical trials are divided into three phases: Phase I, II, and III, with each phase characterizing various aspects of the therapy’s safety and efficacy. The public cannot access these therapies until after the Food and Drug Administration (FDA) approves the therapy. 186 A recent study estimated the magnitude of research and development costs for biopharmaceuticals based on specific-drug cost, development time, and clinical success rate. 187 It found that development of biopharmaceuticals takes an average of 12.5 years from initial investment to final approval. 188 Furthermore, this same study noted that total capitalized costs per approved biopharmaceutical could be as high as $1.241 billion 189 with an overall clinical approval success rate of 30%. 190

Without the protection of patents, biotechnology researchers may be deterred from pursuing costly, high-risk research projects. 191 In fact, companies routinely screen and eliminate potential programs with inadequate patent protection. 192 Empirical studies also show that patents play roles in securing investment and financing for start-ups, and that increased patenting by venture-backed companies in the biotechnology industry is correlated with investment. 193

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186. Biopharmaceuticals, like pharmaceuticals, cannot benefit the public without FDA approval. See Benjamin N. Roin, Unpatentable Drugs and the Standards of Patentability, 87 TEX. L. REV. 503, 505 (2009).

187. DiMasi & Grabowski, supra note 185, at 470.

188. Id. at 475.

189. Id.

190. Id. at 472.

191. See, e.g., Roin, supra note 186, at 504 (noting wide acceptance that patents play essential roles in motivating pharmaceutical research and development).

192. See id. at 513 (citing BERNICE SCHACTER, THE NEW MEDICINES: HOW DRUGS ARE CREATED, APPROVED, MARKETED, AND SOLD 52 (2006); C. Merle Crawford, Defining the Charter for Product Innovation, in GENERATING TECHNOLOGICAL INNOVATION 165, 175 (Edward B. Roberts ed., 1987); Peter Gwynne & Gary Heebner, Protecting the Assets, 297 SCIENCE 2083, 2086 (2002); Lester A. Mitscher & Apurba Dutta, Contemporary Drug Discovery, in 1 DRUG DISCOVERY AND DEVELOPMENT 103, 115 (Mukund S. Chorghade ed., 2006)).

Although patents may provide valuable incentives for researchers and investors to pursue lines of research, patents can also stifle innovation. Gridlock can result when too many patent owners hold rights to discoveries and block others from building on those discoveries.\textsuperscript{194} Patent-related licensing barriers and transaction costs may also hinder research.\textsuperscript{195} Moreover, rewarding researchers for merely incremental innovations would contradict the policies underlying the patent system, and lower standards of patentability could deter investment in riskier and innovative research.

In sum, whether a biotechnology invention should be patentable presents a difficult question. Biotechnology inventions often depend on researchers using a proven set of tools while methodically varying parameters, and much research consequently involves an element of “obviousness to try.” Because \textit{Kubin’s} obvious to try standard attacks the method of making an invention, it threatens lines of research that logically follow from a discovery. For example, scientists may use established methods to insert a gene into a cell line to express a purified protein that may one day be of therapeutic value. Courts may find that those methods, the cell lines, or the protein products are unpatentable as “obvious to try.” \textit{Kubin} also brings into question other areas of research that utilize established methods. For example, patents for antibody therapeutics, such as Enbrel\textsuperscript{®} and Herceptin\textsuperscript{®} or as yet undeveloped therapies, may be vulnerable because methods for generating them have become routine. If similar new therapies are obvious, investors might avoid the costly research and development efforts required to bring them to market, thereby depriving the public of access to these inventions.

IV. CONCLUSION

\textit{Kubin} overruled key holdings in \textit{Deuel} by finding that conventional methodologies for gene cloning might preclude patent protection for gene sequences and that the obvious to try test applies to the unpredictable art of biotechnology. Although the Federal Circuit did not state that polynucleotide sequences are obvious \textit{per se}, its holding effectively lowered the bar for finding gene patents obvious.

Advances in biotechnology often build upon basic methods, with research proceeding in incremental steps. Because obvious to try focuses on the methods of discovery, the plodding and stepwise exploration of new...


areas in biotechnology research and development may not show the inventive step required to satisfy the nonobviousness requirement. These methods may involve great effort and costs, and provide many social benefits. Kubin employs a stringent standard to evaluate obviousness, and application of this high standard may retard investment in biotechnology. Obviousness standards that account for the complexity, unpredictability, and costly nature of biotechnology are crucial to promote the investment and risk-taking necessary to drive innovations in the field.
A matter of opinion: Opinions of counsel remain necessary after In re Seagate

Pan C. Lee

A tension exists between opinions of counsel, willful infringement, and the attorney-client privilege. Patent infringement defendants face a vexing decision. Entering into evidence an opinion of counsel declaring noninfringement or invalidity of an asserted patent acts as a strong defense to willfulness. However, asserting this defense requires waiving attorney-client privilege. If a defendant chooses not to assert the opinion of counsel defense to preserve the attorney-client privilege, he risks facing enhanced damages if a jury finds willful infringement.

Law regarding willfulness and opinions of counsel changed significantly when the Federal Circuit issued In re Seagate in 2007. In this watershed en banc decision, the Federal Circuit overruled its own precedent regarding willful infringement. Prior to Seagate, the Federal Circuit explicitly imposed an affirmative duty on potential defendants to obtain an opinion of counsel per Underwater Devices Inc. v. Morrison-Knudsen Co. The Seagate court replaced this duty of care standard with an objective recklessness standard. This new standard for willful infringement “abandon[ed] the affirmative duty of due care, . . . [and emphasized] that there is no affirmative obligation to obtain opinion of counsel.”

The new two-pronged willfulness test under Seagate entails both an objective prong and a subjective prong. First, the objective standard requires a plaintiff to prove, with clear and convincing evidence, an objectively high likelihood that a defendant’s actions constituted infringement of a valid patent. Second, under the subjective standard, a plaintiff bears the burden of proof to show that the accused infringer either knew or should have known

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1. See In re Seagate, 497 F.3d 1360, 1372 (Fed. Cir. 2007) (en banc) (discussing scope of waiver resulting from advice of counsel defense with regard to willful infringement).
2. See id. at 1369 (discussing advice of counsel defense).
3. Id. at 1372.
5. Seagate, 497 F.3d at 1371.
6. Id.
7. Id.
8. Id.
this objectively defined risk of infringement existed. Initially, Seagate appeared to eliminate the relevance of opinion letters in determining willfulness in infringement proceedings. Indeed, an opinion letter that is asserted should continue to act as a safe harbor from being found willful since it refutes the subjective prong of the Seagate standard.

However, Seagate did not resolve whether a jury may consider the lack of an opinion of counsel in determining willfulness. Accused infringers might argue that the new Seagate standard for willfulness should prevent a jury from such consideration, since there is no obligation to procure the opinion of counsel after awareness of potential infringement and the burden of proving willful infringement is placed upon the patentee. Patentees will respond, however, that Seagate did not overrule Underwater Devices in considering the totality of circumstances with regard to willful infringement. Clarity regarding whether opinion letters remain necessary is desirable because potential infringers are forced to choose between spending significant resources to obtain opinions of counsel and risking enhanced damages from a finding of willful infringement.

District court decisions after Seagate fall on both sides of this fence regarding whether a jury may consider the lack of an opinion of counsel. These cases have hinged on the application of the totality of the circumstances test, identified in Read Corp. v. Portec as a list of factors to be considered in determining willfulness. The second Read factor assessed whether the

9. Id.

10. In its discussion on the advice of counsel defense, the Seagate court acknowledged the historical role of waiving privilege in order to protect against a finding of willfulness. The court overruled the affirmative duty of care in Underwater Devices, and removed the obligation to procure an opinion of counsel, but did not negate the benefit that an advice of counsel defense would provide. Id. at 1369, 71.


12. Seagate, 497 F.3d at 1371.

13. Underwater Devices Inc. v. Morrison-Knudsen Co., 717 F.2d 1380, 1390 (Fed. Cir. 1983); see also Read Corp. v. Portec, Inc., 970 F.2d 816, 826–27 (Fed. Cir. 1992) (identifying the factors to be considered in analyzing the totality of the circumstances).


16. The Read factors are:
accused infringer investigated the patent at issue and formed a good faith belief of invalidity or noninfringement. Some district courts have utilized this aspect of the totality of circumstances test to justify allowing a jury to consider the lack of an opinion of counsel. However, the validity of these tests post-Seagate is questionable. The new standard of willfulness imposed by Seagate overruled presumptions upon which this Read factor is based. Some district courts have instead relied upon factors identified in Cohesive Technologies, Inc. v. Waters Corp.\textsuperscript{17} Though these factors were created post-Seagate, their validity is questionable because they cite no authority, and appear contradictory to Seagate’s stance on opinion letters.

Additionally, recent cases of indirect infringement have muddled any headway gained by Seagate in reducing the negative impact of lacking of an opinion of counsel.\textsuperscript{18} In Broadcom v. Qualcomm,\textsuperscript{19} the Federal Circuit ruled that a jury may consider the lack of an opinion of counsel in determining intent to induce. The Broadcom court narrowly distinguished Seagate in its decision, drawing an uncertain line between direct infringement and inducement of infringement. The court utilized language closely analogous to the Seagate standard, but applied contradictory reasoning.\textsuperscript{20} Thus, disparate rulings regarding a jury’s consideration of the lack of an opinion of counsel exist at both district and appellate levels. Consistency throughout these decisions might have been achieved if the compass of the Seagate court’s intent guided subsequent courts.

\textsuperscript{1} whether the infringer deliberately copied the ideas or design of another;
\textsuperscript{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
\textsuperscript{3} the infringer’s behavior as a party to the litigation . . .
\textsuperscript{4} Defendant’s size and financial condition.
\textsuperscript{5} Closeness of the case.
\textsuperscript{6} Duration of defendant’s misconduct.
\textsuperscript{7} Remedial action by the defendant.
\textsuperscript{8} Defendant’s motivation for harm.
\textsuperscript{9} whether defendant attempted to conceal its misconduct.

Use of these factors in patent cases is in line with punitive damage considerations in other tort contexts.

\textsuperscript{17} Cohesive Techs., Inc. v. Waters Corp., 526 F. Supp. 2d 84 (D. Mass. 2007) (overruled on other grounds by Cohesive Techs., Inc. v. Waters Corp., 543 F.3d 1351 (Fed. Cir. 2008)).
\textsuperscript{18} See Broadcom Corp. v. Qualcomm, Inc., 543 F.3d 683 (Fed. Cir. 2008).
\textsuperscript{19} Id.
\textsuperscript{20} Id. at 699.
This Note argues that lack of an opinion letter should not be relevant in any litigation proceedings on willfulness because of the importance of the attorney-client privilege to the Federal Circuit in Seagate. Section I provides a brief background regarding opinions of counsel in the patent industry. Section II surveys the history of the willfulness doctrine leading up to Seagate. Analysis of the doctrine’s evolution highlights Seagate’s distinct departure from the Federal Circuit’s traditional view on willful infringement and opinions of counsel. Section III discusses the confusion at the district court level regarding how to treat the lack of an opinion of counsel, and identifies inconsistencies between these decisions and the holdings of Seagate. The Note identifies potential solutions to the unsure post-Seagate landscape in Section IV.

I. BACKGROUND ON OPINIONS OF COUNSEL

For approximately a quarter-century prior to Seagate, potential infringers had an affirmative duty to obtain an opinion letter from counsel. Thus, obtaining an opinion of counsel was standard procedure when dealing with patent infringement issues. This section examines the functions opinion letters served in a pre-Seagate world.

There are two common types of opinion letters: letters that determine an entity’s freedom to operate (clearance opinions), and letters that assess the likelihood of liability when a patent has been asserted (non-infringement or invalidity opinions). Each serves a distinct purpose.

Clearance opinion letters are most valuable at the beginning of a product development cycle. Early notice of potential infringement allows a business to alter the design of a project around problem patents, and thus avoid costly changes late in the design cycle. Given their proactive posture, clearance opinion letters may be especially effective as a defense against any willful infringement, but only if the opinion counsel considered the patent(s) asserted in the litigation.

23. Id.
24. Id. at 4.
25. Id.
Though very useful, clearance opinions come at a significant cost due to their scope. A freedom to operate (FTO) survey can easily encompass hundreds of patents, making clearance letters expensive. Often, it may be more efficient to narrow the scope of a clearance opinion by focusing upon the patents held by likely competitors within a field of use. Moreover, the landscape of intellectual property is in constant change, and good faith requires follow-up that accounts for newly issued patents as well as any changes in scope of the project in question. Thus, clearance opinions are a significant investment and may be impractical for many projects.

Non-infringement opinions, unlike clearance opinions, have a clearly defined scope. These opinions respond to a known threat, typically a single patent or family of patents asserted by a patentee. The non-infringement opinion process begins with a study evaluating the risk of the patent infringement charge. An attorney interprets the scope of the patent’s claims by examining the allegedly infringed patent, its file history, and its prior art references. Each claim is compared to the allegedly infringing device. The attorney applies the same type of analysis a court would in assessing infringement, including application of the doctrine of equivalents. This analysis and its conclusion are then incorporated into a formal opinion letter. Similarly, invalidity opinions interpret the asserted patent and apply patent law as a court would in deciding whether a patent was valid. These opinions often involve an additional search for previously undiscovered prior art with which to invalidate the patent. An ideal opinion to refute willfulness would contain both non-infringement and invalidity analyses.

Businesses typically consider opinion letters when they learn of a potentially infringing patent, often through receipt of a letter from the patentee. While this letter may not threaten a lawsuit, prior to Seagate this letter would have

26. Id. at 4.
27. Id. at 10.
30. Radack, supra note 28.
31. Id.
33. Id.
34. Id.
35. Lemley & Tangri, supra note 14, at 1090.
required a recipient to seek an opinion of counsel, which can cost anywhere between $20,000 to $100,000 per patent. This mandate was designed to protect the accused infringer from the willfulness charge that is almost certain to appear if an infringement suit arises.

For the specific purpose of litigation, savvy accused infringers would request only a favorably written opinion, as opposed to a properly candid and balanced one. If a favorable opinion was not available, the savvy accused infringer would elect not to have an opinion letter at all. At times, opinion counsel may write one thing and orally inform the client differently. This allows the recipient to gain accurate legal advice without being exposed to the liability that would otherwise be revealed by the opinion letter. However, since utilization of an opinion letter at trial waives the attorney-client privilege, all the opinion counsel's communications become subject to disclosure. Thus, the opinion counsel is placed in an ethical quandary where they either must lie regarding the communication, or testify that the opinion letter is inaccurate. This scenario occurs often, and its frequency has caused it to become known as the “willfulness game.”

Opinions of counsel play a significant role in any patent infringement scenario. Prior to *Seagate*, a non-infringement or invalidity opinion was necessary to rebut claims of willful infringement. Though *Seagate* eliminated an accused infringer's obligation to procure such an opinion, it maintained utilization of an opinion of counsel as a safe harbor against willfulness. Opinions of counsel provide value in other ways as well. An accused infringer may choose to license the patent in question based upon the opinion's analysis. Once litigation occurs, an opinion of counsel may form the factual basis for denying infringement when filing a response.

36. *Id.* at 1085.
37. *Id.*
38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.*
42. *In re Seagate*, 497 F.3d 1360, 1372 (Fed. Cir. 2007).
43. Lemley & Tangri, *supra* note 14, at 1104–05.
44. *Id.* at 1085.
46. *Seagate*, 497 F.3d at 1371.
47. Woller, *supra* note 32.
48. *Id.*
II. THE DOCTRINE OF WILLFULNESS

The doctrine of willfulness originally favored patentees, but was gradually adjusted by the courts to reduce the burdens placed upon accused infringers. The Federal Circuit’s ruling in Seagate significantly updated the law regarding willful infringement in this direction. This Part examines the doctrine of willfulness in caselaw leading up to and including Seagate.

A. THE COURTS CREATE WILLFULNESS STANDARDS IN FAVOR OF PATENTEEs

The Patent Act of 1793 mandated damages of triple the price of a patentee’s invention for any infringement. However, the Patent Act of 1836 made treble damages no longer mandatory, instead giving judges discretion over enhanced damages. This enabled the judicial doctrine of assigning enhanced damages to willful infringement. Indeed, the Supreme Court has long held that enhanced damages are available when the plaintiff shows willful, or bad faith, infringement. While a jury determines willfulness, the enhancement is determined by the court, which has the discretion to enhance damages by as little as nothing to as much as three times the awarded amount.

One of the Federal Circuit’s first decisions created a standard by which to determine willful infringement of a patent. In Underwater Devices, the Federal Circuit placed upon defendants the burden of a duty of due care in order to avoid willfulness. Upon notice, a potential infringer had an affirmative duty to exercise due care in determining whether or not they actually infringed. This affirmative duty included seeking competent legal advice, which needed to be obtained before the initiation of any potentially infringing activity. Thus, as soon as a potential infringer became aware that another patent existed, they were required to obtain a legal opinion finding either non-infringement or invalidity, before continuing with any potentially infringing activity.

Whereas Underwater Devices only created an affirmative duty for an accused infringer to obtain opinion of counsel upon notice of infringement,
subsequent cases created an adverse inference if such an opinion was not produced at trial. In *Kloster Speedsteel AB v. Crucible Inc.*, the Federal Circuit held that absence of an opinion of counsel as evidence against willful infringement warranted one of two conclusions: (1) either the accused infringer did not obtain such an opinion, or (2) the accused infringer obtained an adverse opinion. This placed a significant burden upon accused infringers with regard to discovery, since disclosure of an opinion of counsel waived the attorney-client privilege with regard to that subject matter. Defendants were thus forced to choose between either waiving their attorney-client privilege or facing the adverse inference of willfulness.

These cases created an environment in which opinion letters were considered absolutely necessary. However, due to the costs involved with obtaining an opinion of counsel, companies that received many infringement notices found obtaining an opinion letter in response to each notice infeasible. Thus, an accused infringer was likely often forced to make judgment calls. Typically, upon receiving a letter from a patent holder asserting their patent, in-house counsel was likely to obtain an independent opinion letter upon determining that a reasonable possibility of infringement existed. Additionally, *Underwater Devices* produced an incentive for businesses to refrain from performing searches of the patents surrounding their product, out of fear that knowledge of a potentially infringed patent may trigger this affirmative duty.

At trial, this affirmative duty, combined with an adverse inference, placed severe pressure upon defendants to utilize the opinion of counsel as a defense to willfulness, thus waiving their attorney-client privilege with regard to the opinion. Plaintiff’s attorneys naturally pressed their advantage of this waiver in discovery, and forced the disclosure of more than just opinion

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57. *Id.* at 1580; *see also* Fromson v. W. Litho Plate & Supply Co., 853 F.2d 1568, 1572–73 (Fed. Cir. 1988).
58. *In re Seagate*, 497 F.3d 1360, 1371-72 (Fed. Cir. 2007) (“[T]he proper legal standard for willful infringement informs the relevance of evidence relating to that issue and, more importantly here, the proper scope of discovery.”). Prior to *Seagate*, the scope of the attorney-client privilege waiver was not clearly defined. *Seagate* clarified that the scope of such waiver does not extend to trial counsel. *Id.* at 1374.
60. Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp., 383 F.3d 1337, 1351 (Fed. Cir. 2004) (Dyk, J., dissenting) (“[D]ue care requirement has fostered a reluctance to review patents.”).
61. *Seagate*, 497 F.3d at 1369 (“In light of the duty of due care, accused willful infringers commonly assert an advice of counsel defense.”).
counsel’s communication. Indeed, in cases such as *Informatica Corp. v. Business Objects Data Integration, Inc.*, plaintiff’s counsel successfully convinced the court to extend the scope of such waiver to trial counsel.\textsuperscript{62}

Furthermore, in persuading the jury that a defendant had infringed willfully, plaintiff’s counsel could utilize the adverse inference argument.\textsuperscript{63} Plaintiff’s counsel could argue to the jury that the absence of an opinion meant only one of two things: either the accused infringer chose not to get an opinion, or the opinion was unfavorable.\textsuperscript{64} A typical jury instruction would emphasize the affirmative duty of *Underwater Devices* and highlight the duty to obtain a competent opinion of counsel.\textsuperscript{65} Consideration by the jury of these matters likely impacted defense counsel decisions regarding the introduction of an opinion letter into evidence. Even if the defendant had significant reservations about utilizing the defense of an opinion letter, the tremendous consequence of an adverse inference made it very likely that it would do so.\textsuperscript{66}

Cynicism regarding opinion letters infected the patent field.\textsuperscript{67} It was commonly understood that these opinions of counsel would be used as evidence to defend against willfulness.\textsuperscript{68} There existed within the patent industry a concern that these opinions did not embody the sound, candid advice that an opinion of counsel should provide.\textsuperscript{69} Opinions of counsel

\begin{itemize}
\item \textsuperscript{62} Informatica Corp. v. Bus. Objects Data Integration, Inc., 454 F. Supp. 2d 957, 959 (N.D. Cal. 2006) (“Such waiver applies to opinion counsel and trial counsel alike.”).
\item \textsuperscript{63} Kloster Speedsteel AB v. Crucible, Inc., 793 F.2d 1565, 1580 (Fed. Cir. 1986).
\item \textsuperscript{64} Id.
\item \textsuperscript{65} See, e.g., Jury Instruction at 78–79, On Demand Mach. Corp. v. Ingram Indus., No. 4:01CV1668 (E.D. Mo. 2004) 2004 Jury Instr. LEXIS 467:
\begin{quote}
Once Defendants had actual notice of ODMC’s Patent, each Defendant had an affirmative duty to determine whether or not it infringed the Ross Patent upon introducing the accused methods of manufacturing books. In determining whether Defendants fulfilled their duty to avoid infringement, the test is whether, under all the circumstances, a reasonably prudent person would conduct himself with any confidence that a court would hold the patent invalid or not infringed. That duty will normally entail the obtaining of competent legal advice before engaging in any potentially infringing activity or continuing such activity. The fact that such an opinion of counsel was obtained by Defendants does not guarantee that the infringement will not be willful.
\end{quote}
\item \textsuperscript{66} Economic decision makers seek more knowledge only when they believe the cost of acquiring it is less than the disadvantages due to uncertainty. FRITZ MACHLUP, THE ECONOMICS OF INFORMATION AND HUMAN CAPITAL 25–26 (1984).
\item \textsuperscript{68} Lemley & Tangri, supra note 14, at 1104; Wolf, supra note 67.
\item \textsuperscript{69} Lemley & Tangri, supra note 14, at 1104; Wolf, supra note 67.
\end{itemize}
began to earn disparaging names such as “whitewash opinions” or “window-dressing opinions.”

B. THE COURTS EASE THE BURDEN PLACED UPON ACCUSED INFRINGERS

The Federal Circuit removed the adverse inference from *Kloster Speedsteel* in its en banc decision in *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GMBH v. Dana Corp.*

Respecting the importance of attorney-client privilege, the *Knorr-Bremse* court held that a defendant who either does not obtain, or refuses to disclose, the opinion of counsel in reliance upon attorney-client privilege, does not suffer from an adverse inference. While the *Knorr-Bremse* decision was a victory for accused infringers in its removal of the adverse inference, the affirmative duty from *Underwater Devices* remained intact. Furthermore, *Knorr-Bremse* also followed *Underwater Devices* in considering the “totality of circumstances” when determining willful infringement. Therefore, it remained necessary for accused infringers to seek opinion letters from competent counsel upon notice of potential infringement. And reliance upon opinion of counsel as a defense to willful infringement still required a waiver of attorney-client privilege. Thus, the tension between waiving attorney-client privilege and facing an adverse inference was reduced but not eliminated.

The scope of the attorney-client privilege waiver was a central issue since it was not clearly defined. The Federal Circuit dealt with this matter in *In re EchoStar* and established that the waiver extended to all communications relating to the same subject matter, including communications with attorneys unassociated with the opinion letter.

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70. Lemley & Tangri, supra note 14, at 1104; Wolf, supra note 67.
72. Id.
73. Id. at 1345–46 ("Although there continues to be an affirmative duty of due care to avoid infringement of the known patent rights of others, the failure to obtain an exculpatory opinion of counsel shall no longer provide an adverse inference or evidentiary presumption that such an opinion would have been unfavorable.") (citations omitted).
74. Id. at 1347.
75. Id. at 1345 ("A defendant may of course choose to waive the privilege and produce the advice of counsel. However, the assertion of attorney-client and/or work-product privilege and the withholding of the advice of counsel shall no longer entail an adverse inference as to the nature of the advice.").
Knorr-Bremse worked to reduce the burden of defending against willful infringement.\(^\text{78}\) However, its impact upon defendants in seeking the advice of counsel was diluted, since it reaffirmed the Underwater Devices duty of care.\(^\text{79}\) Just as it did prior to Knorr-Bremse, the unchanged affirmative duty of care continued to prompt accused infringers to obtain opinions of counsel.\(^\text{80}\) However, with the removal of the adverse inference, defendants likely felt slightly less pressure to enter an opinion letter into evidence and waive attorney-client privilege. Whereas before Knorr-Bremse it spelled certain injury to withhold an opinion letter as a defense to willfulness, after Knorr-Bremse defense counsel was likely able to better balance the drawbacks of waiving privilege with the chances of a willfulness finding.

Reasons why counsel might choose not to utilize an opinion letter vary. Since patent prosecution counsel often writes opinion letters, the prosecutor may not have been wary of the pitfalls in trial when writing the letter. For example, the language used within the opinion letter might shed negative light upon other issues at trial, even if the conclusion of the letter is favorable. Alternatively, the language used within the letter may contradict the court’s claim construction. By removing the adverse inference, Knorr-Bremse served to equalize the tradeoffs of using an opinion of counsel, but still resulted in a catch-22 situation.\(^\text{81}\) The defense is forced to choose between maintaining attorney-client privilege for purposes of defending against liability, and waiving attorney-client privilege to defend against willfulness.\(^\text{82}\) In re EchoStar worsened the situation by being unclear as to whether the waiver of privilege extended to either the communication or work-product of trial counsel.\(^\text{83}\)

C. THE FEDERAL CIRCUIT ATTEMPTS TO CLEAN THE SLATE

Recognizing the severe implications of extending the scope of waiver to trial counsel, the Federal Circuit tackled the issue en banc in Seagate.\(^\text{84}\) As part of

\(^{78}\) Knorr-Bremse, 383 F.3d at 1345.

\(^{79}\) Id. at 1345–46 (“there continues to be an affirmative duty of due care to avoid infringement of the known patent rights of others”) (citations omitted).

\(^{80}\) Id. at 1351 (Fed. Cir. 2004) (Dyk, J., dissenting) (“the majority opinion does not address whether a potential infringer can satisfy the requirement of due care without securing and disclosing an opinion of counsel, or, if such an opinion is not absolutely required, whether an adverse inference can be drawn from the accused infringer’s failure to obtain and disclose such an opinion”).

\(^{81}\) Id. at 1345.

\(^{82}\) In re Seagate, 497 F.3d 1360, 1369 (Fed. Cir. 2007).

\(^{83}\) Id. at 1370 (“EchoStar did not consider waiver of the advice of counsel defense as it relates to trial counsel.”).

\(^{84}\) Id. at 1360.
its analysis of the scope of waiver issue, the *Seagate* court overhauled the standard of willfulness established by *Underwater Devices*.\(^85\) While the new *Seagate* standard provides that an opinion of counsel may act as a safe harbor from willfulness, it left unclear whether a jury should be permitted to consider the lack of an opinion of counsel.

The *Seagate* court revisited the doctrine of willfulness, stating that it governed the scope of discovery for the issue at hand.\(^86\) In examining the standard, the court drew upon cases involving the Copyright Act and other civil liabilities, which all held that willfulness equated to reckless behavior.\(^87\) The court thus concluded that willful infringement required proof of objective recklessness.\(^88\)

The *Seagate* court established a new two-part objective standard for proving willful infringement in place of the *Underwater Devices* standard.\(^89\) First, the patentee must show that the accused infringer “acted despite an objectively high likelihood that its actions constituted infringement of a valid patent.”\(^90\) The second component requires the patentee to show that the risk was “either known or so obvious that it should have been known to the accused infringer.”\(^91\) The patentee must prove both elements by clear and convincing evidence.\(^92\) The *Seagate* court recognized that by leaving behind the affirmative duty of care imposed by *Underwater Devices* and placing the burden of proof upon the plaintiff, there would no longer be any obligation for a potential infringer to obtain opinion of counsel.\(^93\)

In analyzing the scope of waiver issue, the *Seagate* court was concerned by the policy implications of a party simultaneously using waiver as both a sword and a shield.\(^94\) That is, a party should not be allowed to disclose favorable material while maintaining the privilege of confidentiality on unfavorable matters. The court recognized that the events relevant to willfulness would ordinarily occur prior to litigation.\(^95\) The court also noted that trial counsel

\(^{85}\) *Id.* at 1371.

\(^{86}\) *Id.* at 1371–72.

\(^{87}\) *Id.* at 1370–71; *see also* Safeco Ins. Co. of Am. v. Burr, 551 U.S. 47, 52 (2007) (holding that reckless action is covered by willful failure); Yurman Design, Inc. v. PAJ, Inc., 262 F.3d 101, 112 (2d. Cir. 2001) (“Willfulness . . . means that the defendant ‘recklessly disregarded’ the possibility . . . [of] infringement.”).

\(^{88}\) *Seagate*, 497 F.3d at 1371.

\(^{89}\) *Id.*

\(^{90}\) *Id.*

\(^{91}\) *Id.*

\(^{92}\) *Id.*

\(^{93}\) *Id.*

\(^{94}\) *Id.*

\(^{95}\) *Id.* at 1373.
and opinion counsel serve distinctly different purposes. Thus, since communications of trial counsel have little relevance in light of the new willfulness doctrine, the court held that this risk of a waiver acting as both sword and shield no longer exists. Accordingly, the court generally held that waiver of the attorney-client privilege for opinion counsel does not constitute a waiver of trial counsel, but left final discretion to the trial courts. Following a similar line of reasoning, the court further held that waiver of work product as a result of relying upon opinion counsel does not extend to the work product of trial counsel.

The Seagate decision seems clear on its face with regard to the use of opinions of counsel. There are three initial conclusions. First, the burden of proving willfulness has been shifted onto the accuser. This might reasonably relieve at least some of the pressure upon accused infringers to utilize an opinion of counsel as a defense to willfulness. The catch-22 situation in which defendants had often found themselves would thus be removed. Secondly, the Seagate court specifically emphasized that there is no affirmative obligation to obtain opinion of counsel. And finally, entering a competent opinion of counsel into evidence as a defense should act as a safe harbor with regard to willfulness since it refutes knowledge of infringement.

Seagate’s new standard for willful infringement can be framed into the objective prong of whether there existed high likelihood of infringement, and the subjective prong of whether the infringer knew, or should have known they were infringing. Since opinion letters are an assessment of the risk of infringement upon an asserted patent, their relevance is tied to the second, subjective prong of the new willfulness standard. An opinion letter serves as evidence of what the accused infringer knew or should have known. Thus, an opinion of counsel declaring non-infringement or invalidity refutes knowledge of any objectively high likelihood of infringement. Further, since

96. Id. at 1372.
97. Id.
98. Id. at 1371.
99. Id. at 1374.
100. Id. at 1371.
101. Id.
102. Id. (“to establish willful infringement, a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent.”). Thus, a favorable opinion letter would refute the objectively high likelihood that an accused infringer’s actions constituted infringement.
103. Id.
104. Id. at 1373 (explaining that opinion counsel serves to provide an objective assessment for making informed business decisions).
Seagate removed the Underwater Devices duty of care, an act satisfying the former, and stricter, duty of care should serve as a greater defense under the Seagate standard.

This safe harbor was demonstrated in Finisar Corp. v. DirecTV Group, Inc. DirecTV was accused of willful infringement. While they had commissioned a non-infringement opinion, the district court held that DirecTV willfully infringed, partly because DirecTV had not obtained an invalidity opinion. However, the Federal Circuit reversed the ruling of the district court, and held that a competent opinion of counsel of either form would enable a conclusion that the accused infringer did not act willfully.

While the three initial conclusions remain true, analysis of the case law proceeding Seagate shows that many unanswered questions remain. The question most pertinent to opinion letters is demonstrated by the converse of the third conclusion: while having an opinion of counsel should act as a safe harbor to the subjective prong of the new willfulness standard, should lack of an opinion letter have an impact upon the assessment of willfulness? Since a jury determines the second, subjective prong of the Seagate standard, the question thus becomes whether it is appropriate for a jury to consider the lack of an opinion of counsel in determining willfulness.

### III. A JURY SHOULD NOT CONSIDER THE LACK OF AN OPINION LETTER UNDER THE TOTALITY OF THE CIRCUMSTANCES

Historically, a jury decides willfulness. A reasonable reader of the Seagate decision would conclude that the court intended to remove any negative impacts associated with the lack of an opinion letter, as evidenced by its express removal of any duty to obtain one. Thus, a jury should not be permitted to consider the lack of an opinion of counsel when deciding willfulness.

105. Id. at 1371.
107. Id. at 1326.
108. Id. at 1339.
109. Id.
110. Seagate did not discuss the role of the jury with respect to finding willfulness, or whether the objectively-defined risk is a question of law or fact. Donald S. Chisum, Donald S. Chisum on Willful infringement, Objective Recklessness and the Trial Attorney-Client Privilege, 2008 Emerging Issues 527, Sept. 27, 2007, at 4.
111. Id.
However, the issue has generated controversy because plaintiffs have an interest in allowing a jury to consider the lack of an opinion of counsel in considering willfulness. If a jury were permitted to consider the lack of an opinion, plaintiff's counsel would undoubtedly argue that such an omission implies bad faith. The plaintiff's counsel may suggest to the jury that lack of an opinion letter suggests either intentional ignorance, or a negative opinion. Even if an accused infringer possessed a favorable opinion letter but chose not to utilize it, opposing counsel is still able to imply to the jury that defendants either do not possess an opinion letter, or that it is unfavorable. Plaintiff's counsel can easily ask the jury: if they had a favorable opinion letter, don’t you think they would have shown it to you? This line of argument to the jury, coupled with permission for the jury to consider lack of an opinion of counsel in deciding willfulness, may result in a de facto existence of the adverse inference standard from Kloster Speedsteel AB. Even though a jury cannot be instructed to draw an adverse inference, under this scenario a jury is nonetheless likely to draw one on its own.112

A. THE READ FACTORS IN POST-SEAGATE DISTRICT COURT CASES

After Underwater Devices, subsequent case law evolved a “totality of the circumstances” approach containing several enumerated factors for determining willfulness.113 In arguing that the jury ought to consider lack of an opinion of counsel in deciding willfulness, plaintiffs relied upon factors identified in Read Corp. v. Portec, Inc.,114 developed under the old willfulness standard.115 The Read court identified nine factors to be considered when

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112. See McKesson Info. Solutions, Inc. v. Bridge Med., Inc., 434 F. Supp. 2d 810, 812 (E.D. Cal. 2006) (“It is inescapable that the jury would likely conclude that [defendant] received an unfavorable opinion, otherwise [defendant] would reveal it. This is precisely the negative inference [Knorr] prohibits.”).

113. The “totality of the circumstances” are embodied in the Read factors. Donald Chisum explains:

On the standard for willful infringement, Underwater Devices announced the affirmative duty-of-care standard soon after the Federal Circuit's creation. At that time (that is, circa 1983), there was “widespread disregard of patent rights,” which undermined the “national innovation incentive.” Decisions evolved a “totality of the circumstances” approach and listed pertinent factors . . . . The court noted: “Over time, our cases evolved to evaluate willfulness and its duty of due care under the totality of the circumstances, and we enumerated factors informing the inquiry. E.g., Read Corp. v. Portec, Inc., 970 F.2d 816, 826–27 (Fed. Cir. 1992).”


determining whether the bad faith of an infringer merits enhanced damages, commonly referred to as the “\textit{Read} factors.”\textsuperscript{116} The second factor listed by the court is “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.”\textsuperscript{117}

Decisions after \textit{Seagate} have been split as to whether the totality of the circumstances test applying the \textit{Read} factors remains applicable. This, in turn, has had direct bearing upon whether courts have found it appropriate for a jury to consider the lack of an opinion of counsel with regard to willfulness.\textsuperscript{118} However, closer analysis reveals that the second \textit{Read} factor is no longer applicable given that \textit{Seagate} overruled assumptions upon which the second \textit{Read} factor relied. District court holdings have fallen across the entire spectrum with regard to whether a jury may consider the lack of an opinion of counsel under the totality of the circumstances.

In \textit{Philips v. KXD Technology}, the district court relied upon the totality of the circumstances test when issuing default judgment against the defendants.\textsuperscript{119} While this case did not specifically address whether it was appropriate for a jury to take into consideration the lack of an opinion of counsel, the federal rules for default judgment require that the truth of the allegations be established by evidence.\textsuperscript{120} Philips alleged willful infringement in the complaint.\textsuperscript{121} To support willfulness, one of the pieces of evidence the court considered was that none of the defendants had sought or obtained an

\textsuperscript{116.} \textit{Read Corp.}, 970 F.2d at 826–27. For a full listing of the read factors, see supra note 16.

\textsuperscript{117.} \textit{Id.} at 827.

\textsuperscript{118.} \textit{See Rhino Assocs., L.P. v. Berg Mfg. & Sales Corp.}, 531 F. Supp. 2d 652, 658 (M.D. Pa. 2007) (“To determine whether an infringement is willful . . . the court must look at the totality of the circumstances.”); \textit{see also Depomed, Inc. v. Ivax Corp.}, 532 F. Supp. 2d 1170, 1177 (N.D. Cal. 2007) (“It is unsettled whether the Federal Circuit’s prior ‘totality of the circumstances’ test is now abrogated, or whether the factors identified in \textit{Read Corp} . . . remain relevant to the willfulness inquiry.”). Furthermore, the totality of the circumstances analysis has at times led to a favorable outcome for an accused infringer. \textit{See Trading Techs. Int’l v. eSpeed, Inc.}, No. 04 C 5312 (N.D. Ill. Jan. 3, 2008) 2008 WL 63233 (holding that \textit{Seagate} did not alter the requirement for the totality of the circumstances to be taken into account to determine willfulness, and finding that the plaintiff did not meet its burden in demonstrating the willfulness test under \textit{Seagate}).


\textsuperscript{120.} Fed. R. Civ. P. 55(b)(2).

\textsuperscript{121.} Order, supra note 119, at *2.
opinion of counsel regarding Philips' patents. Thus, as the finder of fact in a default judgment action, the Philips court determined that the totality of the circumstances test applied, and that lack of an opinion of counsel may be considered as evidence of willful infringement.

The court in Energy Transportation v. Demant directly considered whether a jury may be informed by a plaintiff of the lack of an opinion of counsel by the defendant. The defendants relied upon the change in willfulness standard in Seagate, and argued that the new standard for willfulness meant that a jury could not be allowed to consider the lack of an opinion of counsel. They suggested that the change from the affirmative duty of care to an objective recklessness standard, informs the totality of the circumstances standard such that the jury cannot consider lack of an opinion of counsel. The court disagreed with this argument and denied the request by defendants to preclude lack of an opinion of counsel from the willfulness evidence allowable for consideration by the jury. The court concluded that nothing in Seagate forbids a jury to consider lack of an opinion of counsel as part of the totality of the circumstances in determining willfulness.

The court in Lucent Tech. v. Gateway never reached the issue of whether a jury may consider the lack of an opinion of counsel. However, when the

122. Id.
123. While the plaintiff provided the evidence evaluated by the court, in a default judgment action the court decides whether the truth of the allegation is established by evidence, and thus decides the appropriateness of any evidence brought before it.
125. Id.
126. Id.
127. Id.
128. Id.
129. Id. Note that SEB, S.A. v. Montgomery Ward utilized the same rationality as Energy Devices, but operated under the guidance of Knorr-Bremse. Montgomery Ward moved for a new trial based upon improper arguments by SEB's counsel at closing arguments. SEB argued to the jury that Montgomery Ward's failure to seek and obtain an opinion of counsel is evidence of willful infringement. The court initially held that nothing in Knorr-Bremse forbids a jury to consider the lack of an opinion of counsel in considering willfulness under the totality of the circumstances. SEB, S.A. v. Montgomery Ward, No. 99 Civ. 9284 (S.D.N.Y. Oct. 9, 2007) 2007 WL 3165783. The Montgomery Ward court did not consider the impact of Seagate upon the totality of circumstances test in issuance of that order. Upon reconsideration, the Montgomery Ward court held that the jury was not properly instructed under the new Seagate standard and vacated the enhanced damages amount. However, the Montgomery Ward court did not directly comment upon whether it would be appropriate for the jury to consider the lack of an opinion letter under Seagate. SEB, S.A. v. Montgomery Ward, No. 99 Civ. 9284 (S.D.N.Y. Oct. 1, 2008) 2008 WL 4340416.
Gateway court granted summary judgment it commented upon the new willful infringement standard under Seagate.\footnote{Id. at *11.} In its discussion, the Gateway court declared that the Seagate court did not intend to jettison the approach of evaluating the totality of the circumstances.\footnote{Id.} But the Gateway court took a view that is favorable to an accused infringer with regard to the totality of circumstances test.\footnote{Id.} In considering the new Seagate standard, the court acknowledged that Seagate abandoned the affirmative obligation to seek an opinion of counsel, but went on to state that the advice of counsel may “remain relevant, at least as a defense to willfulness.”\footnote{Id. at *2.} Thus, the court supported the notion that having an opinion of counsel may serve to help an accused infringer, but the absence of one should not harm the defendant.

In contrast with the holdings of Philips and Energy Transportation, some district courts have held that under the new standard of Seagate, a jury cannot be allowed to consider lack of an opinion of counsel in determining willfulness. In Memry Corp. v. Kentucky Oil,\footnote{Order on Motions in Limine, Memry Corp. v. Kentucky Oil Tech., No. C-04-03843 (N.D. Cal. Nov. 27, 2007) 2007 WL 4208317.} the defendant filed a motion in limine to exclude evidence regarding opinions of counsel.\footnote{Id. at *1.} The court granted this motion and stated that since none of the parties were relying upon an advice of counsel defense, “no party should be allowed to ask whether any other party sought or obtained legal advice regarding issues in this case.”\footnote{Id. at *9.}

The Federal Circuit affirmed this sentiment in Dell USA v. Lucent.\footnote{Dell USA L.P. v. Lucent Techs., 464 F. Supp. 2d 620 (E.D. Tex 2006).} Lucent filed a motion in limine to preclude mention of Lucent’s lack of an opinion of counsel in trial.\footnote{Lucent’s Motion in Limine No. 6 to Preclude Dell from Mentioning Lucent’s Decision Not to Rely on Opinion of Counsel in Defense of Dell’s Willful Infringement Allegations, Dell USA v. Lucent Tech. Inc., No. 4:03cv347 (E.D. Tex. Nov. 16, 2007) 2007 WL 5272290.} They argued that since Seagate abandoned the affirmative duty of due care, a defendant’s decision not to obtain an opinion of counsel is no longer relevant to willfulness, and is thus inadmissible at trial.\footnote{Id. at *2.} In its motion, Lucent expressed concern that discussion by Dell regarding Lucent’s decision not to obtain advice of counsel would unduly prejudice the jury.\footnote{Id. at *3.}
Dell’s response to this motion argued that *Seagate* never adopted a per se rule that made failure to obtain an opinion of counsel irrelevant to willfulness. With regard to the new *Seagate* standard for willfulness, the plaintiff argued that the lack of an opinion of counsel is relevant to the second prong of the *Seagate* test. Dell further suggested that any risk of confusing the jury can be mitigated through proper instructions regarding willfulness. The court adopted a firm stance on the matter and stated that since *Seagate* established an objective test for willfulness, whether or not a defendant obtained an opinion of counsel had become irrelevant to willfulness. Moreover, since failure to obtain an opinion of counsel is irrelevant to the willfulness inquiry, it would be inadmissible at trial.

### B. *SEAGATE* INVALIDATES THE *READ* FACTORS

With district court rulings on both ends of the spectrum, further analysis regarding the post-*Seagate* validity of the second *Read* factor is warranted. The *Read* factors enforced the old willfulness standard. The language of the second *Read* factor, whether the accused infringer investigated the scope of the patent and formed a good faith belief that it was invalid or not infringed, implies the existence of an affirmative duty, which existed under case law at the time. 

The authority for the second *Read* factor originated in *Lam v. Johns*. *Lam* asked whether possession of an opinion of counsel was enough to exculpate a party from willfulness. The *Lam* court took existence of the opinion letter for granted and instead focused upon the opinion letter’s sufficiency and the bad faith behavior surrounding it. The court never considered the issue from a perspective in which no affirmative obligation to obtain opinion of counsel exists. Thus, in creating what eventually became the second *Read* factor, the lack of an opinion of counsel was not within the court’s purview.
Rather, it assumed the existence of an opinion letter and created the factor to ask whether or not the opinion letter alone may suffice as a defense. Further, the Read court’s discussion of the factors regarded the enhancement of damages and not a finding of willfulness by a jury. This is shown by the Read court’s statement that “a finding of willful infringement does not mandate enhancement of damages, the . . . factors taken together assist the trial court in . . . determining whether to exercise its discretion to award enhanced damages and how much the damages should be increased.” This creates another disjunction in using the totality of circumstances as justification for a jury to consider the lack of an opinion of counsel with regard to willfulness.

The second Read factor was applicable under the prior willfulness standard because the existence of an opinion of counsel was expected. Since Seagate removed the affirmative duty of due care that made opinions of counsel mandatory, it is reasonable to conclude that Seagate has, at the very least, altered the totality of the circumstances test.

C. THE COHESIVE FACTORS

Another application of the Seagate standard was carried out in Cohesive Technologies Inc. v. Waters Corp. As was done with the Read factors, courts have made questionable use of the factors outlined by Cohesive to allow a jury to consider the lack of an opinion of counsel in determining willfulness. The Cohesive court began its analysis of willful infringement by citing Seagate’s language. The court then proceeded to outline a six-factor test to be considered in determining willful infringement:

1. whether there was a bona fide disagreement regarding patent invalidity or infringement,
2. whether the infringer solicited or followed the advice of counsel,
3. whether there was continued infringement after notice of probable infringement was received,
4. whether there was a degree of similarity between the patented and accused devices,
5. whether the infringer took efforts to avoid infringement, and
6. whether the infringer was indemnified against infringement costs.

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154. Id. at 828.
156. Id. at 103–04.
The *Cohesive* court did not cite any authority for these factors. In applying this test, the court found that the defendant had obtained an opinion of counsel in good faith, and that there existed a bona fide disagreement over the infringement of plaintiff's patents. Thus, the plaintiff was unable to prove willful infringement by clear and convincing evidence.

Whereas the court in *Cohesive* applied the test as a matter of law, in *Creative Internet Advertising Corp. v. Yahoo! Inc.*, the same six factors were incorporated into the jury instructions as factors to be considered under the totality of the circumstances. One of the factors listed was “whether or not [defendant] sought or followed advice of counsel.” The defendant, Yahoo!, did not obtain a formal opinion of counsel. The jury found that the plaintiff's patent was willfully infringed. Yahoo! filed a motion for judgment as a matter of law arguing that the plaintiff had failed to meet its burden of proving willfulness. The *Yahoo!* court denied the motion. It began by citing the *Cohesive* factors. After reviewing evidence pertinent to these factors, the *Yahoo!* court found that the jury could have reasonably arrived at conclusions supporting willful infringement. The first of the five conclusions listed was that Yahoo! did not solicit advice of counsel. Based upon these conclusions, the court decided that the jury could have reasonably found that Yahoo’s behavior satisfied the objectively reckless *Seagate* standard.

The *Cohesive* factors improperly authorize a jury to consider a lack of an opinion of counsel in deciding willfulness. Unlike the *Read* factors, the *Cohesive* factors were created post-*Seagate*. Incorporation of these factors into jury instructions clearly allows a jury to consider the lack of an opinion of counsel. However, the soundness of this practice rests upon shaky ground. The test’s validity is questionable at best since the *Cohesive* court made no

157. *Id.*
158. *Id.* at 104.
159. *Id.* at 103.
162. *Id.*
164. *Id.* at *1.
165. *Id.*
166. *Id.* at *2.
167. *Id.* at *4.
168. *Id.*
169. *Id.*
attempt to link the factors with any authority, let alone the *Seagate* decision. Also, the *Cohesive* court’s intended application of the second factor is difficult to discern. In *Cohesive*, the court applied that factor favorably on behalf of the defendant. Such an application is equivalent to the safe harbor discussed, *supra*, and is clearly consistent with the holding of *Seagate*. How the court would have applied this factor had there been a lack of an opinion letter, or if any consideration were even given to this matter, is unknown.

In August, 2009, the defendants filed an appeal to the *Yahoo!* decision. The Federal Circuit’s analysis will reach the validity of the *Cohesive* factors only if it is found that the plaintiffs met their burden regarding the objective prong of the *Seagate* standard. It is likely that a court would find the *Cohesive* factors to be invalid given both the lack of any authority for the factors and *Seagate’s* clear stance against any obligation to procure an opinion of counsel.

D. INDIRECT INFRINGEMENT

While the Federal Circuit has not yet directly addressed the issue of whether it is appropriate for a jury to consider the lack of an opinion letter in finding willfulness, it has approached the topic tangentially in an issue regarding induced infringement. In *Broadcom v. Qualcomm*, the Federal Circuit addressed Qualcomm’s concern that it was improper for the jury to consider the lack of an opinion of counsel in determining indirect infringement. The jury instruction stated that, “in the totality of the circumstances, you may consider all of the circumstances, including whether or not Qualcomm obtained the advice of a competent lawyer.” Relying upon *Seagate’s* elimination of the affirmative duty of due care, Qualcomm argued that this new standard impacted the test for establishing the intent element of inducement, making opinions of counsel irrelevant in such a context. *Broadcom* addressed the new willfulness standard by distinguishing *Seagate*, since the decision neither specifically addressed whether lack of an opinion letter was admissible as evidence, nor whether the intent standard for inducement had changed.

The *Broadcom* court held that *Seagate* did not alter the state of mind requirement for inducement. Broadcom encouraged the court to rely upon the specific intent standard adopted by *DSU Medical Corporation v. JMS Corporation*, which governs the intent standard for inducement of

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173. *Id.* at 698.
174. *Id.* at 698–99.
175. *Id.*
176. *Id.*
infringement, and allows specific intent to be proven by circumstantial evidence.\footnote{177} In its analysis, the court drew upon case law directly applicable to specific intent of inducement, and concluded that it was proper for the jury to consider all of the circumstances, including the lack of an opinion letter, in determining Qualcomm’s intent to induce infringement.\footnote{179} The court declared that the opinion of counsel remains relevant to whether the defendant knew or should have known that their actions would cause direct infringement of the patent.\footnote{180}

\textit{Broadcom} dealt with indirect infringement, and thus did not directly address the question of whether it is proper for a jury to consider the failure of an accused infringer to obtain opinion of counsel in a willful infringement case.\footnote{181} However, \textit{Broadcom} provided a chance for the Federal Circuit to provide guidance on the subject and its silence could indicate hesitation to alter the standard of considering the totality of circumstances.

The \textit{Broadcom} decision is at odds with the new willfulness standard of \textit{Seagate}. In arriving at its conclusion that \textit{Seagate} did not change the state of mind requirement for inducement, the \textit{Broadcom} court states, “it would be manifestly unfair to allow opinion-of-counsel evidence to serve an exculpatory function . . . and yet not permit patentees to identify failures to procure such advice as circumstantial evidence of intent to infringe.”\footnote{182} The court essentially stated that if an opinion of counsel could exonerate an accused infringer, then the opposite must also be true. That is, lack of an opinion letter should incriminate the accused infringer. This goes directly against the holding and intent behind \textit{Seagate}. The court in \textit{Seagate} specifically emphasized that there is no affirmative obligation to obtain opinion of counsel.\footnote{183} \textit{Seagate} removed the affirmative duty of due care that mandated seeking an opinion of counsel, and this decision is contradicted by the \textit{Broadcom} court’s rationale that lack of an opinion letter should carry a negative impact.

\footnote{177} DSU Med. Corp. v. JMS Co., 471 F.3d 1293 (Fed. Cir. 2006) (en banc). Prior to \textit{DSU}, there were two lines of cases which took different approaches to the level of intent required for inducement. One line of cases followed the general intent standard of \textit{Hewlett-Packard Co. v. Bausch & Lomb Inc.}, 909 F.2d 1464 (Fed. Cir. 1990). The other line of cases followed the specific intent standard of \textit{Manville Sales Corp v. Paramount Systems, Inc.}, 917 F.2d 544 (Fed. Cir. 1990). In \textit{DSU}, the Federal Circuit decided en banc to adopt the \textit{Manville} test of specific intent.
\footnote{178} \textit{Broadcom}, 543 F.3d at 699.
\footnote{179} \textit{Id}.
\footnote{180} \textit{Id}. at 699–700.
\footnote{181} \textit{Id} at 699.
\footnote{182} \textit{Id}.
\footnote{183} \textit{In re Seagate}, 497 F.3d 1360, 1371 (Fed. Cir. 2007) (en banc).
While it is true that Broadcom relied upon DSU rather than Seagate, in its analysis it ignored the similarity between the second prong of the DSU test and the second prong of the Seagate test. Specifically, the Broadcom court relied upon this language of DSU: defendant “[kn]ew or should have known [that] its action would cause the direct infringement.” 184 Similarly, Seagate’s second prong states: “risk was either known or so obvious that it should have been known to the accused infringer.” 185 The Broadcom court attempted to separate its decision from Seagate by drawing a hairline divide between intent and willfulness. While the Broadcom court set aside the Seagate decision by holding that it did not change the standard of intent for inducement, they relied upon language very analogous to that of Seagate in order to justify a contradictory holding.

The situation that Broadcom creates is counterintuitive in practical terms. For example, if company A receives an assertion letter, under Seagate there is no need to get an opinion of counsel. However, if company A’s customer, company B, receives an assertion letter for a product that uses company A’s product, then suddenly company A must seek an opinion of counsel for fear of a de facto adverse inference on the part of a jury in an inducement claim under Broadcom. The notion of having to seek an opinion of counsel regarding another entity’s activities is very disconcerting.

IV. DISCUSSION

Though the en banc Federal Circuit did not directly state its concern, the court was reasonably aware of the unease and cynicism throughout the patent profession regarding sham opinions of counsel. In the Seagate decision, the court placed strong emphasis upon the value of the attorney-client privilege as the “oldest of the privileges for confidential communications known to the common law.” 186 The court further stated that the guidance for its analysis was “to encourage full and frank communications between attorneys and their clients.” 187 Taken in light of this context, it may be inferred that one of the court’s motivations for emphasizing that the affirmative obligation to obtain opinion of counsel was eliminated relates to the attorney-client privilege. That is, the court recognized that the old standard of willfulness created a gap in the attorney-client privilege, where clients were not receiving proper advice. Because counsel knew that the

184. Broadcom, 543 F.3d at 699.
185. Seagate, 497 F.3d at 1371.
186. Id. at 1372.
187. Id. (quoting Upjohn Co. v. United States, 449 U.S. 383 (1981)).
opinion letter was to be used as evidence, these letters would logically conclude in favor of the client; otherwise, they would prove to be worthless. Furthermore, counsel would speak to the client in code, for fear of the waiver of attorney-client privilege. *Seagate* recognized this issue and took a drastic step toward restoring this gap in the attorney-client privilege. By removing the negative impacts of obtaining an honest opinion letter, the *Seagate* decision effectively restored the purpose of an opinion of counsel: to provide useful and candid advice.

Progress toward this goal has been hindered by confusion at the district court level regarding whether it is appropriate for a jury to consider the lack of an opinion of counsel. It has been impeded to an even higher degree by the holding in *Broadcom*. The Federal Circuit has almost brought the practical use of an opinion letter full circle. After *Broadcom*, complainants can easily add a boilerplate indirect infringement claim in their complaint to make the lack of an opinion letter relevant to the jury’s consideration. This returns us to the pre-*Seagate* situation, where a defendant is forced to choose between maintaining privilege for defense against infringement, and waiving privilege to defend against intent of inducement. While *Seagate*’s holding at least protects the privilege of trial counsel from being waived, counsel is once again incentivized to produce whitewash opinions. Indeed, though not dispositive, a recent survey indicated that a majority of those polled have seen no change with regard to opinions of counsel since *Seagate*.188 If the *Broadcom* ruling had been consistent with the holding of *Seagate*, there would have been potential to see the return of opinion letters providing sound, candid advice to clients.

Outside of case law, potential solutions to the confusion surrounding whether a jury should be allowed to consider the lack of an opinion of counsel are found in model jury instructions and patent reform initiatives. The Northern District of California issued new model jury instructions on willful infringement.189 It provides an optional instruction allowing a jury to consider an opinion of counsel in assessing an alleged infringer’s reckless disregard, but only if the alleged infringer relies upon the opinion of counsel.190 In effect, this model jury instruction embodies the spirit of the

188. The survey results reported 58% seeing no change, 22% seeing formal opinions being replaced with informal opinions, 15% seeing fewer opinions, and 5% seeing more opinions. Wolf, supra note 67.


190. *Id.*
Seagate decision. An opinion of counsel entered into evidence by an accused infringer may serve to act as a safe harbor with regard to the second, subjective prong of the Seagate standard. Lack of an opinion letter is irrelevant to the determination of willfulness, and may not be considered by the jury in determining willfulness.

The Northern District of California model jury instructions are not unique in its treatment of willful infringement. The American Intellectual Property Law Association also included a similar clause within the 2008 update to its model jury instructions. However, the jury instructions commissioned by Federal Circuit Chief Judge Michel do not include any treatment of opinions of counsel with regard to willfulness. While the Federal Circuit has not yet officially endorsed these instructions, they are likely to provide ammunition for plaintiffs in the form of proposed jury instructions.

The Patent Reform Act of 2009 has been recommended by the Senate Committee on the Judiciary for consideration upon the Senate floor. The bill would amend the standard for willfulness according to the Seagate decision. Furthermore, it would create limitations on willfulness in favor of accused infringers. Under the proposed amendment, an accused infringer may not be found willful if they reasonably relied upon advice of counsel. Moreover, the amended statute would dictate that lack of an opinion of counsel is irrelevant to a determination of willful infringement. Thus, the Patent Reform Act aims to implement the same policy that is established by the model jury instructions of the Northern District of California, where an opinion of counsel serves as a safe harbor to willfulness, but lack of one cannot be allowed to generate any kind of negative inference.

While statutory reform garnered by the Patent Reform Act would be the most authoritative method of implementing Seagate’s stand on opinions of counsel, such legislation is unlikely to occur quickly, if at all. Thus, the most effective means for adopting a policy with regard to a jury’s consideration of

191. Id.
192. Id.
196. Id. at § 284(e)(3).
197. Id. at § 284(e)(3)(B).
198. Id. at § 284(e)(3)(C).
lack of an opinion of counsel that is consistent with Seagate would be adoption of model jury instructions similar to that of the Northern District of California.

V. CONCLUSION

District court decisions have evidenced confusion on whether a jury may consider the lack of an opinion of counsel post-Seagate. Thus, an environment where opinion letters are viewed as necessary to defend against willfulness remains. Consequentially, white-wash opinions still permeate the patent industry. The Seagate court had a worthy goal of re-establishing the credibility and utility of an opinion of counsel. Broadcom, however, has hindered progress toward Seagate’s goal because of its reliance upon DSU. As an en banc decision, Seagate should carry significantly more weight in guiding the district courts. The simplest, most direct route to implementing the intent behind the Seagate opinion is widespread adoption of the Northern District of California model jury instructions, which embody the policy underlying Seagate.
FORUM SHOPPING AND VENUE TRANSFER IN PATENT CASES: MARSHALL’S RESPONSE TO TS TECH AND GENENTECH

Elizabeth P. Offen-Brown

Patents play an ever more integral role in today’s economy, resulting in an increase in patent infringement suits and declaratory judgment actions as patent holders fight to enforce their rights. Nationally, over 2500 patent infringement lawsuits were filed per year in 2006, 2007, 2008, and 2009.

Patents provide value to their holders in varying contexts. Start-ups and established corporations use patents for a variety of purposes, including securing venture capital funding, solidifying a position in the marketplace, and maintaining a monopoly on innovation. Moreover, both practicing and non-practicing patent owners enforce their exclusive rights via licensing and litigation. As companies look to secure market share through their patent portfolios and non-practicing entities strive to maintain control over their patents for strategic purposes, the legal world has witnessed a corresponding increase in patent litigation.

The resulting lawsuits can have enormous economic consequences for alleged infringers. An expensive and time-intensive patent infringement suit can put a company out of business with legal fees, block its key products from the marketplace, or harm its national reputation.

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2. See ROBERT P. MERGES & JOHN F. DUFFY, PATENT LAW AND POLICY: CASES AND MATERIALS 11 (4th ed. 2007) (“Since the creation of the Federal Circuit [in 1982], patents have been held valid more frequently . . . . It is also much easier to get an injunction against an infringer. And money damages have soared too . . . .”).


4. Graham et al., supra note 1, at 1299 fig.2 (reporting startups’ motivations for patenting).

Because of the high stakes on both sides, every element of a patent infringement suit (or declaratory judgment action) is critical to the outcome. This includes the choice of forum by plaintiffs, which has long been recognized as important in patent infringement actions. As plaintiffs strive to choose the forum most favorable to their case, several federal district courts have become patent litigation “hotbeds.” Some emerged because of their reputation as “rocket dockets,” and the most notable hotbed, due to a variety of factors, explained infra, is the Eastern District of Texas.

Until recently, defendants in the Eastern District of Texas had a very hard time transferring out of the district, but three recent appellate decisions (one Fifth Circuit and two Federal Circuit) clarified the standard governing whether to transfer venue out of that district under 28 U.S.C. § 1404(a). These appellate decisions granted writs of mandamus to overturn transfer denials out of the Eastern District of Texas, holding that venue transfer should be granted only if, upon balancing the forum non conveniens factors, the transferee venue is “clearly more convenient.” The Eastern District of Texas has since transferred more cases, aligning its analysis with the circuit court decisions. The Federal Circuit has granted additional writs of mandamus to overturn transfer denials, adding to the precedential weight of the Fifth Circuit and Federal Circuit courts’ decisions.

This Note discusses the ramifications of the recent appellate decisions overturning denials of transfer out of the Eastern District of Texas. Part I sets forth the legal background for personal jurisdiction, venue, and transfer

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7. See infra Table 1 (listing the ten most popular patent litigation districts).

8. See, e.g., Gina Carter, “Rocket Docket” Speeds Patent Infringement Suits, WIS. TECH. NETWORK NEWS, Mar. 14, 2007, http://wistechnology.com/articles/3771/ (“In the world of IP litigation, lawsuits generally take years. Lawsuits launched from Madison’s rocket docket progress at light speed by comparison, often settling in a few months or going to trial within about a year.”).


10. In re Genentech, 566 F.3d 1338 (Fed. Cir. 2009); In re TS Tech USA, Corp., 551 F.3d 1315 (Fed. Cir. 2008); In re Volkswagen of Am., Inc. (Volkswagen I), 545 F.3d 304 (5th Cir. 2008).

11. E.g., Volkswagen I, 545 F.3d at 315; see also infra Section II.A.

12. See infra Part III.

13. See, e.g., In re Nintendo Co., 589 F.3d 1194 (Fed. Cir. 2009); In re Hoffmann-La Roche, Inc., 587 F.3d 1333 (Fed. Cir. 2009); see also infra Section II.B.
requirements in federal courts, discusses the general concept of forum shopping, and explores the Eastern District of Texas’ status as a patent litigation hotbed. Part II analyzes recent appeals from the Eastern District of Texas and the resulting transfer standard that the transferee venue be “clearly more convenient.” Part III reviews the subsequent trends in venue decisions in the Eastern District of Texas, examines which factors have guided such decisions, and explores the tactics plaintiffs are developing to prevent transfer in light of the recent shift in case law. Finally, Part IV considers the venue provisions in pending patent reform proposals in light of the “clearly more convenient” transfer standard.

I. THE LAW AND PRACTICE OF FORUM SELECTION

Jurisdiction over major patent infringement actions can normally be established in almost any federal district court. A few jurisdictions have developed patent-specific “local rules,” generally desired by plaintiffs, and some have made their courtrooms more amenable to patent infringement plaintiffs, resulting in an increase in “forum shopping” for infringement suits. Until recently, it was very difficult for defendants to transfer cases out of these patentee friendly jurisdictions. But in 2008 the Federal Circuit issued a ruling, In re TS Tech USA, Corp., granting a writ of mandamus for venue transfer out of the Eastern District of Texas. This decision paved the way for defendants to transfer their cases to a more convenient forum. This Part summarizes the personal jurisdiction and venue requirements in federal courts, explains the venue transfer rules, introduces the concept of forum shopping between the federal district courts in patent cases, and focuses on Marshall, Texas within the Eastern District of Texas as the most prominent patent litigation venue.

A. ESTABLISHING JURISDICTION IN PATENT CASES

Federal subject matter jurisdiction over patent cases dates back to the Judiciary Act of 1789, and by statute lies exclusively in the federal courts.
This subject matter jurisdictional rule allows patent infringement actions to be brought in any federal district court, provided that both venue and personal jurisdiction requirements are met. Plaintiffs thus have considerable leeway in choice of forum because personal jurisdiction is almost always possible anywhere in the United States.

To establish personal jurisdiction over a defendant, the forum must be one with which the defendant has “certain minimum contacts with it such that the maintenance of the suit does not offend ‘traditional notions of fair play and substantial justice.’”19 This minimum contacts requirement can be met by “purposeful availment” by the defendant (such as selling products) in the forum jurisdiction.20 To decide if personal jurisdictional requirements are met, “[a] court must consider the burden on the defendant, the interests of the forum State, and the plaintiff’s interest in obtaining relief,”21 as well as overall judicial efficiency and “the shared interest of the several States in furthering fundamental substantive social policies.”22 Thus, when a defendant engages in commercial activities aimed towards a particular forum’s residents, she can be pulled into litigation there if her due process requirements are met.23 In most patent infringement actions, the jurisdictional requirement is easily met because any company trying to sell its products on the national stage will thus be subject to suit in most or all districts.

Once jurisdiction over the defendant is established, the venue statute for patent infringement actions, 28 U.S.C. § 1400(b), provides that: “Any civil action for patent infringement may be brought in the judicial district where the defendant resides, or where the defendant has committed acts of infringement and has a regular and established place of business.”24 The general venue statute, 28 U.S.C. § 1391(c) provides a more detailed definition of the term “reside,” defining a corporate defendant to “reside in any judicial

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20. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 475–76 (1985) (“Where the defendant ‘deliberately’ has engaged in significant activities within a State, or has created ‘continuing obligations’ between himself and residents of the forum, he manifestly has availed himself of the privilege of conducting business there, and because his activities are shielded by ‘the benefits and protections’ of the forum’s laws it is presumptively not unreasonable to require him to submit to the burdens of litigation in that forum as well.” (internal citations omitted)).
23. U.S. CONST. amend. XIV, § 1; Burger King, 471 U.S. at 475–76.
district in which it is subject to personal jurisdiction at the time the action is commenced.\textsuperscript{25} Though the patent venue statute was historically distinct from the more general venue provision,\textsuperscript{26} the Federal Circuit held in \textit{VE Holding Corp. v. Johnson Gas Appliance Co.} that the meaning of the term “resides” as defined in the patent statute should be interpreted in accordance with the general venue statute.\textsuperscript{27} The Federal Circuit thus interprets the jurisdiction and venue requirements in intellectual property disputes to meet the required “minimum contacts” test when an accused infringing product is placed into the “stream of commerce.”\textsuperscript{28} Thus, most large national corporations can be brought into patent infringement actions in almost any of the ninety-four different federal district courts, as defendant corporations are subject to patent infringement lawsuits anywhere that they are subject to personal jurisdiction.\textsuperscript{29}

\section*{B. Venue Transfer}

The American legal system provides plaintiffs the luxury of forum selection.\textsuperscript{30} This flexibility for plaintiffs, however, can pull defendants into jurisdictions that may be unfriendly or geographically inconvenient. The first-filed suit traditionally had preference in corresponding declaratory judgment actions (to render a patent invalid or not infringed) and patent infringement suits, because both fell under the venue transfer provision, explained, \textit{infra}.\textsuperscript{31} This changed in \textit{Micron Technology, Inc. v. Mosaid Technologies, Inc.}, when a declaratory judgment action was filed in the Northern District of California.

\begin{itemize}
\item \textsuperscript{25} 28 U.S.C. § 1391(c) (2006).
\item \textsuperscript{26} See 8 DONALD S. CHISUM, CHISUM ON PATENTS § 21.02 (2) (2009) (explaining that “[b]efore the 1988 Judicial Code amendments, the courts interpreted § 1400(b) as exclusive of all other statutory provisions on venue”).
\item \textsuperscript{27} VE Holding Corp. v. Johnson Gas Appliance Co., 917 F.2d 1574, 1578 (Fed. Cir. 1990) (holding that “[i]n its face, § 1391(c) clearly applies to § 1400(b), and thus redefines the meaning of the term ‘resides’ in that section”).
\item \textsuperscript{28} See, e.g., Beverly Hills Fan Co. v. Royal Sovereign Corp., 21 F.3d 1558, 1566 (Fed. Cir. 1994) (“[D]efendants, acting in consort, placed the accused fan in the stream of commerce, they knew the likely destination of the products, and their conduct and connections with the forum state were such that they should reasonably have anticipated being brought into court there.”).
\item \textsuperscript{29} Corporations are subject to personal jurisdiction anywhere they sell products to residents of a particular forum as this is “purposeful availment” of using the forum’s resources, and therefore could be pulled into litigation in that jurisdiction. See Asahi Metal Indus. Co. v. Super. Ct., 480 U.S. 102, 110 (1987).
\item \textsuperscript{30} Kevin M. Clermont & Theodore Eisenberg, \textit{Exorcising the Evil of Forum Shopping}, 80 CORNELL L. REV. 1507, 1509 (1995) (“The American way is to provide plaintiffs with a wide choice of venues.”).
\item \textsuperscript{31} Micron Tech., Inc. v. Mosaid Techs., Inc., 518 F.3d 897, 904 (Fed. Cir. 2008) (citing Genentech, Inc. v. Eli Lilly & Co., 998 F.2d 931, 937 (1993)).
\end{itemize}
one day prior to a corresponding patent infringement suit filing in the
Eastern District of Texas.\(^{32}\) The Federal Circuit held that the “first to file”
rule does not necessarily apply to declaratory judgment actions filed in
advance of a matching patent infringement suit, because the trial court must
apply the full § 1404(a) transfer analysis and “consider the real underlying
dispute.”\(^{33}\) The Federal Circuit aimed to “reduce the incentives for a race to
the courthouse because both parties will realize that the case will be heard or
transferred to the most convenient or suitable forum.”\(^{34}\)

The rules for transfer of venue are laid out in § 1404(a): “For the
convenience of parties and witnesses, in the interest of justice, a district
court may transfer any civil action to any other district or division where it
might have been brought.” The Supreme Court gave the federal district
courts broad discretion in § 1404(a) interpretation\(^{35}\) to carry out an
“individualized, case-by-case consideration of convenience and fairness.”\(^{36}\)
The burden of proof in demonstrating the need to transfer lies with the
party bringing the motion to transfer venue,\(^{37}\) but the standard of proof and
factors considered vary by jurisdiction.\(^{38}\)

In patent infringement actions, appellate review of transfer decisions is
rare because transfer orders are considered to be interlocutory orders and
thus not immediately appealable under 28 U.S.C. § 1291.\(^{39}\) Transfer decisions
can only be appealed after final judgment or, in the alternative, by
certification under 28 U.S.C. § 1292(b) or by petition for a writ of
mandamus.\(^{40}\) Due to the high-stakes nature of patent cases, parties seeking

\(^{32}\) Id. at 900.

\(^{33}\) Id. at 904. Recognizing the “new more lenient standard for declaratory judgment
jurisdiction,” the court still held that “the first-filed suit rule, for instance, will not always
yield the most convenient and suitable forum,” and must be considered in light of the
§ 1404(a) transfer determination. Id.

\(^{34}\) Id. at 905.


\(^{37}\) In re Genentech, 566 F.3d 1338, 1342 (Fed. Cir. 2009) (noting the defendant’s
“burden of demonstrating the need to transfer”); Chrysler Credit Corp. v. County Chrysler
Inc., 928 F.2d 1509, 1515 (10th Cir. 1991) (“The party moving to transfer a case pursuant to
§ 1404(a) bears the burden of establishing that the existing forum is inconvenient.”).

\(^{38}\) See Stowell R.R. Kelner, “A drift on an Uncharted Sea”: A Survey of Section 1404(a)
factors in the § 1404(a) analysis that the district courts weigh differently and inconsistently,
specifically in regards to “convenience of the parties, witness convenience, court or system
convenience, and the interest of justice”).

\(^{39}\) 15 CHARLES A. WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL
PRACTICE AND PROCEDURE § 3855 (3d ed. 2008).

\(^{40}\) Chrysler, 928 F.2d at 1517 n.7.
review of a transfer decision under § 1404(a) often file for writs of mandamus. A writ of mandamus may be used to “correct a patently erroneous denial of transfer pursuant to § 1404(a),” with the burden of proof lying on the party seeking the writ to demonstrate that it has a “clear and indisputable right” to issuance of the writ and that it has no other means of obtaining desired relief. Four cases in 2009 at the Federal Circuit applied the relevant Fifth Circuit precedent to grant writs of mandamus to transfer patent infringement actions out of the Eastern District of Texas.

C. FORUM SHOPPING IN PATENT CASES

Because patent infringement plaintiffs suing national corporations can bring suit in almost any district court, plaintiffs can “forum shop” in an attempt to locate the friendliest forum their specific claims. This forum choice can have a major impact on litigation proceedings. Choice of forum by one plaintiff often affects multiple defendants. In the past decade, there have been more than twice as many defendants as infringement suits, indicating that patentees are suing multiple defendants simultaneously. Historically, factors such as convenience to the parties, the reputation of local judges, and parties’ relationship with those judges were significant criteria in forum selection. A recent trend is moving away from the traditional factors to weigh heavily the following criteria: a court’s docket and speed to adjudication; the local judges’ and the overall jury pool’s familiarity with technology and patent cases; the local rules of the court; and the

41. In re Genentech, 566 F.3d 1338, 1341 (Fed. Cir. 2009).
42. Id. (quoting Allied Chem. Corp. v. Daiflon, Inc., 449 U.S. 33, 35 (1980)).
43. See infra Section II.A.1 (setting the Fifth Circuit standard for venue transfer in Volkswagen I).
44. See infra Part II (discussing the TS Tech, Genentech, Hoffmann-De LaRoche, and Nintendo decisions).
45. See supra Section II.A (explaining the jurisdictional requirements for patent cases).
46. Stewart Org., Inc. v. Ricoh Corp., 487 U.S. 22, 39–40 (1988) (Scalia, J., dissenting) (“Venue is often a vitally important matter, as is shown by the frequency with which parties contractually provide for and litigate the issue. Suit might well not be pursued, or might not be as successful, in a significantly less convenient forum.”). Forum shopping in patent litigation is critiqued by many commentators, whose critiques can be grouped into three theories: “(1) the normative evil theory; (2) the economic efficiency theory; and, (3) the harm to innovation incentive theory.” See, e.g., Kevin A. Meehan, Shopping for Expedient, Inexpensive & Predictable Patent Litigation, 2008 B.C. INTELL. PROP. & TECH. FORUM 102901, at *4–5 (2009) (discussing these three theories).
47. LEX MACHINA, STATISTICS, http://lexmachina.com/cases/statistics (showing that in 2006, 2007, and 2008 there were 2.41, 3.18, and 2.63 more defendants than lawsuits filed).
specific judges’ practice in relation to various patent-specific actions such as claim construction hearings and evidence allowed in construing claims.49

Though patent local rules originated in response to the complexity and uniqueness of patent litigation suits,50 many of the jurisdictions with “patent local rules” are now targeted by patent infringement plaintiffs. The concept of patent local rules originated in the Northern District of California in the 1990s when patent infringement actions were proliferating as a result of the growth of technological innovation in Silicon Valley.51 Facing recurring legal issues, the Northern District of California enacted local rules to regulate procedural aspects in patent cases ranging from complaint filing to claim construction hearings.52 For example, jury instructions in patent cases are not dictated by the Federal Circuit but instead mandated individually by each district court in accordance with their local rules.53 The amount of responsibility in fact-finding and legal analysis given to a jury as opposed to a judge can affect the outcome of a case as juries tend to express bias towards patentees.54 In their analysis of the various district courts’ differing patent local rules, James Ware, U.S. District Court Judge for the Northern District of California, and Brian Davy have summarized them to contain three elements:

(1) cooperation—parties are required to confer to develop a case schedule and to make joint submissions; (2) disclosure—parties are required to make timely disclosures of their legal contentions and provide supporting documentation; and (3) judicial management—the assigned judge becomes involved in the case early and may actively supervise the process leading up to the claim construction hearing.55

49. Id. at 899–901.
50. The first patent local rules in the Northern District of California were implemented to “enhance[] judicial management of patent-related cases” in the context of revising its local rules to prevent excess cost and delay. James Ware & Brian Davy, The History, Content, Application and Influence of the Northern District of California’s Patent Local Rules, 25 SANTA CLARA COMPUTER & HIGH TECH. L.J. 965, 979 (2009).
51. Id. at 966.
52. Id. at 967.
54. Id. at 127 (“Patent owners will likely opt for jury verdicts in order to take advantage of the pro-patentee bias. Defendants, conversely, will likely opt for the judge to determine the ultimate conclusion of nonobviousness.”).
55. Ware & Davy, supra note 50, at 967.
The Federal Circuit favorably evaluated the Northern District of California’s Patent Local Rules in all four appeals in which they arose. The Northern District of California’s rules have also been used as a model by a number of other districts, including the Eastern District of Texas. The rules within each district have minor procedural differences that can have varying consequences on litigation proceedings. More district courts nationwide with an interest in attracting patent cases are passing their own local rules to increase patent case management efficiency. This may lure potential patentee plaintiffs seeking timely adjudication to bring litigation in those districts.

The Eastern District of Texas has been the most widely publicized patent infringement forum due to its plaintiff-friendly juries, patent-experienced judges, and local patent rules compelling open discovery with tight deadlines. Though the Eastern District of Virginia was viewed by commentators as “the rocket-docket patent litigation district” in the 1990s, its patent case numbers decreased drastically when the Eastern District of Texas became a patent litigation hotbed. Table 1 illustrates the Eastern District of Texas’ steep climb in filing rates in the past decade from thirty-one suits filed in 2002 to 368 suits filed in 2007. This leveled off in 2008 before a small dip in 2009.

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56. Id. at 1008–11 (describing in detail the four relevant Federal Circuit decisions).
58. See generally Ware & Davy, supra note 50, at 1019–31 (summarizing the differences between the various jurisdictions’ local patent rules).
60. Leychikis, supra note 9, at 206–07.
62. In the two years prior (2000 and 2001), there were twenty-five and thirty-four patent litigation suits filed in the Eastern District of Texas, respectively. LEX MACHINA, COURTS (SHOWING PATENT CASES), http://lexmachina.com/courts?filter=Patent.
Table 1: Top Patent Litigation Districts for Patent Infringement Suits Filed 2000–2009

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<td>166</td>
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<td>300</td>
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<td>144</td>
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<td>70</td>
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<td>51</td>
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<tr>
<td>U.S. Total</td>
<td>2527</td>
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<td>2523</td>
<td>2600</td>
<td>2776</td>
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<td>2690</td>
<td>25984</td>
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</table>

This table also shows the competing patent districts. The Central and Northern Districts of California both had a consistent stream of patent litigation suits filed in the past decade. They are the only districts ranked ahead of the Eastern District of Texas in total suits filed from 2000 to 2009. Of the top ten patent districts, only the Eastern District of Texas experienced a drastic increase in patent filings, though the District of Delaware has made a modest climb in its numbers as well, from 118 in 2005 to 234 in 2009.

63. All data gathered from Lex Machina. LEX MACHINA, http://lexmachina.com/. The data from years 2000 and 2001 was omitted from the table due to space constraints.
D. FOCUS ON MARSHALL, TEXAS

This sharp climb in patent suits in the Eastern District of Texas, perhaps most notably in its Marshall Division, results in part from the plaintiff-friendly juries. Until 2006, eighteen years elapsed without a jury decision in favor of a defendant in the Eastern District of Texas. In that year there were two defendant victories. In addition to this high rate of success at trial, there have been many patentee-friendly high damage awards, including the largest patent infringement damage award in U.S. history of $1.67 billion dollars, awarded by a jury in the Eastern District of Texas on June 29, 2009.

Marshall, Texas used to be a hotbed for personal injury lawyers, but broad tort reform shifted the town’s legal focus “from PI to I.P. – that is, they moved out of personal injury and into intellectual property.” Plaintiffs tend to hire local lawyers who are well connected within the region and out-of-town counsel work with local counsel even if they are admitted to practice in the Eastern District of Texas. These local lawyers possess personal knowledge of the judges and jury pool, making it more difficult for outside counsel to break into the tight-knit legal community. Others have also noted that the Eastern District of Texas’s District Clerk’s office is “customer-oriented,” welcoming to patent cases, and offers technology-friendly docket management. Additionally, plaintiffs appreciate the docket’s relatively low

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67. Creswell, supra note 64; see also Alan Cohen, FROM PI TO IP: Personal injury lawyers in Texas want to get into patent litigation, and The Roth Law Firm is leading the stampede, IP L. & BUS., Nov. 2005, at 36 (describing the jump for lawyers in Marshall, Texas from high stakes personal injury suits to patent infringement actions).
68. Creswell, supra note 64, at 31.
69. Cohen, supra note 67, at 36 (quoting out-of-town litigators describing local counsel as “a courthouse rat,” who “know[s] the judges views,” and as useful to “track down information that is not readily available to ‘outsiders’”).
70. Creswell, supra note 64, at 31 (“Hiring local in Marshall means that you will get a lawyer who not only knows the jurors, but who also probably knows their friends and even personal details like how often they go to church, local lawyers say.”).
71. Nguyen, supra note 61, at 141–42. For example, the court’s website displays the mission statement, “[o]ur mission is to provide excellent service to our customers . . . .” U.S.
percentage of criminal cases because criminal cases take precedence over civil cases. Thus, the limited docket competition with criminal cases minimizes the chance of a delay in civil proceedings.\(^{72}\)

There have been reports of the Eastern District of Texas’s docket slowing down.\(^{73}\) New jurisdictions such as the Western District of Wisconsin are starting to be viewed as “rocket dockets” in the eyes of the legal community and plaintiff-patentees.\(^{74}\) As more jurisdictions strive to adjudicate patent lawsuits efficiently, the new, more objective transfer standard may give defendants more flexibility to balance the former plaintiff-friendly system.\(^{75}\) Table 1, supra, indicates a potential decline from the Eastern District of Texas’ 2007 peak of 368 patent litigation suits filed, down to 300 in 2008, and 240 in 2009. Though its docket may be slowing, the court has recently made some controversial decisions friendly to plaintiffs. For example, in the wake of the Supreme Court’s decision in eBay Inc. v. MercExchange, L.L.C., in which the Court raised the bar for injunctive relief in patent infringement suits,\(^{76}\) the Eastern District of Texas in 2009

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72. See Michael C. Smith, Rocket Docket: Marshall Court Leads Nation in Hearing Patent Cases, 69 TEX. B.J. 1045, 1046 (2006) (noting that the Marshall court’s criminal docket is only about ten percent compared to the “typical” federal judge’s docket being half criminal and half civil).

73. Statistics indicate that estimated time-to-trial in the Eastern District of Texas as of December 2009 is over two years. LEX MACHINA, COURTS: U.S. DISTRICT COURT FOR THE EASTERN DISTRICT OF TEXAS, http://lexmachina.com/courts/txed/Patent; see also McKelvie, supra note 61, at 3 (noting that the judges were “beginning to fall behind” in the Eastern District of Texas with an increase of almost 100 patent cases pending from 2005 to 2006).

74. See Carter, supra note 8 (emphasizing the Wisconsin court’s “combination of savvy jurists and a university community with a penchant for incubating biotech start ups” with “warp-speed justice” as elements aiding to “attract[] attention from innovative, IP-centric companies”); Sheri Qualters, New Patent Rocket Docket Rises in Wisconsin, NAT’L L.J., March 21, 2008, available at http://www.axley.com/uploads/media/newpatentrocketdocket.pdf (asserting that “[l]awyers say they’re attracted by the district’s educated jury pool, which reflects the work force and populace connected to the University of Wisconsin and the thriving local high technology sector”); Jack Zemlicka, “Rocket Docket” May Lose Some Thrust With New Judges, WIS. L.J., April 29, 2009, http://www.wislawjournal.com/article.cfm/2009/05/04/Rocket-docket-may-lose-some-thrust-with-new-judges (reporting that “the Western District [of Wisconsin] was the second fastest among the 94 district courts in 2008 in the timeline from filing to disposition of civil cases (4.6 months) and third from filing to trial (12.3 months)”).

75. See infra Part III.

granted an injunction in *i4i Limited Partnership v. Microsoft Corp.*[^77] This enjoined Microsoft from selling its Word software in the United States in addition to a 200 million dollar jury verdict that the court enhanced by 40 million dollars.^[78]

### II. RECENT DEVELOPMENTS

Prior to late 2008, patent infringement defendants were continuously sued in plaintiff-friendly jurisdictions, and it was difficult to obtain transfer (when contested) to a more convenient district. The broad discretion afforded to the district courts in venue transfer determinations[^79] was routinely applied to deny motions to transfer in patent infringement suits asserting convenience for the parties.^[80] For example, in an almost eighteen year period, from January 1, 1991 until November 30, 2008, 318 transfer motions were filed but only sixty-one granted for patent infringement actions in the Eastern District of Texas.^[81] The “contested win rate” of transfer motions (as opposed to those unopposed or supported by both parties),


[^79]: See *supra* Section I.B.

[^80]: See, e.g., *Monster Cable Prod., Inc. v. Trippe Mfg. Co.*, No. 9:07-CV-286, 2008 WL 2492060 (E.D. Tex. June 18, 2008) (denying transfer in a patent case where the parties were located in California and Illinois and without any significant connection to Texas except other lawsuits pertaining to different products); *VCode Holdings, Inc. v. Cognex Corp.*, No. 2:07-CV-138, 2007 WL 2238054 (E.D. Tex. Aug. 3, 2007) (refusing to grant transfer to Minnesota); *Aerielle, Inc. v. Monster Cable Prod.*, No. 2:06-CV-382, 2007 WL 951639 (E.D. Tex. Mar. 26, 2007) (denying transfer in a patent case with both parties incorporated and having primary place of business in California and lacking significant connection to Texas). *But see* *Orica Explosives Tech., Pty., Ltd. v. Austin Powder Co.*, No. 2:06-CV-450, 2007 WL 1115238 (E.D. Tex. Apr. 13, 2007) (granting transfer from the Eastern District of Texas to the Central District of California in a patent case where the product was designed and developed in California whereas the alleged infringing product was not sold, used, or manufactured in the transferor district); *02 Micro Int’l Ltd. v. Monolithic Power Sys., Inc.*, No. 2:04-CV-359, 2006 WL 887391, at *2 (E.D. Tex. Mar. 26, 2006) (transferring a patent case from the Eastern District of Texas to the Northern District of California which “was the court first vested with jurisdiction over the dispute between these parties concerning these related patents”).

reported by LegalMetric, was 32.1% for defendants in 2008, but increased slightly in relation to the district’s long-term average.82

The Federal Circuit has responded to these low transfer rates, and it seems that the district courts are taking notice, with recent decisions granting transfer in accordance with the TS Tech and Genentech decisions.83 The development of the new transfer standard originates from the Fifth Circuit’s grant of transfer out of the Eastern District of Texas84 and develops with four subsequent transfer motions granted by the Federal Circuit.85

A. PRIMARY FEDERAL AND FIFTH CIRCUIT DECISIONS GRANT TRANSFER FROM THE EASTERN DISTRICT OF TEXAS

A Fifth Circuit decision and two recent Federal Circuit opinions invoked the writ of mandamus standard of clear abuse of discretion to overturn the Eastern District of Texas’ denials of transfer, each time granting transfer out of the district.86 In venue transfer motions, the federal district courts and the Federal Circuit apply the circuit-specific laws of the court where the initial cause of action is filed.87 The Eastern District of Texas lies within the Fifth Circuit, and therefore Fifth Circuit standards apply to transfer motions filed there.88

When transfer is denied at the district court level, a writ of mandamus may be used to “correct a patently erroneous denial of transfer pursuant to § 1404(a).”89 Writs have been approved in this manner by the Federal Circuit using the Fifth Circuit’s regionally appropriate standards.90 Fifth Circuit precedent holds that the transferee venue must be “clearly more convenient then the venue chosen by the plaintiff” for transfer to be granted.91 In the transfer analysis, the Fifth Circuit applies both “public” and “private” interest

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82. LEGAL METRIC, supra note 81. “[C]ontested win rate” for motions excludes consent rulings; overall Judge Ward’s court’s (carrying the highest number of venue transfer motions) rose from 27.1% long-term to 37.5% in 2008. Id.
83. See infra Part III.
84. See infra Section II.A.1.
85. See infra Sections II.A.2, II.A.3, II.B.2.
86. See In re Genentech, 566 F.3d 1338 (Fed. Cir. 2009); In re TS Tech USA, Corp., 551 F.3d 1315 (Fed. Cir. 2008); In re Volkswagen of Am., Inc. (Volkswagen I), 545 F.3d 304 (5th Cir. 2008).
88. TS Tech, 551 F.3d at 1319.
89. Genentech, 566 F.3d at 1341.
90. See, e.g., TS Tech, 551 F.3d at 1319 (granting a writ of mandamus to transfer the patent infringement action out of the Eastern District of Texas by applying “the laws of the regional circuit in which the district court sits”).
91. Volkswagen I, 545 F.3d at 315.
factors to decide whether transfer is appropriate under § 1404(a). These factors are termed the Gilbert factors because they were originally established by the Supreme Court in Gulf Oil Corp. v. Gilbert applying the common law doctrine of forum non conveniens, just prior to the enactment of § 1404(a). The public interest factors are: “(1) the administrative difficulties flowing from court congestion; (2) the local interest in having localized interests decided at home; (3) the familiarity of the forum with the law that will govern the case; and (4) the avoidance of unnecessary problems of conflict of laws [or in] the application of foreign law.” Conversely, the private interest factors include: “(1) the relative ease of access to sources of proof; (2) the availability of compulsory process to secure the attendance of witnesses; (3) the cost of attendance for willing witnesses; and (4) all other practical problems that make trial of a case easy, expeditious, and expensive.” These factors are “not necessarily exhaustive or exclusive” when applied in transfer cases, and none alone “can be said to be of dispositive weight” when applied.

Three appellate decisions applied the Gilbert factors to overturn transfer denials by the Eastern District of Texas, going through the eight-factor analysis to grant writs of mandamus. The Federal Circuit transferred two patent infringement actions, In re TS Tech and In re Genentech, out of the Eastern District of Texas to a “clearly more convenient” transferee venue, on a balance of the factors. To better understand the Federal Circuit’s holdings, however, one must first examine In re Volkswagen (Volkswagen I), the products liability case that set the Fifth Circuit precedent to grant transfer.

1. Volkswagen I

Volkswagen I set the stage for transfer out of the Eastern District of Texas. The Fifth Circuit granted a writ of mandamus to overturn denial of transfer. The original action was filed in the Eastern District of Texas,
Marshall Division, which had no connection to either the suit or the parties. Conversely, the Dallas Division of the Northern District of Texas was extensively connected to the plaintiff, witnesses, and facts involved in the case. The Fifth Circuit granted transfer of the case to the Northern District of Texas pursuant to the defendant’s writ of mandamus, holding that the district court “gave undue weight to the plaintiff’s choice of venue, ignored our precedents, misapplied the law, and misapprehended the relevant facts.”

a) Relevant Facts and Procedural History

The products liability action arose from a car accident that occurred in Dallas, Texas (Northern District of Texas) involving a car bought in that city and without any known witnesses in the Eastern District of Texas. The original plaintiffs were residents of Collin County, Texas and the third party defendant was a resident of Dallas County, Texas. Both of these locations are in the Northern District of Texas, and each is approximately 150 miles from Marshall, Texas (in the Eastern District of Texas) where the suit was filed. The writ petitioners were the New Jersey subsidiary Volkswagen of America, Inc. and the German Corporation Volkswagen A.G., neither substantially connected to either Texas district.

The district court looked to the plaintiffs’ forum choice, stating that it “will not be disturbed unless it is clearly outweighed by other factors.” The court relied on the national scope of the defendant’s business (including Texas) for personal jurisdiction purposes to justify proper venue. The district court held that because both the plaintiffs and the third party defendant lived approximately 150 miles from the Eastern District of Texas, this distance was not significant enough to weigh the convenience factor to the parties in favor of transfer (the other defendants would be significantly inconvenienced regardless of transfer since they were located out of state). The court also analyzed convenience to the non-party witnesses (which is

101. Id. at 307–08.
102. Id.
103. Id. at 309.
104. Id. at 307–08.
106. Id.
107. Id. at *1.
108. Id. at *2 (citing Shoemake v. Union Pac. R.R. Co., 233 F. Supp. 2d 828, 830 (E.D. Tex. 2002)).
109. Id.
110. Id.
more heavily weighed than convenience to party witnesses), stating that even though defendants had identified various witnesses living within the Northern District of Texas in the Dallas area, the 155 mile distance between the districts was not far enough to warrant transfer to that district. Additionally, the defendants briefed the issue of the witnesses being outside the one hundred mile radius of the Eastern District courthouse’s subpoena power, but the court stated that all of the defendant’s listed witnesses could be compelled by the Eastern District because they were Texas residents. Though the district court recognized that the accident occurred in the Northern District of Texas—the location of the documents and physical evidence relating to the accident—it failed to give significant weight to these considerations. Instead, the court focused on a “local interest” shared by citizens of both districts (the accused product was sold in both locations), holding that it would not burden the citizens in the Eastern District of Texas to adjudicate the issue there.

The Eastern District of Texas exercised its discretion to deny the venue transfer motion. But after a series of motions and petitions, the Fifth Circuit granted transfer to the Northern District of Texas via a writ of mandamus and affirmed en banc, holding that “the district court reached a

111. Id. at *3 (emphasizing that though the analysis of witnesses was necessary, there was a lack of information about the identified witnesses and stating that “the Court cannot determine that they are indeed key fact witnesses whose convenience should be addressed in this analysis”).
112. Id.
113. Rule 45(b)(2) stipulates that a subpoena may be served: “(A) within the district of the issuing court,” or “(B) outside that district but within 100 miles of the place specified for the deposition, hearing, trial, production, or inspection.” Fed. R. Civ. P. 45(b)(2).
114. Singleton, 2006 WL 2634768, at *3 (“A court may compel any witness residing in the state in which the court sits to attend trial, subject to reasonable compensation if the witness incurs substantial expense.” (citing Fed. R. Civ. P. 45(c)(3))).
115. Id. at *3–4.
116. Id. at *4.
117. Id. at *5.
118. Volkswagen next filed a motion of reconsideration that was denied for the same reasons as the initial transfer motion, and their first petition to the Fifth Circuit for a writ of mandamus was denied by a divided panel. In re Volkswagen of Am., Inc., 545 F.3d 304, 308 (5th Cir. 2008) (quoting Judge Garza’s dissent in denying the writ petition: “[t]he only connection between this case and the Eastern District of Texas is plaintiffs’ choice to file there; all other factors relevant to transfer of venue weigh overwhelmingly in favor of the Northern District of Texas.” In re Volkswagen of Am., Inc., 223 Fed. App’x 305, 307 (5th Cir. 2007) (Garza, J., dissenting) (emphasis in original)). Subsequently, Volkswagen petitioned for rehearing en banc, which was granted, and the full court issued the writ to transfer the case to the Dallas Division. Volkswagen I, 545 F.3d at 308. The original plaintiffs, the Singletons, then filed for another rehearing en banc which was granted and affirmed the Fifth Circuit’s transfer decision. Id. at 309.
patently erroneous result and clearly abused its discretion in denying the transfer.”119

b) The Fifth Circuit’s Analysis

The Fifth Circuit reviewed the Eastern District court’s decision to deny transfer and determined that the district court “misconstrue[d] the weight of the plaintiffs’ choice of venue, . . . misappl[ied] the Gilbert factors, [and] disregard[ed] the specific precedents of this Court,” amounting to “extraordinary errors” requiring reversal and transfer under the writ of mandamus standard.120 The court applied the mandamus standard as “appropriate to correct a clear abuse of discretion,” finding mandamus relief appropriate for venue transfer decisions.121 After noting that the case fulfilled the requirement that the plaintiffs could have brought the suit in the Northern District of Texas, pursuant to § 1391, the court turned to the district court’s decision, and its “err[or] [in] giving inordinate weight to the plaintiffs’ choice of venue.”122

The Fifth Circuit criticized the district court for applying the dismissal standard of forum non conveniens in its analysis, instead of the correct standard under § 1404(a) in which the party seeking transfer “must show good cause” with less weight given to the plaintiff’s choice of venue.123 Next considering the Gilbert “private” and “public” interest factors, the Fifth Circuit criticized the district court’s failure to properly weigh the ease of access to the documents and physical evidence located in the Northern District of Texas124 as well as its flawed analysis of how subpoena power of the court would affect the proceedings.125

The Fifth Circuit also noted that its own precedent concerning the 100-mile threshold for witness travel as inconvenient was disregarded in the district court’s analysis because it should have weighed in favor of transfer.126

119. Volkswagen I, 545 F.3d at 309.
120. Id. at 318.
121. Id. at 309–10 (emphasis added).
122. Id. at 312.
123. Id. at 315 (quoting Humble Oil & Ref. Co. v. Bell Marine Serv., Inc., 321 F.2d 53, 56 (5th Cir. 1963)).
124. Id. at 316.
125. Id. at 316–17 (noting that “trial subpoenas for these witnesses to travel more than 100 miles would be subject to motions to quash under Fed. R. Civ. P. 45(c)(3)” and that because the Dallas court would have “absolute subpoena power for both depositions and trial,” the district court erred in its analysis and it should have weighed this factor towards transfer (internal citations omitted)).
126. Id. (“When the distance between an existing venue for trial of a matter and a proposed venue under § 1404(a) is more than 100 miles, the factor of inconvenience to
The witnesses identified by the defendants would have to travel approximately 150 miles to the court (along with the two of the plaintiffs, the third resided in Kansas and would have to travel to Texas regardless) causing inconvenience in terms of “not only . . . monetary costs, but also the personal costs associated with being away from work, family, and community.” Additionally, the claimed public interest of Marshall residents was criticized in the opinion because “[t]he district court’s provided rationale could apply virtually to any judicial district or division in the United States.” The court held that simply having an interest in a defective product does not equate with having an actual stake in resolving the case.

The Fifth Circuit accordingly ruled that the district court’s errors rose to the level of a “patently erroneous result,” holding that it “gloss[ed] over the fact that not a single relevant factor favors the [plaintiffs’] chosen venue.” With transfer as the only adequate means of relief, the additional requirements to grant a writ of mandamus were also met. Thus, it was appropriate to grant Volkswagen’s writ and transfer the case to the Dallas Division of the Northern District of Texas.

2. In re TS Tech

The Federal Circuit followed Volkswagen I in TS Tech, setting the transfer standard for patent infringement actions in the Fifth Circuit. Plaintiff Lear Corporation brought suit for patent infringement against two Ohio corporations and one Canadian company, TS Tech USA, North America, and Canada, respectively, in the Eastern District of Texas. Defendants’ request for transfer to the Southern District of Ohio was denied by the district court. The Federal Circuit granted defendants’ mandamus petition to allow

[note 127]
Id.

[note 128]
Id. at 318.

[note 129]
Id.

[note 130]
Id. at 319.

[note 131]
Id. at 319.

[note 132]
Id. Though there was an accompanying dissent by Judge King to this opinion, the Supreme Court denied certiorari on February 23, 2009. Singleton v. Volkswagen of Am., Inc., 129 S.Ct. 1336 (2009).

[note 133]
In re TS Tech USA, Corp., 551 F.3d 1315, 1322 (Fed. Cir. 2008) (confirming Volkswagen I’s application of Fifth Circuit law to review a district court’s transfer denial via a writ of mandamus).

[note 134]
Delaware corporation with principal place of business in Michigan.

[note 135]

[note 136]
Id. at *4.
transfer, following *Volkswagen I*, stating that “TS Tech has met its difficult burden of establishing that the district court clearly abused its discretion in denying transfer.”

a) Relevant Facts and Procedural History

The district court recognized that both parties were located outside of Texas, key party witnesses resided in Ohio, Canada, and Michigan, and that it would be more convenient for the Ohio residents to transfer. Nonetheless, the court held that the plaintiff’s choice of forum indicated their convenience (and convenience for their Michigan witnesses as well), and that the defendants failed to specify sufficient information as to the witnesses’ testimony and travel inconvenience to justify transfer. The district court similarly held that though much evidence was located in Ohio and Canada, it did not weigh for or against transfer due to the inherent mobility of the relevant electronic documents. Additionally, the court found that the sale of the infringing products within the Eastern District of Texas was “significant and relevant to the action” and that the district’s citizens would have a “substantial interest” in the outcome of the case, thus weighing against transfer.

Judge Ward denied the transfer motion. TS Tech petitioned the Federal Circuit for a writ of mandamus for transfer, and the appellate court granted the writ on December 29, 2008 because of “several key errors” in the district court’s § 1404(a) analysis.

b) The Federal Circuit’s Analysis

The Federal Circuit granted TS Tech’s writ of mandamus, focusing on the district court’s errors. The district court gave “inordinate weight” to plaintiffs’ venue choice, ignored precedent on convenience to non-parties (including the 100-mile rule) and the public interest in localized matters, and improperly analyzed the factor of access to sources of proof. Though the Federal Circuit held that the district court correctly analyzed some of the

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139. *Id.*
140. *Id.* at *3.
141. *Id.*
142. *Id.* at *4.
143. *In re TS Tech USA*, Corp., 551 F.3d 1315, 1320 (Fed. Cir. 2008).
144. *Id.* at 1320–21.
Gilbert factors, it held that the district court’s classification of plaintiffs’ choice of venue as an additional “factor” against transfer occupied too much weight in the decision.

The Federal Circuit went into detail analyzing the Gilbert factors, first noting that “[t]he district court’s order . . . completely disregarded the 100-mile rule” and ignored the 900 mile travel distance differential between the Texas and Ohio courts in “clear error.” The court also emphasized the location of documentary evidence in Ohio, Michigan, and Canada. It held that the district court’s justification that many sources could be transferred electronically “presents a lesser inconvenience now than it might have absent recent developments [but it] does not render this factor superfluous.”

The Federal Circuit also rejected as illogical the district court’s claims that the citizens of the Eastern District of Texas had “substantial interest” in the case because the patented invention at suit was sold in the district. The accused infringing product was sold throughout the United States, giving the same “substantial interest” to citizens of any of the ninety-four district courts. The court held that this erroneous application of the Gilbert factors paralleled Volkswagen I, and the Eastern District of Texas “clearly abused its discretion in denying transfer from a venue with no meaningful ties to the case.”

The Federal Circuit concluded that the district court “glossed over the fact that not a single relevant factor favored the plaintiffs’ choice of venue” and that TS Tech “demonstrated a clear and indisputable right to a writ.”

3. In re Genentech

In accordance with its decision in TS Tech, the Federal Circuit overturned the Eastern District of Texas’s denial of transfer as “clearly abus[ing] its discretion in denying transfer of venue” where the German company Sanofi filed suit against two California companies: Genentech and Biogen. In
reaching its conclusion, the Federal Circuit relied on geographic considerations in applying the Gilbert private and public interest factors.\footnote{155}{Id.}

\begin{itemize}
\item[a)] Relevant Facts and Procedural History

Sanofi filed a patent infringement action against Genentech and Biogen in the Eastern District of Texas on the same day that those defendants filed a corresponding declaratory judgment action in the Northern District of California seeking a declaration of noninfringement and invalidity of Sanofi’s patents.\footnote{156}{Sanofi-Aventis Deutschland GmbH v. Genentech, Inc., 607 F. Supp. 2d 769, 773 (E.D. Tex. 2009).} In the Northern District of California, Genentech requested that the two cases be consolidated by filing a Notice of Pendency of Other Action in the Proceeding.\footnote{157}{Id.} In response, Sanofi moved to dismiss in California on personal jurisdictional grounds and asked that the California court allow the Texas court to decide the forum.\footnote{158}{Id.} Then, in the Eastern District of Texas, Genentech filed a motion to transfer the infringement suit to the Northern District of California pursuant to § 1404(a).\footnote{159}{Id.}

None of the parties of the suit identified any witnesses who resided in the Eastern District of Texas.\footnote{160}{Genentech, 566 F.3d at 1340–41.} The petitioners for the writ, Genentech and Biogen, identified at least ten witnesses located within the Northern District of California.\footnote{161}{Id. at 1343.} Two of those witnesses were patent prosecutors who had written some of the relevant patents and at least three were non-parties who possessed relevant material fact information.\footnote{162}{Id.} Sanofi, who opposed the transfer, identified six inventors who resided in Europe, four other patent prosecutors who resided on the East Coast (of the United States), and a potential prior art author witness who resided in Iowa.\footnote{163}{Id. at 1345.}

None of the parties had any relevant documents located within the Eastern District of Texas.\footnote{164}{Id.} The majority of Genentech’s relevant corporate documents were housed in the Northern District of California, all of Biogen’s pertinent materials were housed in San Diego, California, Sanofi’s relevant patent prosecution documents were kept in Washington D.C., and other related documents were located in Europe.\footnote{165}{Id.}
The courts also considered several additional facts, including evidence that Genentech had filed a past patent suit in the Eastern District of Texas.\footnote{166} Moreover, various studies indicated that the Eastern District of Texas had a faster time to trial than the Northern District of California.\footnote{167}

The Texas district court’s analysis of the public and private interest factors focused on Genentech’s previous filing in that forum, potential lack of personal jurisdiction over Sanofi in the Northern District of California, the supposed shorter time to trial in Texas, and the interest of Texas residents “because the allegedly infringing products are pharmaceuticals sold here.”\footnote{168} The court denied the motion to transfer, stating that “Genentech simply has not carried . . . a ‘significant burden’ to show that the Northern District of California is a ‘clearly more convenient’ venue.”\footnote{169}

b) The Federal Circuit’s Analysis

The Federal Circuit granted Genentech and Biogen’s writ of mandamus, reversing the Eastern District of Texas’ denial of venue transfer as a clear abuse of discretion.\footnote{170} The Federal Circuit focused heavily on the geographical convenience of the forum in terms of witnesses, availability of compulsory process, and access to evidence, as well as practical problems and court congestion.\footnote{171}

The court re-analyzed the Fifth Circuit’s “100-mile” rule,\footnote{172} but, in contrast to Volkswagen I,\footnote{173} determined that it “should not be rigidly applied” in this circumstance because “[t]he witnesses from Europe will be required to travel a significant distance no matter where they testify.”\footnote{174} The court instead focused on the petitioner’s California witnesses to support transfer.\footnote{175} It noted that a defendant should not be required at that stage in the litigation to show anything more than that the potential witnesses hold information that

\begin{itemize}
\item \footnote{166} Id. at 1346.
\item \footnote{167} Id. at 1347 (citing Sanofi-Aventis Deutschland GmbH v. Genentech, Inc., 607 F. Supp. 2d 769, 780 (E.D. Tex. 2009)).
\item \footnote{168} Sanofi-Aventis, 607 F. Supp. 2d at 781.
\item \footnote{169} Id. (quoting In re Volkswagen of Am., Inc., 545 F.3d 304, 314 n.10 (5th Cir. 2008)).
\item \footnote{170} Genentech, 566 F.3d at 1348.
\item \footnote{171} See generally id. (analyzing the appropriate factors to determine that forum transfer should be granted).
\item \footnote{172} The “100-mile” rule requires that “[w]hen the distance between an existing venue for trial of the matter and a proposed venue under § 1404(a) is more than 100 miles, the factor of inconvenience to witnesses increases in direct relationship to the additional distance to be traveled.” Id. at 1343 (quoting In re Volkswagen of Am., Inc., 545 F.3d 304, 317 (5th Cir. 2008)).
\item \footnote{173} Supra Section II.A.1.b.
\item \footnote{174} Genentech, 566 F.3d at 1344.
\item \footnote{175} Id. at 1343–44.
\end{itemize}
is relevant and material.\(^{176}\) Regarding the potential witnesses residing in Iowa and on the East Coast, the court noted that Texas was not necessarily a “centralized location” as the district court had argued; due to the absence of any witnesses from Texas, and the “substantial number of material witnesses resid[ing] within the transferee venue and the state of California . . . the district court clearly erred in not determining this factor to weigh in favor of transfer.”\(^{177}\) The court extended this analysis to the convenience to the parties, noting that it also favored transfer as both Genentech and Biogen had a significant California presence,\(^{178}\) but Sanofi would “be only slightly more inconvenienced by the case being tried in California than in Texas.”\(^{179}\)

The California court’s subpoena power via Rule 45(b)(2) of the Federal Rules of Civil Procedure also weighed in favor of transfer\(^{180}\) because not a single witness could be compelled to appear before the Texas court.\(^{181}\) Additionally, the Federal Circuit noted that “[i]n patent infringement cases, the bulk of the relevant evidence usually comes from the accused infringer,” and therefore the location of the defendant’s documents “weighs in favor of transfer to that location.”\(^{182}\) A large majority of Genentech’s relevant documents were housed in the Northern District of California and all of Biogen’s documents were housed in its San Diego facility.\(^{183}\) The location of these documents, without transfer, would result in “a significant and unnecessary burden on the petitioners.”\(^{184}\)

In regards to Genentech’s previous filing within the Eastern District of Texas, the Federal Circuit pointed out the Supreme Court’s standard that “[§ 1404(a)] requires ‘individualized, case-by-case consideration of convenience and fairness.’”\(^{185}\) Because the case concerned a completely different set of parties, witnesses, evidence, and facts, this judicial economy issue did not weigh against transfer.\(^{186}\)

176. Id. at 1343.
177. Id. at 1344–45.
178. Genentech’s headquarters were within the Northern District and Biogen’s facilities for research and development were in San Diego. Id. at 1345.
179. Id.
180. See supra note 113.
181. Genentech, 566 F.3d at 1345.
183. Id. at 1346.
184. Id.
185. Id. (quoting Van Dusen v. Barrack, 376 U.S. 612 (1964)).
186. Id.
The Federal Circuit also addressed Sanofi’s concern that the Northern District of California lacked personal jurisdiction over Sanofi. The court recited the standard for personal jurisdiction by stating that “there is only a requirement that the transferee court have jurisdiction over the defendants in the transferred complaint.” Therefore, the concern was not relevant.

Finally, the court examined the “most speculative” factor in the analysis of court congestion, in terms of the timeframe for the case to be tried and decided. Though the Federal Circuit conceded that the statistics relied upon by the district court did indicate that the Eastern District of Texas would potentially be a faster venue to try the case, it held that speed of the transferee court cannot be dispositive in a circumstance when many other relevant factors are either neutral or weigh in favor of transfer. This follows Volkswagen I’s focus on convenience to the parties and witnesses as the deciding factors.

B. FEDERAL CIRCUIT TRANSFER DECISIONS APPLYING TS TECH AND GENENTECH

The Federal Circuit made venue transfer more accessible for patent infringement defendants with its decisions in TS Tech and Genentech. The court solidified its stance and drew a firm line to guide future venue transfer decisions by denying two writs of mandamus to transfer and granting two others in 2009.

1. Two Denials of Transfer post-Genentech

In late 2009, the Federal Circuit denied two petitions for writs of mandamus in In re Telular Corp. and In re Volkswagen of America, Inc. (Volkswagen II). In Telular, the Federal Circuit upheld the Eastern District of Texas’ denial of transfer, finding inconvenience to the plaintiffs if the case were to transfer even though the patentee had no unique connection to the original trial district. The defendant, Telular Corporation, moved to transfer the patent infringement action from the Eastern District of Texas to the Northern

187. Id.
188. Id. (citing Hoffman v. Blaski, 363 U.S. 335, 343–44 (1960)).
189. Id. at 1347.
190. Id.
192. 566 F.3d 1349, 1352 (Fed. Cir. 2009).
District of Illinois, its primary place of business. 194 The patentee, Tobi Gellman, was a Dallas, Texas resident. 195 Evidence was located in both Texas and Illinois and defense witnesses resided in Illinois and Georgia. 196 The Eastern District of Texas denied the motion, finding that “the competing factors do not justify a transfer.” 197 Telular filed a writ for mandamus relief at the Federal Circuit five months later following the TS Tech decision. 198

The Federal Circuit upheld the trial court’s decision because the defendant failed to demonstrate that the proposed transferee venue was “clearly more convenient.” 199 The Federal Circuit noted that the circumstances stood “in stark contrast to the circumstances leading to the grants of mandamus in TS Tech and Volkswagen [I], in which the facts overwhelmingly supported transfer.” 200 In particular, the court found that transfer was not justified merely because the Eastern District of Texas had no significant connection to and corresponding “interest” in the case. 201 Additionally, the court noted that the five-month delay “weigh[ed] against the need for issuance of an extraordinary writ.” 202

In Volkswagen II the Federal Circuit upheld the trial court’s denial of transfer because the plaintiff had multiple cases pending in the trial district. 203 The plaintiff, a Texas company, had previously litigated cases in the Eastern District of Texas and had several pending and related cases before the trial court there. 204 The Federal Circuit’s analysis in Volkswagen II turned on these multiple pending lawsuits which, if separated, would “lead[] to the wastefulness of time, energy and money that § 1404(a) was designed to prevent.” 205 The judicial economy issue precluded a more thorough analysis of the remaining Gilbert factors because it was in the interest of the court to “hav[e] the same district court try the cases involving the same patents.” 206

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195. Id.
196. Id. at *3–4.
197. Id. at *5.
198. In re Telular Corp., 319 Fed. App’x 909, 911 (Fed. Cir. 2009) (citing other cases with similar delayed writ petitions that denied mandamus relief).
199. Id. at 912.
200. Id.
201. Id.
202. Id. at 911.
203. In re Volkswagen of Am., Inc. (Volkswagen II), 566 F.3d 1349, 1351–52 (Fed. Cir. 2009).
204. Id. at 1350–51.
205. Id. at 1351 (quoting Continental Grain Co. v. FBL-585, 364 U.S. 19, 26 (1960)).
206. Id.; see also infra Section III.A.2.
This decision upholding the denial of transfer issued the same day as the grant of Genentech’s writ of mandamus to transfer.\textsuperscript{207} The Federal Circuit thus cited the \textit{Genentech} ruling for examples of how the \textit{Gilbert} factors should be applied.\textsuperscript{208}

Though both these transfer denials involved parties from different locations and had witnesses located closer to the proposed transferee venues than to the Eastern District of Texas, the specific issues of time delay before filing for mandamus relief and the judicial economy factors particular to the cases precluded the full \textit{Gilbert} factor analysis. In these cases, the Federal Circuit refined its \textit{TS Tech} and \textit{Genentech} precedent, holding that a full review of the factors is unnecessary if a unique circumstance heavily outweighs other considerations.

\textbf{2. Two Transfer Motions Granted Post-\textit{Genentech}}

The Federal Circuit reinforced its \textit{Gilbert} factor analysis in \textit{TS Tech} and \textit{Genentech} when it granted two subsequent writs of mandamus to transfer in late 2009.\textsuperscript{209} In both \textit{In re Hoffmann-La Roche Inc.} and \textit{In re Nintendo Co., Ltd.}, the Federal Circuit transferred the actions out of the Eastern District of Texas because the cases “feature[d] a stark contrast in relevance, convenience, and fairness between the two venues.”\textsuperscript{210}

In \textit{Hoffmann-La Roche}, the Federal Circuit granted transfer to the Eastern District of North Carolina, where there was a strong local interest in adjudication.\textsuperscript{211} The plaintiff’s headquarters were in California, but the defendant’s drug was developed and tested in the Eastern District of North Carolina.\textsuperscript{212} There was no connection to the Eastern District of Texas except that the plaintiff asserted that some of the documents were located in Texas, but they were transferred there electronically “but for” the pending litigation.\textsuperscript{213} The Federal Circuit recognized that “the assertion that these documents are ‘Texas’ documents is a fiction which appears to have been created to manipulate the propriety of venue.”\textsuperscript{214}

\begin{enumerate}
\item 207. \textit{Volkswagen II}, 566 F.3d at 1351.
\item 208. \textit{Id.}
\item 209. \textit{In re Nintendo Co.}, 589 F.3d 1194 (Fed. Cir. 2009); \textit{In re Hoffmann-La Roche, Inc.}, 587 F.3d 1333 (Fed. Cir. 2009).
\item 210. \textit{Nintendo}, 589 F.3d at 1198; \textit{Hoffmann-La Roche}, 587 F.3d at 1336.
\item 211. \textit{Hoffmann-La Roche}, 587 F.3d at 1338.
\item 212. \textit{Id.} at 1336.
\item 213. \textit{Id.} 1337.
\item 214. \textit{Id.}
\end{enumerate}
The parties identified one Texas witness in their initial disclosures and motion papers, but the Federal Circuit held that the Eastern District of Texas did not have “absolute subpoena power” over him. Conversely, the Eastern District of North Carolina had this power over at least four other non-party witnesses. The court also found a strong local interest in North Carolina because “the cause of action calls into question the work and reputation of several individuals ... who presumably conduct business in that community.” The Federal Circuit commented that the district court “ignored this significant contrast” of local interest in venue and “rendered this factor meaningless.” The court emphasized the local connection to the lawsuit as a highly relevant factor, granting transfer out of the Eastern District of Texas after balancing the Gilbert factors.

The Federal Circuit also overturned the Eastern District of Texas’ denial of transfer in Nintendo, granting the petitioner’s writ and transferring the case to the Western District of Washington. Like Hoffmann-La Roche, the Nintendo suit lacked “any material connection” to the Texas district, and the transfer venue possessed a high local interest in the matter. The plaintiff-patentee was incorporated in Ohio, with its principle place of business located there as well. The defendants were from Japan and Washington, where much of the evidence was located. Witnesses were identified in Washington, Japan, Ohio, and New York. The Federal Circuit recognized that the suit’s connection to the Washington district favored transfer since it was the defendant’s place of incorporation and primary place of business.

In its analysis of the Gilbert factors, the Federal Circuit next turned to witness convenience and cost of attendance. The court disagreed with the district court’s determination that the factor only weighed slightly in favor of transfer. Several witnesses resided in the Western District of Washington.

215. Id. at 1335.
216. Id. at 1338 (“[The court] does not have the subpoena power to require that Dr. Chang attend both a trial and a deposition.”).
217. Id.
218. Id. at 1336.
219. Id. at 1338.
220. Id.
221. In re Nintendo Co., 589 F.3d 1194, 1201 (Fed. Cir. 2009).
222. Id. at 1198.
223. Id. at 1196–97.
224. Id.
225. Id. at 1197.
226. Id. at 1198.
227. Id. at 1199.
228. Id.
but none resided in Texas. Furthermore, the Federal Circuit calculated that the Texas venue would require an additional 700 miles of travel for the witnesses residing in other states, and an extra 1,756 miles and seven hours of travel for the four Japanese witnesses. Therefore, in accordance with *TS Tech*, this factor “clearly favor[ed] transfer.”

Though location and ease of access to sources of proof is often neutral in transfer cases, the court noted that “the place where the defendant’s documents are kept weighs in favor of transfer to that location.” In reference to this factor, the district court reasoned that Texas served as a “centralized location” because the majority of the evidence was housed in Washington or Japan, but the Federal Circuit disagreed. Following *Genentech*, which disregarded this “centralized location” theory in analyzing convenience to witnesses, the Federal Circuit extended this analysis to sources of proof, weighing this factor towards transfer. On balance of the factors, the court granted the writ because “the district court clearly abused its discretion in denying transfer from a venue with no meaningful ties to the case.”

### III. VENUE TRANSFER FROM THE EASTERN DISTRICT OF TEXAS FOLLOWING *TS TECH* AND *GENENTECH*.

In the wake of the *TS Tech* and *Genentech* decisions, it will be harder to keep patent infringement actions within the Eastern District of Texas. This is likely to prompt creative lawyering by plaintiffs trying to prevent transfer. The bulk of the transfer decisions post-*TS Tech* have hinged on the location

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229. *Id.*
230. *Id.*
231. *Id.*
232. *See infra* Section III.A.3.
233. *Nintendo*, 589 F.3d at 1199 (quoting *In re Genentech, Inc.*, 566 F.3d 1338, 1345 (Fed. Cir. 2009)).
234. *Id.* at 1199–1200.
235. *Id.*
236. *Id.* at 1200. The court also noted that though Nintendo’s motion for reconsideration was still pending at the district court, Nintendo “is not required to wait for the district court's decision on the motion for reconsideration because the district court clearly abused its discretion when deciding the original motion.” *Id.*
of parties and witnesses as well as judicial economy factors. The other factors in the Gilbert analysis are routinely found to be neutral or only slightly weighed for or against transfer.\textsuperscript{239} Plaintiff’s choice of forum is not treated as an independent factor in the analysis, but is “accorded deference” as the moving party bears the burden of establishing that the transferee venue is “clearly more convenient” via the Gilbert factor analysis.\textsuperscript{240}

A. \textbf{GILBERT FACTORS THAT DRIVE THE TRANSFER DETERMINATION}

Courts’ analyses of the Gilbert factors in 2009 Eastern District of Texas transfer decisions hinged on convenience for parties and witnesses and judicial economy. The remaining Gilbert factors, explained \textit{infra} Section III.A.3, tend to be either non-determinative or neutral in the legal analysis.

1. \textbf{Regional vs. National}

Following \textit{TS Tech}, many patent transfer decisions have turned on the private interest factors, including “the cost of attendance for willing witnesses”\textsuperscript{241} and “all other practical problems that make trial of a case easy, expeditious, and expensive”—generally speaking, the convenience to parties and witnesses both party and non-party.\textsuperscript{242} Regional cases concentrated away from the Eastern District of Texas now have a greater chance of transfer compared to those cases that are national in scope in terms of witnesses and parties, which have generally been kept in the Eastern District of Texas.

\textsuperscript{239} See \textit{infra} Section III.A.3.

\textsuperscript{240} \textit{In re TS Tech USA, Corp.}, 551 F.3d 1315, 1320 (Fed. Cir. 2008) (citing \textit{In re Volkswagen of Am., Inc.}, 545 F.3d 304, 314 n.10 (5th Cir. 2008)).

\textsuperscript{241} See, e.g., \textit{Volkswagen I}, 545 F.3d at 315. Cost of attendance for witnesses is computed considering that “[a]dditional distance [from home] means additional travel time; additional travel time increases the probability for meal and lodging expenses; and additional travel time with overnight stays increases the time which these fact witnesses must be away from their regular employment.” \textit{TS Tech}, 551 F.3d at 1320 (citing \textit{In re Volkswagen AG}, 371 F.3d 201, 205 (5th Cir. 2004)); see also Sanofi-Aventis Deutschland GmbH v. Novo Nordisk, Inc., 614 F. Supp. 2d 772, 779 (E.D. Tex. 2009) (considering increased “actual costs” associated with witness travel to New York City as opposed to Lufkin, Texas, but decreased “travel costs” from witnesses’ residences taking precedent to weigh the factor towards transfer).

\textsuperscript{242} See, e.g., \textit{Volkswagen I}, 545 F.3d at 315. Actual travel time (including connection time for flights) in addition to literal travel distance has been considered in recent Eastern District of Texas cases. Novartis Vaccines & Diagnostics, Inc. v. Bayer Healthcare, L.L.C., No. 2:08-CV-068, 2009 WL 3157455, at *2–3 (E.D. Tex. Sept. 28, 2009) (examining both travel distance and time in determining that the difference between flying from Europe to the Texas and California courthouses would be “insignificant[;]”); Acceleron, L.L.C. v. Egenera, Inc., 634 F. Supp. 2d 758, 767 (E.D. Tex. 2009) (considering flying and driving time in determining that “Texas’ central location makes it a more convenient venue for all the witnesses in the case than the District of Delaware”).
In Partsriver, Inc. v. Shopzilla, Inc., the trial court granted transfer where the case had a regional nature. The plaintiff, six out of seven defendants, and the original patent owner were all located in California. The seventh defendant resided in Washington. In a brief opinion, Judge Folsom of the Eastern District of Texas went directly to the relevant factor, stating that “the overall nature of this case . . . is regional and therefore would be more conveniently handled by the Northern District of California,” and thus granted transfer.

In contrast, many cases deemed to be “national” by the Eastern District of Texas have managed to overcome defendants’ transfer motions, with and without sufficient connections to the district. Judge Love found this factor to be neutral in Konami Digital Entertainment Co. v. Harmonix Music Systems, Inc., where the defendants requested transfer to the District of Massachusetts and witnesses were located on both the east and west coasts. Examining the well-established 100-mile rule, Judge Love noted that “there are a significant number of witnesses by either side who will be inconvenienced to a significant degree.” This national scattering of witnesses, parties, and sources of proof led to denial of transfer.

Similarly, the court emphasized Texas’ “centralized location” in the joint transfer motion denial in J2 Global Communications, Inc. v. Protus IP Solutions,

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244. Id.
245. Id.
246. Id; see also Chrimar Sys., Inc. v. Garrettcom, Inc., No. 2:09-CV-85-TJW (E.D. Tex. Aug. 27, 2009) (ruling in a one page order that the non-Texan plaintiff “failed to show a sufficient connection to this District that would warrant denying transfer” in a case with two California defendants); Fifth Generation Computer Corp. v. Int'l Bus. Machs. Corp., No. 9:08-CV-205, 2009 WL 398783, at *6 (E.D. Tex. Feb. 17, 2009) (finding “[k]ey to the court’s decision” the lack of connection to Texas, barring one potential witness, and the cluster of witnesses and parties in or near the Southern District of New York to “weigh fairly heavily in favor of transfer”); Odom v. Microsoft Corp., 596 F. Supp. 2d 995, 1004 (E.D. Tex. 2009) (holding that the case was “significantly localized in the Northwest,” with both parties and all but one witness located regionally which weighed in favor of transfer to show that transfer from Texas to Oregon would be “clearly more convenient”).
249. Id. at *9.
The parties’ headquarters (and evidence) were located in California, Ontario, Georgia, and Washington. The defendants identified witnesses located in numerous states and abroad on multiple continents. Because the parties and witnesses were spread across the United States and the world, the court found that the proposed transferee venue of the Central District of California would be “no more convenient” than the Eastern District of Texas and denied the transfer motion. Texas’ central location is less significant when there is sufficient connection to the transferee district which can sway the court to grant transfer. Similarly, connection to the transferor court will weigh heavily against transfer.

2. Judicial Economy

In addition to geographic considerations, various judicial economy factors have weighed heavily in recent cases, including additional state law claims, prior or concurrent litigation involving the same or a similar patent, and the litigation timeline. In patent infringement suits that involve additional claims governed under state law, this aspect of the lawsuit must be considered when deciding whether or not to transfer. For example, in Odom v. Microsoft Corp., there were potential Oregon state law contractual issues to be addressed, contributing to the regional nature of the case and thus its transfer from the Eastern District of Texas to the District of Oregon.

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251. Id.
252. Id.
256. Odom v. Microsoft Corp., 596 F. Supp. 2d 995, 1004 (E.D. Tex. 2009) (stating that “where a case involves interpretation of a particular state’s laws, this factor may weigh in favor of transfer”).
257. Id.
Prior or concurrent litigation in the same court involving the same patent(s) also weighs heavily in the transfer determination. For instance, Judge Ward denied transfer in *Novartis Vaccines & Diagnostics, Inc. v. Bayer Healthcare, L.L.C.* because there was a related lawsuit pending simultaneously in the same court involving the same patent. After considering “the interests of justice” emphasized in § 1404(a), Judge Ward recognized that the “two cases involve[d] the same claim construction issues” and that transferring one “will only consume unnecessarily additional judicial resources.”

The litigation timeline can also greatly affect the transfer determination. This is evidenced by the transfer grant in *Abstrax, Inc. v. Sun Microsystems, Inc.* Sun's case had been consolidated with another suit regarding the same patent in the Eastern District of Texas for both discovery and claim construction. The court granted transfer to the regionally appropriate Northern District of California on the condition that Sun would adhere to the claim construction opinion already issued by the Eastern District of Texas. This single party transfer would not have been possible had the claims not yet been construed.

This factor can also weigh in favor of transfer when there is simultaneous or past litigation involving the contested patent in the transferee district. For example, the defendant in *Jackson v. Intel Corp.* applying for transfer out of Texas had previously litigated the patent at issue with over seventy-five parties in the Northern District of Illinois (his “home district”). Even though there were no pending actions involving the contested patent, Judge Ward granted the transfer motion because “the accumulated knowledge and familiarity of the judges in that court with both the plaintiff and his patent would indeed facilitate efficient use of judicial resources.”

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258. *See In re Volkswagen of Am., Inc.*, 566 F.3d 1349, 1351 (Fed. Cir. 2009) (“[T]he existence of multiple lawsuits involving the same issues is a paramount consideration when determining whether a transfer is in the interest of justice.”).


260. *Id.*


262. *Id.* at *1.

263. *Id.* at *2 n.3.


265. *Id.* (“Where the interests of judicial economy [are] so strongly in favor of transferring a case, the Federal Circuit has held that other factors may be ‘afforded little or
In a pair of cases involving the same parties but different patents, the weighing of this factor dictated opposite transfer outcomes where the court found insufficient similarities between the cases.266 The trial court granted transfer in a case involving six patents all stemming from one original patent application, three of which had previously been litigated in the District of Maryland.267 However, the court denied transfer in the suit involving a patent without a similar litigation history. 268 Considering the case with past connections to Maryland, the court looked to the “significant overlap” between the current and previous factors in its transfer grant to “preserve judicial economy.”269 Though the plaintiffs in the other case argued that the two cases involved related technologies and the same parties, the court found “few similarities” between the patents.270 The court ruled that their strained relation was “not sufficient to weigh in favor of transfer.”271

3. Remaining Non-Determinative Factors

The remaining Gilbert factors are less central to courts’ transfer decisions than the convenience and judicial economy factors. Among these subordinate private interest factors is the availability and ease of access to sources of proof. As Volkswagen I set forth, “access to some sources of proof presents a lesser inconvenience now than it might have absent recent developments.”272 Even so, both Genentech and Nintendo found this factor weighed towards transfer where a significant number of defendant’s documents were in or near the proposed transferee district.273 Given the extent to which technological advances aid electronic discovery, this factor usually is neutral,274 but it cannot be completely disregarded. Though many cases do call for

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267. Invitrogen I, 2009 WL 331891, at *1 (noting that the previous eleven year litigation resulted in many rulings including claim construction).

268. Invitrogen II, 2009 WL 331889, at *5 (holding that the Eastern District of Texas is “more convenient” than Maryland for the California witnesses).


271. Id.

272. In re Volkswagen of Am., Inc. (Volkswagen I), 545 F.3d 304, 316 (5th Cir. 2008).

273. In re Nintendo Co., 589 F.3d 1194, 1199–1200 (Fed. Cir. 2009); In re Genentech, 566 F.3d 1338, 1346 (Fed. Cir. 2009).

274. See, e.g., Konami Digital Entm’t Co. v. Harmonix Music Sys., Inc., No. 6:08-CV-286, 2009 WL 781134, at *5 (E.D. Tex. 2009) (holding that “with respect to sources of proof that are purely electronic information . . . it does not follow that transfer . . . would be more convenient for anyone”).
physical evidence from varying locations, this factor seldom weighs for or against transfer.275

Similarly, the availability of compulsory process to secure witnesses’ testimony often receives neutral weight. This factor is only relevant in favor of transfer regarding third party witnesses residing in the transferee venue, and is only weighed heavily when “absolute subpoena power”276 is held by the transferee venue.277

Another less important public interest factor revolves around “the administrative difficulties flowing from court congestion.”278 Various sources of statistics have been used by different parties to show docket speed, and judges have yet to let this factor weigh heavily for or against transfer.279 Courts may also consider “the local interest in having localized interests decided at home.”280 Most patent infringement suits involve products sold nationally. This gives the citizens of each federal district equal interest in the outcome and renders this factor neutral in regards to nationally marketed and sold products.281

275. See, e.g., Novartis Vaccines & Diagnostics, Inc. v. Hoffman-La Roche, Inc., 597 F. Supp. 2d 706, 711 (E.D. Tex. 2009) (finding that where documents were “spread across the nation,” there is no arguable increase of access to proof from transfer).

276. “‘Absolute subpoena power’ is simply the concept that all relevant and material third party witnesses reside within the subpoena power of a particular venue.” Acceleron, L.L.C. v. Egenera, Inc., 634 F. Supp. 2d 758, 765 (E.D. Tex. 2009) (internal citations omitted).

277. See Volkswagen I, 545 F.3d at 316 (weighing this factor in favor of and to eventually grant transfer when all of the third party witnesses resided within the transferee venue).

278. Id. at 315.

279. See, e.g., In re TS Tech, USA, Corp., 551 F.3d 1315, 1320 (Fed. Cir. 2008) (affirming the lower court’s determination that “administrative difficulties due to court congestion was a neutral factor in deciding whether to transfer”); Novartis Vaccines & Diagnostics v. Bayer Healthcare, L.L.C., No. 2:08-CV-068, 2009 WL 3157455, at *4 (E.D. Tex. Sept. 28, 2009) (holding the factor neutral because statistics from 2007 comparing patent cases per judge in the Eastern District of Texas and the Northern District of California “fail[] to show that [they] translate into more administrative difficulties or a slower disposition of cases in the Eastern District”); Hoffman-La Roche, 597 F. Supp. 2d at 714 (finding a “negligible” difference between the tenth and fourteenth fastest civil dockets in the nation with a 1.5 month difference in average time to trial). But see Acceleron, 634 F. Supp. 2d at 767 (weighing the factor against transfer where the median time to trial difference was 19.5 months greater in the proposed transferee venue).

280. Volkswagen I, 545 F.3d at 315.

281. See, e.g., TS Tech, 551 F.3d at 1321 (“[T]he vehicles containing TS Tech’s allegedly infringing headrest assemblies were sold throughout the United States, and thus the citizens of the Eastern District of Texas have no more or less of a meaningful connection to this case than any other venue.”).
One must also consider “the familiarity of the forum with the law that will govern the case.” Patent litigation involves federal law, and therefore, this factor is neutral unless additional state law claims are involved in the suit. The last factor, “the avoidance of unnecessary problems of conflict of laws [or in] the application of foreign law,” was found by the Eastern District of Texas in patent litigation disputes to be “inapplicable in the transfer analysis.”

B. **Plaintiffs’ Tactics to Defeat Transfer**

In light of the new transfer standard’s application in the Eastern District of Texas, plaintiffs have developed creative tactics to try to keep their cases in the district. The plaintiffs in *Balthasar Online, Inc. v. Network Solutions, L.L.C.* tried to add local Texas defendants in an amended complaint following the *TS Tech* decision. But Judge Folsom severed the case, transferring the original California defendants to the Northern District of California while denying transfer as “extremely inconvenient for and unfair to” the added local Texas defendants. The decision has been viewed by practitioners to “provide a lot of guidance going forward” on future venue disputes. It potentially could protect local Texas companies from being dragged into law suits by plaintiffs in an effort to retain venue choice.

Additionally, defendants in declaratory judgment actions (who would be plaintiffs in patent infringement suits) have started to use the new venue transfer case law to their advantage to bring patent cases into the Eastern District of Texas. In November 2009, the District of Delaware transferred a pair of declaratory judgment actions against QuinStreet, Inc. to the Eastern District of Texas. The Delaware judge granted transfer for judicial
economy reasons, because Judge Folsom in the Eastern District of Texas had previously construed the claims of the contested patents and had a related case pending. In granting the motion, the Delaware judge noted that she “continue[s] to be amazed by the energy and resources expended on motions to transfer.” In such instances, the developments in transfer case-law, widely considered to be defendant-friendly, are being manipulated to get some infringement plaintiffs into their desired jurisdiction, when first being defendants in a declaratory judgment suit.

IV. PATENT REFORM

Three patent reform proposals are pending in Congress in 2009: House Bill 1260 and Senate Bills 515 and 610. Though Congress has not recently passed any major patent reform, the current legislation proposes major changes to the venue provisions in a rewrite of § 1400. The legislation proposes to overturn the holding in *VE Holding Corp. v. Johnson Gas Appliance Co.*, which interpreted the meaning of “resides” in the patent statute to match the general venue statute, and aims to narrow venue in patent cases. The current patent reform proposals in the 111th Congress have differing venue proposals to achieve this directive. House Bill 1260 proposes a change to the venue statute itself to avoid forum shopping in patent cases, lays out specific guidelines tailored to patent cases to determine venue, and adds a provision to guide venue transfer decisions. Senate Bill

290. Id. at 2 n.2.
291. Id. at 1.
292. Only S. 515 is discussed due to lack of movement on S. 610.
293. See supra Section I.A.
296. Id. The new provision, 28 U.S.C. §1400(d), would read,
(d) If a plaintiff brings a civil action for patent infringement or declaratory judgment relief under subsection (c), then the defendant may request the district court to transfer that action to another district or division where, in the court’s determination—(1) any of the parties has substantial evidence or witnesses that otherwise would present considerable
515 originally proposed almost identical guidelines to House Bill 1260,297 but was amended in April of 2009, striking out the detailed venue guidelines and limiting its venue proposal to modifying § 1400(c), codifying the “clearly more convenient” standard set in the Fifth Circuit’s Volkswagen I opinion (followed by TS Tech and Gencotech at the Federal Circuit, supra Section II.A).298 The Senate Report on the Patent Reform Act of 2009 (Senate Bill 515) pointed to the Federal Circuit’s TS Tech decision as evidence that the standard should be adopted to apply to the patent venue statute specifically,299 and this venue proposal has most recently garnered support from Gary Locke, Secretary of Commerce.300

To avoid forum shopping, the House Bill’s proposed change to § 1400(b) to prevent parties from “manufactur[ing] venue” invites much of the previous criticism of the almost identical venue provisions in the 2007 bills.301 It calls for an evaluation of “intent” in the proposed statute which could result in increased discovery to resolve this subjective factor.302 The House Bill also limits the choice of venue in both patent infringement and declaratory judgment actions so that cases can only be brought in the district of the defendant’s principal place of business; its place of incorporation; its primary U.S. subsidiary location (for foreign corporation defendants); the location of alleged “substantial acts of infringement” (if there is a defendant-controlled physical facility there); and plaintiff-based locations only for nonprofits, individual inventors being a sole plaintiff, and higher education institutions.303 While currently national corporations can be sued in

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301. See, e.g., Rooklidge & Stasio, supra note 17, at 3–4.

302. Id. (criticizing this “subjective intent standard” with the assertion that it would cause “increased cost and complexity in patent infringement litigation from the very beginning”).

almost any district," this reform attempts to limit venue in to only “convenient” districts.

There are potential problems associated with the House Bill's venue proposals. Although a company’s principal place of business and place of incorporation or formation can easily be determined, the House Bill's clause pertaining to foreign corporations can be confusing as it requires ascertaining the “primary” U.S. subsidiary. Some have argued that it “invites disputes about what the 'primary' subsidiary is,” and has a gap when U.S. and foreign defendants are joined, potentially creating “an unmanageable and unpredictable mess.”

Similarly, the House Bill's clause allowing venue based on the location of infringing acts invites new disputes over the meaning of the word “substantial,” in the context of both “substantial acts of infringement” and the definition of the defendant’s “regular and established physical facility that the defendant controls and that constitutes a substantial portion of the operations of the defendant.”

This proposal mirrors patent venue statutes prior to the 1988 revisions that required a determination of “where the defendant has committed acts of infringement and has a regular and established place of business.” The former statute was criticized as increasing litigation burdens and “prolong[ing] patent litigation.”

The past concerns over determining a “regular and established place of business” also remain, as prior cases under this standard have turned on various “small shards of evidence,” and the complexity would only increased with current technological advances and the growth of online companies. Critics have commented more recently that these types of multi-part provisions “are
ripe for complex factual disputes and do[] nothing to create certainty in
venue selection, a goal of the . . . patent venue reform provisions.”

The House Bill goes on to only allow transfer where “any of the parties
has substantial evidence or witnesses that otherwise would present
considerable evidentiary burdens to the defendant if such transfer were not
granted,” but only if “such transfer would not cause undue hardship to the
plaintiff.” Historically, Congress has struggled to codify the general venue
and transfer statutes, and here the patent statute presents similar issues.
The simplification to the Senate Bill to follow the case law’s “clearly more
convenient” standard, demonstrates that proper transfer guidelines can
potentially solve the venue conflict, but this will rely heavily on how the
courts interpret them.

V. CONCLUSION

The three circuit court venue transfer decisions most favorable to
defendants, Volkswagen I, TS Tech, and Genentech, bolstered by Hoffmann-La
Roche and Nintendo, set a solid standard for district court venue transfer
determinations. The Eastern District of Texas (among other districts) has
responded, transferring cases when geography or judicial economy factors
dictate transfer. Although it might now be more difficult to keep a case in the
Eastern District of Texas, it is still a highly desired jurisdiction for
plaintiffs. Plaintiffs are already developing new filing tactics in an effort to
obtain their desired venues, and defendants are responding by filing pre-
emptive declaratory judgment actions in less plaintiff-friendly courts. Both
lawyers and patent holders will continue to use creativity to obtain their
choice of forum, and, unless Congress dictates otherwise, courts will use the
Gilbert factors as the guiding framework. While the Gilbert factors give
defendants some leeway to obtain transfer to a more favorable or neutral
jurisdiction, the balancing of the eight factors allows for much judicial
discretion. The Federal Circuit specified that the plaintiff’s choice of venue
should not be weighed as an additional factor, but the court has yet to define

310. Rooklidge & Stasio, supra note 17, at 4.
311. H.R. 1260.
312. See WRIGHT, MILLER & COOPER, supra note 39, § 3848.
313. See supra Section II.A.
314. See supra Part III (discussing recent venue transfer decisions in the Eastern District
of Texas following the “clearly more convenient” standard on the balance of the Gilbert
factors).
315. Supra Section I.D.
just how much deference the plaintiff’s choice should receive. Despite the development of standards in recent decisions, such uncertainties persist in the venue transfer analysis for patent infringement actions. While courts continue to struggle to define clear standards, Congress is in a position to provide greater clarity by enacting legislation which specifies how courts should resolve questions of venue in patent litigation. Both of the proposed Congressional bills have benefits and drawbacks, but either would directly address the problem with the patent-specific venue provisions by codifying a clear framework of analysis for the courts.

316. See In re Volkswagen of Am., Inc., 545 F.3d 304, 314 n.10 (5th Cir. 2008) (“Although a plaintiff’s choice of venue is not a distinct factor in the venue transfer analysis, it is nonetheless taken into account as it places a significant burden on the movant to show good cause for the transfer.”).

317. See supra Part IV.
ADVERSE CLINICAL AND PUBLIC HEALTH CONSEQUENCES OF LIMITED ANTI-RETROVIRAL LICENSING

Jay Purcell

Within twelve years of its identification as the cause of Acquired Immune Deficiency Syndrome (AIDS), the human immunodeficiency virus (HIV) was effectively cured. By 1995, scientific innovation produced nine medicines to suppress the virus, transforming HIV into a chronic condition. Mortality from AIDS plummeted, yet these advances did not span the globe. Drug costs prevented any expansion of treatments within resource-limited settings, where the vast majority of patients lived. Since 2003, governmental, non-governmental and multilateral agencies, and impacted countries, drastically scaled-up the provision of HIV medicines—over four million more patients now receive at least some therapy. This global “scale-up” of HIV treatment depends on mass production of generics, manufacture of which requires patent licensing, expiration or unavailability. The majority of therapies on which patients rely are in the public domain; most generic production exists because of patent expiration or unavailability, and not licensure. Because HIV drug development is so recent, drugs in the public domain are not simply older, but are also considerably less valuable in suppressing HIV and considerably more costly in terms of their extensive side effects. Drugs available in the public domain are less effective and frequently toxic to patients. Additionally, the newer, safe treatments that define the domestic standard of care are mostly unavailable in child- and fixed-dose and formulations. Whether excluded by price or technology, many low- and middle-income (LMI) countries cannot adopt modern treatments to treat their own, more substantial epidemics. These trends create significant deviations in the standard of care for HIV around the world.

Part I of this Note explores the epidemic’s spread, discusses the medical community’s subsequent response, and finally concentrates on governmental efforts to treat infected persons and the effect of legal regulations. Part II considers how these legal systems differently impact particular patient populations, specifically examining disparities in the standard of care for HIV patients. Part III concludes by surveying recent trends within the field.

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I. THE AIDS EPIDEMIC

A. CURRENT TREATMENTS AND THE EFFECTS OF HIV AND AIDS IN THE DEVELOPING WORLD

In 2008, HIV infected 2.7 million new patients and killed an estimated 2 million people. Since its identification in 1981, AIDS killed 25 million patients; nearly 35 million more currently live with HIV. HIV infects the immune system, destroying the cells that fight infection. Lacking these cells, patients develop AIDS and eventually die from opportunistic secondary infections, such as tuberculosis or pneumonia. Without treatment, HIV almost always causes AIDS.

Most new HIV infections and related deaths occur in sub-Saharan Africa. Greater than 65 percent of infected persons live there. Moreover, new pediatric infections (91 percent) and deaths (72 percent) occur disproportionately in this region. The epidemic’s impact is concentrated where governments cannot respond with effectively targeted health interventions and patients are overwhelmingly impoverished. Lacking resources to create commercial demand or even afford the marginal costs of treatment, these populations fail to attract medicines and formulations specific to local needs. Because of their extreme impoverishment, sub-Saharan communities cannot effectively express demand. Limited domestic

2. Id.
4. AIDS EPIDEMIC UPDATE, supra note 1, at 21.
5. COMMISSION ON MACROECONOMICS AND HEALTH, WORLD HEALTH ORG., MACROECONOMICS AND HEALTH: INVESTING IN HEALTH FOR ECONOMIC DEVELOPMENT 57 (2003), available at http://whqlibdoc.who.int/publications/2001/924154550x.pdf. The Commission noted,

Even if poor countries allocated more domestic resources to health, such measures would still not resolve the basic problem: poor countries lack the needed financial resources to meet the most basic health needs of their populations. At $30 to $40 per capita for essential interventions, these costs would represent more than 10 percent of GNP of the least developed countries, far above what can in fact be mobilized out of domestic resources.
health budgets in the region cannot finance substantial HIV interventions. Consequently, staggering mortality characterized the developing world’s first twenty years of AIDS, as a vanishingly small number of patients received any care before death.

The treatment landscape changed dramatically in 1995 with the innovation of the triple-cocktail, or highly-active anti-retroviral therapy (HAART). Prior to HAART, HIV almost always led to death. Because only one class of antiretroviral (ARV) drugs—nucleoside reverse transcriptase inhibitors (NRTI)—existed prior to 1995, therapies were incapable of suppressing HIV’s rapid replication. HIV copies itself quickly and inaccurately, creating drug-resistant strains within a single patient when she is treated with a single agent. As new classes of therapies entered the clinic in 1995, researchers recognized the potential of using multiple agents against HIV. U.S. and E.U. patients experienced 70 percent declines in mortality following introduction of these new classes of drugs, protease and non-nucleoside reverse transcriptase inhibitors (PI and NNRTI, respectively), in 1995 and 1996. When paired with a backbone of two NRTIs, these new drugs produced potent cocktails that ended the death sentence of AIDS for well-resourced patients.

In the mid-1990s, per-patient costs for cocktail therapies exceeded $10,000 per year. These costs prevented any mortality declines in LMI countries and for uninsured patients in the developed world. A 1998

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6. Currently, there are five classes of action: nucleoside reverse transcriptase inhibitors (NRTI), non-nucleoside reverse transcriptase inhibitors (NNRTI), protease inhibitors (PI), integrase inhibitors (II), CCR5 antagonists, and fusion inhibitors (FI).

7. Scott Hammer et al., A Trial Comparing Nucleoside Monotherapy With Combination Therapy in HIV-Infected Adults With CD4 Cell Counts From 200 to 500 Per Cubic Millimeter, 335 NEW ENG. J. MED. 1081 (1996); Scott Hammer et al., A Controlled Trial of Two Nucleoside Analogues Plus Indinavir in Persons With Human Immunodeficiency Virus Infection and CD4 Cell Counts of 200 Per Cubic Millimeter or Less, 337 NEW ENG. J. MED. 725 (1997); Roy Gulick et al., Treatment With Indinavir, Zidovudine, and Lamivudine in Adults With Human Immunodeficiency Virus Infection and Prior Antiretroviral Therapy, 337 NEW ENG. J. MED. 734 (1997).

8. See id.

9. Such as NRTI+NRTI+PI, or NRTI+NRTI+NNRTI.


11. “Low- and middle-income,” like “developing country,” is a term of art. For simplicity, LMI are generally non-OECD countries, while Least Developed Countries are the poorest states on earth. The World Bank uses precise metrics to classify countries as low-, middle-, and high-income based on per capita gross national income. See WORLD BANK, COUNTRY CLASSIFICATION, http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20420458~menuPK:64133156~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html (last visited October 7, 2010) ("[L]ow income, $975 or
analysis of U.S. and LMI country GNP indicated that ARVs cost 300 times more in the developing world, where most patients live. In the same year, another analysis showed the cost of HAART in Haiti, relative to U.S. health care expenditures, was 225 times more expensive. Developing world price points for ARVs resulted in near-total inaccessibility of the drugs. Donations and scaled pricing mechanisms did little to change these circumstances. Because the most at-risk populations in the world typically cannot pay anything for medicines, potential revenues for worldwide distribution were (and remain) trivial, and neither manufacturers nor purchasers reached patients.

In the absence of effective production and distribution mechanisms to reach the majority of the world’s infected population, predictable results followed: in 2000, fewer than 10,000 patients in Africa received HAART. By 2003, treatment coverage crawled to 2 percent, and reached 10 percent by 2005. The long-term consequences of delaying introduction of HAART to LMI countries are overwhelming demographically—infections in sub-Saharan Africa outnumber U.S. and E.U. infections by a factor of 20:1, but life-years saved in the United States and European Union continue to outnumber life-years saved in sub-Saharan Africa by 3:1. Delays in bringing therapy to South Africa between 2000 and 2005 killed over 330,000 people,

less; lower middle income, $976–$3,855; upper middle income, $3,856–$11,905; and high income, $11,906 or more.”).


17. AIDS EPIDEMIC UPDATE, supra note 1, at 25.


19. AIDS EPIDEMIC UPDATE, supra note 1, at 18.
and caused a loss of over three million life-years.\textsuperscript{20} Life expectancy in Zimbabwe fell by eighteen years between 1990 and 2003.\textsuperscript{21}

After years of inaction, global commitments to treating and preventing HIV grew more than 500 percent between 2002 and 2008.\textsuperscript{22} Substantial funding is channeled through multi-lateral agents and non-governmental organizations (NGOs), such as the Global Fund to Fight AIDS, Tuberculosis and Malaria; UNITAID, the U.N. initiative to scale-up access to treatments in developing countries; and the World Bank. The emergence of the Bill and Melinda Gates Foundation is equally significant—by 2007, its grant-making budget equaled the World Health Organization’s (WHO) total budget.\textsuperscript{23}

Besides these global financing mechanisms, the most significant contributor was American legislation. In 2003, President George Bush signed the Leadership Against HIV/AIDS, Tuberculosis, and Malaria Act.\textsuperscript{24} The Act created the five-year, fifteen-billion-dollar President’s Emergency Plan for AIDS Relief (PEPFAR), the largest global health intervention ever. In 2008, the Global Leadership Against HIV/AIDS, Tuberculosis, and Malaria Reauthorization Act tripled the intervention to $48 billion.\textsuperscript{25} PEPFAR buys and coordinates distribution of therapies, operates testing and treatment clinics, and supports extensive research and health interventions. The aggregate global commitment to HIV/AIDS raised the number of LMI patients on HAART by four million since 2003.\textsuperscript{26} This collective expansion of care cannot be overestimated.

\begin{itemize}
  \item \textsuperscript{20} Pride Chigwedere et al., \textit{Estimating the Lost Benefits of Antiretroviral Drug Use in South Africa}, 49 J. ACQUIRED IMMUNE DEFICIENCY SYNDROME 410 (2008).
  \item \textsuperscript{23} David McCoy et al., \textit{The Bill & Melinda Gates Foundation’s Grant-Making Programme for Global Health}, 373 THE LANCET 1645 (2009).
\end{itemize}
Despite historic increases in funding for therapies and other interventions, most patients still receive no treatment. Patients receiving treatment, however, almost exclusively receive medicines strongly disfavored by the WHO and U.S. Department of Health and Human Services. HIV patients in the United States and Europe no longer receive these antiquated therapies for reasons of toxicity, inefficacy, and tolerability. At the same time President Bush created PEPFAR, U.S. and E.U. physicians removed its components from prescription lists. In the United States and European Union, a variety of small-molecule drugs are combined into cocktails, offering particular side effect profiles based on a patient’s tolerance, allergies, co-morbidities, and other factors. In LMI countries, there is a single cocktail. The foundation of the scale-up is a single pill: Triomune.

Recent increases in funding for global HIV treatment represent an unrivaled public health intervention that is plagued by serious side effects because the pool of accessible medicines is so small. Limited licensing and production of effective, modern compounds hamper efforts to universalize proper care. Additionally, limited licensing of safe and effective compounds prevents appropriate treatments from reaching particular patient groups, notably children. Even if every patient received a timely and accurate diagnosis, the unavailability of modern therapies precludes most patients from receiving adequate treatment. While American and European patient populations receive many iterations of triple- cocktail therapy, most patients, and nearly every LMI patient, receive Triomone exclusively.

B. SOURCING THE SCALE-UP

HAART transformed HIV into a chronic, non-fatal infection. The “scale-up” most significantly brought HAART to more than 4,000,000 people in LMI countries. More than money was required: many initially opposed any scale-up of complex HAART therapies, but every argument against the scale-up proved groundless. See Edward J. Mills et al., Adherence to Antiretroviral Therapy in sub-Saharan Africa and North America: A Meta-analysis, 296 J. AM. MED. ASS’N. 679 (2006); Edward J. Mills et al., Adherence to HAART: A Systematic Review of Developed and Developing Nation Patient-Reported Barriers and Facilitators. 3 PLOS MED e438 (2006); Olivia Keiser et al., Public-Health and Individual Approaches to Antiretroviral Therapy: Township South Africa and Switzerland Compared, 5 PLOS MED e148 (2008); Paul Farmer & Jim Yong Kim, Community-based Approaches to the Control of Multidrug-Resistant Tuberculosis: Introducing ‘DOTS-Plus,” 317 BRIT. MED. J. 671 (1998); Jonathan Mermin et al.,


29. More than money was required: many initially opposed any scale-up of complex HAART therapies, but every argument against the scale-up proved groundless. See Edward J. Mills et al., Adherence to Antiretroviral Therapy in sub-Saharan Africa and North America: A Meta-analysis, 296 J. AM. MED. ASS’N. 679 (2006); Edward J. Mills et al., Adherence to HAART: A Systematic Review of Developed and Developing Nation Patient-Reported Barriers and Facilitators. 3 PLOS MED e438 (2006); Olivia Keiser et al., Public-Health and Individual Approaches to Antiretroviral Therapy: Township South Africa and Switzerland Compared, 5 PLOS MED e148 (2008); Paul Farmer & Jim Yong Kim, Community-based Approaches to the Control of Multidrug-Resistant Tuberculosis: Introducing ‘DOTS-Plus,” 317 BRIT. MED. J. 671 (1998); Jonathan Mermin et al.,
treatment because generic production emerged as the most powerful mechanism for producing ARVs at prices enabling widespread distribution. Over 80 percent of ARVs prescribed in the developing world originate in India’s generic plants. Manufacturers there compete with one another, invest in bulk manufacturing processes, and drive prices toward marginal cost. This competition occurs optimally when patent holders sign multiple licenses, or patent rights do not exist because of expiration or ineligibility. Generic manufacturers “have neither patents nor a costly approval process to deter potential competitors [and] quickly face competition from other companies producing identical drugs. That intense competition forces . . . much lower prices than the innovator firm.” The results of such competition are clear—generic ARVs cost between 3 and 33 percent of branded sales prices.

An example illustrates these observations: six manufacturers sell the developing world’s most common ARV to PEPFAR (Triomune, co-formulated Stavudine, Nevirapine, and Lamivudine). In 2000, the originator

Mortality in HIV-Infected Ugandan Adults Receiving Antiretroviral Treatment and Survival of Their HIV-Uninfected Children: A Prospective Cohort Study, 371 THE LANCET 703 (2008).


32. Principal manufacturers are Alkem, Aurolindo, Cipla, Emcure, Hetero, Macleods, Matrix, Ranbaxy, and Strides. Barr (now Teva), Huahai (China), and Aspen Pharmacare (South Africa) are non-Indian producers of relevance. Aspen Pharmacare, in South Africa, is the only African producer. The others are Barr Pharmaceuticals, of New York, and Zhejiang Huahai Pharmaceutical Co. Ltd, of Zhejiang, China. See Nicholas Zamiska, U.S. Opens the Door to Chinese Pills, WALL ST. J., Oct. 9, 2007. Barr’s tentative approval for didanosine, in December 2004 (ANDA no. 077167), was the first ARV approved under the Food and Drug Administration’s (FDA) new Guidance, but it was a Paragraph IV ANDA and unique to the remaining 103. Aspen’s first approval was the second drug approved under the new Guidance; its second followed in seventeen months. Ninety-nine percent of subsequent tentative approvals originate in India. See FOOD AND DRUG ADMINISTRATION, PRESIDENT’S EMERGENCY PLAN FOR AIDS RELIEF. APPROVED AND TENTATIVELY APPROVED ANTIRETROVIRALS IN ASSOCIATION WITH THE PRESIDENT’S EMERGENCY PLAN, http://www.fda.gov/InternationalPrograms/FDABeyondOurBordersForeignOffices/AsiaAndAfrica/ucm119231.htm (last visited December 29, 2009) [hereinafter FDA].


34. Chien, supra note 31.
price for one year of these drugs approximated $10,439.35 By October 2009, the median price across manufacturers reached $83.36 These price declines directly affect the number of patients served, because most patients in resource-limited settings resource to buy pharmaceuticals. As a result, most treatment budgets come from fixed multilateral and non-governmental sources, such that the number of patients served is a function of drug cost.

PEPFAR encouraged the use and development of generic ARVs. Within a year of the Act's passage, the Food and Drug Administration (FDA) issued a Guidance Document elaborating a review pathway for international distribution of generic ARVs.37 After establishing safety, efficacy, and quality standards, a foreign producer can attain “tentative” FDA approval to sell ARVs to PEPFAR, even while domestic patent protection persists.38 Tentative approval qualifies a drug for PEPFAR distribution, and often qualifies a product for WHO, UNITAID, and Global Fund distribution.39 Tentative approvals, therefore, can generate clearance for the world's largest ARV buyers, a circumstance creating economies of scale for producers. Global AIDS Coordinator Mark Dybul observed the effects of U.S. procurement policies before the House Foreign Affairs Committee in 2007:

PEPFAR also has increased the availability of safe, effective, low-cost generic antiretroviral drugs (ARVs) in the developing world. There was a significant increase in the use of generic products, and in 2007 we will continue to work with partners to utilize the safest, cheapest drugs whenever possible. As a side benefit, the process has also expedited the availability in the United States of six generic versions of ARVs whose U.S. patent protection had expired. [PEPFAR's supply chain system] increased its share of ARV purchases that are generics from 72 percent in April to September 2006, to 88 percent (by volume) in January to March 2007.40

No FDA process, however, affects a patent-holder’s ability to enforce patent rights in any country where the patent is registered.41 PEPFAR does nothing to abate patent rights.

The FDA's tentatively approved PEPFAR ARVs provide a dataset of 104 generic formulations that constitute the backbone of HAART in LMI countries.42 These 104 formulations include 165 active ingredients, some of which are combined into co-formulations. Of the 164 medicines, 135 (82.3%) were unpatented in India, where the vast majority of generic production facilities exist. Only 17.7% of PEPFAR-purchased ARVs result from voluntary license exchanges between patent owners and generic producers. It is likely that the ratio of generic-to-licensed volume actually exceeds these figures, because the majority of procured drugs are for “first-line” patients, all of which were registered before 1995. The pharmaceutical industry largely eschews licensing to manufacturers in India that would then sell generic drugs to PEPFAR. Instead, PEPFAR relies mostly on


42. The data includes strength, dosage, supplier, manufacturer, and date of approval. The author coded the data and performed all calculations, as of November, 2009. FOOD AND DRUG ADMINISTRATION, APPROVED AND TENTATIVELY APPROVED ANTIRETROVIRALS IN ASSOCIATION WITH PRESIDENT'S EMERGENCY PLAN, http://www.fda.gov/internationalprograms/fdabeyondourbordersforeignoffices/asiaandafrica/ucm119231.htm.
compounds in India’s public domain, as a result of the timing of India’s TRIPS obligations. Table 1 illustrates these trends.

Table 1 All PEPFAR Formulations, by Active Substance

<table>
<thead>
<tr>
<th>Drugs Registered After 1995</th>
<th>PEPFAR Iterations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abacavir (Ziagen®)</td>
<td>11</td>
</tr>
<tr>
<td>Atazanavir (Reyataz®)</td>
<td>1</td>
</tr>
<tr>
<td>Emtricitabine (Emtriva®)</td>
<td>5</td>
</tr>
<tr>
<td>Lopinavir/ritonavir (Kaletra®)</td>
<td>3</td>
</tr>
<tr>
<td>Tenfovir disoproxil fumarate (Viread®)</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>29 (17.68%)</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Drugs Registered Before 1995</th>
<th>PEPFAR Iterations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Didanosine (Videx®)</td>
<td>4</td>
</tr>
<tr>
<td>Efavirenz (Sustiva®)</td>
<td>16</td>
</tr>
<tr>
<td>Nevirapine (Viramune®)</td>
<td>22</td>
</tr>
<tr>
<td>Lamivudine (Epivir®)</td>
<td>46</td>
</tr>
<tr>
<td>Stavudine (Zerit®)</td>
<td>20</td>
</tr>
<tr>
<td>Zidovudine (Retrovir®)</td>
<td>27</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>135 (82.3%)</strong></td>
</tr>
</tbody>
</table>


45. FDA, supra note 42.

46. Calculated by summing the number of ingredients in the 104 formulations, supra note 42, and adding priority dates from Chien, supra note 31, and UNAIDS & WORLD HEALTH ORG, PATENT SITUATION OF HIV/AIDS-RELATED DRUGS IN 80 COUNTRIES, supra note 44, at 11–16.

47. FDA, supra note 42.
C. UNDERLYING LEGAL SYSTEMS

Patent law varies by country, though the TRIPS Agreement informs the laws of each member country. TRIPS requires WTO Members enforce patent rights for most pharmaceutical products. Passed in conjunction with the establishment of the World Trade Organization (WTO), it binds all member states with time-phased exceptions. For example, the Least Developed Countries must fully implement TRIPS by January 2016. Additionally, the Doha Declaration of Ministers in 2001 affirmed the ability of states to consider the public health impact of compliance and reiterated the legality of compulsory licenses in public health emergencies. These exceptions, however, do not inform the current analysis because pharmaceutical production occurs mainly in middle-income countries with substantial production facilities—primarily, this production occurs in fully TRIPS-compliant India. Flexibilities for Zimbabwe, for example, cannot help patients there because the country lacks the infrastructure to synthesize or manufacture medicines. Additionally, the phase-in flexibilities of TRIPS excludes middle-income countries, like South Africa.

India’s entry into the WTO required TRIPS compliance. The country amended its Patent Act, effective in 2005, to provide protection for

48. See TRIPS, supra note 43.
49. Id. art. 27 requires patent protection “for any inventions, whether products or processes, in all fields of technology” that are “new, involve an inventive step, and are capable of industrial application.”
50. The U.N. Committee for Development Policy reviews its list of Least Developed Countries every three years, and focuses on income (below $745 per capita), human capital status (nutrition, health, education, and adult literacy), and economic vulnerability (population size, remoteness, export concentration, share of agriculture in GDP, and instability of exports). UNITED NATIONS OFFICE OF THE HIGH REPRESENTATIVE FOR THE LEAST DEVELOPED COUNTRIES, LANDLOCKED DEVELOPING COUNTRIES AND SMALL ISLAND DEVELOPING STATES, CRITERIA FOR LDC, http://www.unohrrls.org/en/ldc/related/59/.
51. TRIPS, supra note 43, art. 31, describes compulsory licensing procedures. See Frederick Abbott & Jerome H. Reichman, The Doha Round’s Public Health Legacy: Strategies for the Production and Diffusion of Patented Medicines Under the Amended TRIPS Provisions, 10 J. INT’L ECON. L. 921 (2007). This Note does not address the possibility of India or any other country issuing a compulsory license. The use of compulsory licenses in health contexts is a substantial topic in its own, and countries have considered, and some implemented, compulsory licenses for ARVs.
53. See MÉDECINS SANS FRONTIÈRES, NEITHER EXPEDITIOUS, NOR A SOLUTION: THE WTO AUGUST 30TH DECISION IS UNWORKABLE (2006). This trend is not static. Brazil aims to build an antiretroviral factory in Mozambique that will produce eight antiretrovirals. Charles Mangwiro, Brazil Offers Drug Factory to AIDS-Ravaged Mozambique, REUTERS, May 29, 2007.
pharmaceutical products. Before 2005, India did not grant medicines product patents—India only granted patent rights to innovative processes. After 2005, products registered in the country after 1995 were eligible for patent protection. Drugs registered before 1995 were “not [to] be substantially affected” by the transition and producers continue to manufacture them without licensing. By coincidence, HAART transformed modern medicine in 1995. Thus the earliest HIV drugs remain in India’s public domain; more advanced, safe, effective, and tolerable drugs remain protected by patents.

While “generics fuel [the] AIDS program,” voluntary licensing does not provide much fuel and the generics that reach PEPFAR patients are low-octane. For reference, of the thirty-two ARVs approved in the United States, only seven received approval before 1995. Post-1995 innovations include almost all protease inhibitors, and three new classes of drugs—integrase inhibitors, fusion inhibitors and CCR5 antagonists. Even the most basic post-1995 therapies are newer, safer, more effective, and less toxic than the compounds PEPFAR distributes. A majority of HIV patients, therefore, suffer a substandard of care. For these patients, medical science did not progress after 1995.

PEPFAR procurement and the subsequent worldwide therapy uptake demonstrate that widespread drug availability is closely linked to generic manufacture, which relies on either sublicensing efforts or patent term expiration. The status quo of scarce voluntary licensing, thus, effectively sequesters recent therapies from LMI patients for the length of their Indian patent terms. The 1995 patentability cutoff date in India—created by TRIPS—and the paucity of voluntary licenses preclude uptake of the HAART compounds that characterize successful HIV treatment in the

56. Lueck, supra note 30.
developed world. Though four million LMI patients received HAART since 2003, a comparison of HAART in LMI countries and in the United States reveals significant and deleterious disparities in toxicity, efficacy, and safety.59 Patients in the developing world ingest drugs of far lower quality than those used by American and European patients. What’s acceptable to U.S. patients and physicians differs markedly from what is acceptable for Kenyan patients.

Reauthorization of PEPFAR in 2008 tripled the program’s size and produced new statutory language ensuring ARVs “are purchased at the lowest possible price at which such pharmaceuticals may be obtained in sufficient quantity on the world market . . . approved, tentatively approved, or otherwise authorized for use by [FDA].” 60 Substantial gaps in technology and availability of therapies persist around the world, partially because of insufficient licensing. While progress continues toward treating most of the world’s infected population, a highly stratified standard of care grows between patients in the developing and the developed world.

II. TREATMENT LINES AND FORMULATIONS

A. FIRST- AND SECOND-LINE THERAPIES

Patients in the developed world rarely use the drugs and treatment schedules offered to similar patients in developing countries. Developed world patients rely on newer, more effective, and less toxic drugs that are generally subject to patent protection in India. Based on geography and income, and not clinical progression or status, more than 80 percent of AIDS patients rely on inadequate therapies, in part because of scarce voluntary licensing to PEPFAR suppliers.61 Because LMI formulations develop as a result of competition between generic manufacturers, a patent holder’s refusal to license her property effectively sequesters it from PEPFAR purchase and LMI uptake. In other words, because PEPFAR purchases most of its input from Indian generic companies, the originator retains the prerogative to refuse PEPFAR distribution by not licensing to manufacturers in India. Relying on India’s public domain alone, despite augmentation of manufacturing capacity and accelerated FDA/WHO approval, ARVs in LMI countries fall into one of two categories: old or malformed.

59. AIDS EPIDEMIC UPDATE, supra note 1, at 9.
61. Globally, approximately 4.7 million patients access HAART, with over 4 million users in LMI countries. UNAIDS, supra note 26.
The disparity between developed-world science and developing-world use is stark and well-known. Former Executive Director of UNAIDS, Dr. Peter Piot, and World Health Organization Director of HIV/AIDS, Dr. Kevin de Cock, observe, “[t]he overwhelming majority of patients are receiving first-line regimens that have significant issues of toxicity.”

Two questions follow: (1) how widely does the standard of care for HIV diverge between the developed and developing world; and (2) what divergence in Western-tolerated and LMI-tolerated toxicity and inefficacy is reasonable?

1. LMI Standard of Care

The standard of care for patients in LMI settings depends entirely on therapy availability. Therapy schedules are functions of licensing behavior: public-domain medications are super-abundant, and medications requiring licensing are scarce. While patients in developed settings select therapies based on efficacy, safety, and side effects, patients in LMI countries rely overwhelmingly on a single cocktail, the components of which existed prior to patent protections in India. Almost every LMI patient begins HAART on the “first-line” therapy Triomune.

This regime abounds because it is inexpensive; its competitive manufacture, and high-volume procurement by bi- and multi-lateral purchasers, creates enormous downward pressure on cost. Triomune costs $83 yearly for patients in low-income countries, and $97 in middle-income countries. The cost of procurement for license-dependent treatments, however, impedes their clinically-indicated use. For

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example, the most common “second-line” therapy, a co-formulation of Abacavir, Didanosine, and Lopinavir/ritonavir, costs $1134 a year.  

Distinguishing “lines” is simple: price, safety and efficacy are the most significant characteristics separating U.S. therapies and LMI “first-line” therapies. Treatment guidelines, and treatment decisions, in the United States are functions of safety and efficacy, but LMI guidelines sacrifice safety and efficacy to stretch budgets. LMI treatment decisions are rare, because Triomune is often the single agent available to patients and providers. Were safer and more effective compounds available, undoubtedly LMI providers would offer these treatments and LMI patients would demand them. The reality, however, is that the rationale behind “current treatment guidelines for antiretroviral therapy is rationing—limiting the number of people who must be treated, providing the cheapest available drugs, and delaying shifts to more expensive drugs for as long as possible.” Although the absolute number of patients for whom Triomune fails to achieve viral suppression is unknown, some observe that 30 percent of patients on Stavudine (a common “first-line” therapy) require switching within twelve months of initiation. The switches rarely occur, however, because the patient in need cannot afford the second treatment. While a Western patient would discontinue a toxic or ineffective therapy, treatment decisions in LMI settings depend on the particular drugs that reach the public domain in India, rather than patient need.

The world’s most abundant formulation of HAART is the “first-line” therapy Triomune, a formulation combining Stavudine, Nevirapine, and Lamivudine. It is overwhelmingly the predominant treatment for patients in LMI countries and the world’s most common HIV treatment. The combination’s low price stretches PEPFAR, UNITAID, and Global Fund dollars to millions of patients. But the consequences of its prevalent use also include widespread toxicity, ineffectiveness, and medical expenses because of side effects. Patients react differently to the same therapies, necessitating individualized drug iterations, but in LMI settings, HAART is


68. Renaud-Théry et al., supra note 63, at S91.

69. See generally Dyubl, supra note 40.
reduced to a single regime containing compounds of limited efficacy. In contrast to this one-size-fits-millions approach, one clinician in Birmingham, Alabama, reported his clinic administered over 800 unique iterations of HAART. Compared to this single clinic, an entire district in Malawi placed 97 percent of patients on just a single iteration (Triomune). Thus, about one eight-hundredth as much diversity-in-therapy exists in an entire district in Malawi as in a single clinic in Alabama, a situation resulting from the license-dependent costs of drugs.

Treatment in LMI countries starts with “first-line” therapies because of their price. U.S. and E.U. patients change therapies because HIV mutates quickly and develops resistance. Notably, U.S. guidelines do not advocate rigid “lines” of treatment, whereas the guidelines for LMI patients consistently refer to such “lines.” On the contrary, Western therapies are individualized, with some clinicians reporting as many as eight different HAART iterations per 100 patients starting therapy. With effective access to all thirty-two ARVs, patients in the United States commonly initiate therapy on a once-daily fixed-dose combination or a regime containing a protease inhibitor. Treatment-naïve patients in the United States and Europe do not ingest Stavudine, while almost every LMI patient does. Reflecting on the disparities between first-world and “first-line” therapies, one commentator observed, “[t]he increased toxicity associated with these agents is well documented in industrialized nations, data that are increasingly echoed by mounting evidence from resource-limited settings.”

2. Stavudine

Stavudine exemplifies the clearest disconnect between developed- and developing-world standards of care for HIV patients. An NRTI, Stavudine

71. Ferradini, supra note 63, at 1338.
75. NRTIs were the original class of ARV drugs.
reaches over 75 percent of patients in developing countries. It does not, however, appear on the list of therapies recommended by the WHO or Department of Health and Human Services. Domestically, physicians replaced Stavudine years ago, when superior, safer, and more effective NRTIs entered the market. Explaining the omnipresence of Stavudine in resource-limited settings is simple: the Clinton Foundation’s 2009 Antiretroviral Price List records Stavudine, at $0.036/unit, as the cheapest ARV on earth. Tenofovir, Stavudine’s domestic replacement, sells at $0.280/unit.

Approved in 1995, Stavudine toxicities were soon reported; peripheral neuropathy (loss of nervous system functions in extremities), lactic acidosis (life-threatening acidification of the blood), and lipodystrophy (body fat migration) affected many Stavudine recipients. In 2002, clinical guidelines first detailed methods for substituting Stavudine with more effective prescriptions. In 2003, U.K. guidelines downgraded Stavudine. Usage of the drug among Dutch patients declined from nearly 50 to fewer than 3 percent between 1996 and 2004. The U.S. List of Recommended Components removed Stavudine in 2004 because of its side effects (peripheral neuropathy, elevated lipids, pancreatitis, and hepatic enzyme abnormalities), and new clinical data indicated other drugs in its class achieved nearly complete viral suppression. In the same year, data from a three-year, eighty-one center, randomized, double-blind study comparing Tenofovir and Stavudine indicated that Tenofovir had comparable benefits, but lacked Stavudine’s

76. Renaud-Théry et al., supra note 63, at S92; Omar Galárraga et al., Forecast of Demand for Antiretroviral Drugs in Low and Middle-Income Countries: 2007–8, 21 ACQUIRED IMMUNE DEFICIENCY SYNDROMES S97, S101 (Supp. 4) (2007).
77. US DEPARTMENT OF HEALTH AND HUMAN SERVICES, supra note 72 at 22–35.
83. Kees Brinkman, Stavudine in Antiretroviral Therapy: is This the End?, 23 ACQUIRED IMMUNE DEFICIENCY SYNDROME 1727, 1727 (2009).
toxicity. In 2006, U.S. guidelines reiterated that Stavudine, in comparison to other drugs in its class, was “more commonly associated” with lipodystrophy and highly associated with lethal lactic acidosis. In 2008, Stavudine was completely removed from U.S. lists of recommended therapy components.

Despite its drawbacks, Stavudine still remains the bedrock drug with which the scale-up treats more than four million HIV patients in LMI nations. In short, juxtaposing U.S. and LMI uptake patterns reveals LMI patents—and therefore most HIV patients—remain unaffected by developments in HIV care since 1995, dependent on compounds in the public domain, and generally treated as if side effects, toxicity, and tolerability were inconsequential. Resource-limited countries with “fixed and limited healthcare resources to treat epidemics, [decide] whether to treat more patients with the cheapest HAART regimes, or whether to use more expensive combinations which might prevent others from accessing HAART at all.” While Stavudine’s low upfront cost seems beneficial for massive worldwide treatment efforts, the costs of toxicity, eventual switching, side effects, efficacy, and the overall cost-effectiveness of treatments suggest otherwise. Additionally, comparisons of Stavudine-containing and Tenofovir-containing regimes indicate that patients on the latter regime remain alive for at least ten months longer. While Stavudine is undoubtedly better than nothing, evidence shows its use is detrimental to patient adherence and its side effects debilitating. The drug’s cheap upfront price mask its true costs.

ARV side effects reduce adherence in patients and lead to mutations, treatment failure, and death. Side effects are the most common reason to switch therapies, and when one lacks a medication to which she could switch,

87. See generally Scott M. Hammer et al., Antiretroviral Therapy in Adults, Updated Recommendations of the International AIDS Society – USA Panel, 300 J. AM. MED. ASS’N. 555 (2008); Brinkman, supra note 83, at 1728.
89. See generally Melissa A. Bender et al., Cost-Effectiveness of Tenofovir as First-Line Antiretroviral Therapy in India, 50 CLINICAL INFECTIOUS DISEASES 416 (2010).
90. See generally Sydney Rosen et al., Cost and Cost-Effectiveness of Switching From Stavudine to Tenofovir in First-Line Antiretroviral Regimens in South Africa, 28 ACQUIRED IMMUNE DEFICIENCY SYNDROME 334 (2008).
91. Melissa A. Bender et al., Cost-Effectiveness of Tenofovir as First-Line Antiretroviral Therapy in India, 50 CLINICAL INFECTIOUS DISEASES 416, 422 (2010).
the result is cessation of therapy.\textsuperscript{92} Administering intolerable therapies to greater than four million patients is inherently unsustainable. Properly treating patients in the United States and European Union led to mortality declines and the adjustment of HIV from a death sentence to a chronic condition. Improperly treated patients, lacking safe and effective medicines, cannot enjoy the successes of properly treated domestic patients. At present, LMI treatments attempt to replicate domestic successes with toxins.

3. Demand, and Failure, to Switch off Stavudine

The inability of patients and practitioners to suspend Stavudine administration leads to several interrelated observations. Firstly, patients not switching, or staying on Stavudine, are often treated inadequately to suppress HIV. Median time to switching from first- to second-line therapies is between sixteen and twenty-one months.\textsuperscript{93} Current data indicate that only 3 percent of patients in the developing world rely on second-line therapies\textsuperscript{94} and experts predict 5 percent of such patients \textit{should} rely on second-line therapies by 2011.\textsuperscript{95} Over four million patients in LMI countries received HAART in 2009, and normal clinical progression indicates that all will eventually switch regimes. Combining these data, of all patients on first-line therapy, nearly one-third \textit{should} switch today but lack access to second-line therapies,\textsuperscript{96} another indication that the Indian public domain cannot sustain the therapeutic demands of millions of LMI patients. While the previous section showed the abundance of Stavudine in LMI regimes complicates the scale-

\textsuperscript{92} Paula Braitstein et al., \textit{Sustainability of First-Line Antiretroviral Regimens: Findings From a Large HIV Treatment Program in Western Kenya}, 52 \textit{J. ACQUIRED IMMUNE DEFICIENCY SYNDROMES} 254, 256 (2010) ("[T]he most common reason for change or discontinuation in [HAART] is toxicity.").

\textsuperscript{93} Patients in the developed world monitor drug effects with regular viral load and CD4 monitoring, but these expensive diagnostics often are neither designed nor priced for resource-limited settings. See generally ART-LINC of IeDEA Study Group, \textit{Switching to Second-Line Antiretroviral Therapy in Resource-Limited Settings: Comparison of Programmes With and Without Viral Load Monitoring}, 23 \textit{ACQUIRED IMMUNE DEFICIENCY SYNDROME} 1867 (2009).

\textsuperscript{94} Stavudine is also associated with mutations outside of its own class, complicating eventual switches. See Joel E. Gallant, \textit{Drug Resistance after Failure of Initial Antiretroviral Therapy in Resource-Limited Countries}, 44 \textit{CLINICAL INFECTIONOUS DISEASES} 453 (2007).

\textsuperscript{95} Francoise Renaud-Théry et al., \textit{supra} note 63, at 389 (indicating ratio of first- to second-line therapy prescriptions is 97:3, with majority of adults and children on Stavudine).


\textsuperscript{96} See generally John Bartlett & John Shao, \textit{Success, Challenges, and Limitations of Current Antiretroviral Therapy in Low-Income and Middle-Income Countries}, 9 \textit{THE LANCET INFECTIOUS DISEASES} 637 (2009); Olivia Keiser et al., \textit{supra} note 29; Habib O. Ramadhani et al., \textit{Predictors of Incomplete Adherence, Virologic Failure, and Antiviral Drug Resistance Among HIV-Infected Adults Receiving Antiretroviral Therapy in Tanzania}, 45 \textit{CLINICAL INFECTIONOUS DISEASES} 1492 (2007); Laurent Ferradini et al., \textit{supra} note 63.
up’s effectiveness, these data demonstrate “first-line” therapies are, at best, inadequate.

Secondly, it is only very recently that individual LMI countries began to switch off Stavudine for Tenofovir. This switch is the result of Tenofovir’s developer, Gilead Sciences, sub-licensing manufacture with thirteen producers in India. Most patients cannot switch off, however, because alternative drugs are unaffordable or unavailable. This indicates the mechanisms on which the scale-up depends are inadequate to sustain existing patient demand. Were HIV infections declining, and patient rosters not increasing continuously, remedies might exist to augment existing mechanisms. But the scale-up, itself an enormous health intervention, expands daily: for every patient beginning HAART, another 2.5 people are infected elsewhere. Global HIV incidence trends are flat, or sloping downward slightly, but this stasis includes 2.7 million new infections yearly, and a projected global burden exceeding 50 million patients by 2030.

Swelling need, and known deficiencies in scaling-up appropriate treatment, shows a substantial number of patients continue to receive ineffective treatments. These first-line treatments increasingly fail to achieve meaningful viral suppression or immunological benefit. Because new patients acquire strains resistant to existing medicines, Stavudine’s efficacy can only decline. Even the relatively ineffective treatment interventions that reach LMI patients cannot sustain the current infected populations because the treatments must eventually be switched. Consider the LMI-rarity and U.S. preference for Atazanavir (Reyataz®, one of two preferred protease inhibitors in the United States). As of December 2009, Bristol-Myers Squibb and a single generic sub-licensee, Emcure, sell Atazanavir to PEPFAR. Atazanavir sells at a median price of $4353 per patient-year in LMI countries.

98. AIDS EPIDEMIC UPDATE, supra note 1, at 7.
101. HEALTH AND HUMAN SERVICES, supra note 72, at 39.
102. FDA, supra note 42.
103. UNAIDS, supra note 36, at 10.
Despite domestic awareness of its superiority and efficacy, convergence between LMI and U.S. treatment schedules remains elusive as the number of Atazanavir producers constrains use of the drug in LMI countries.

As current patients on Stavudine develop resistance, or require switching off of it because of toxicity, licensing post-1995 compounds increases in import. These observations complicate the successes of the scale-up, as analysts are compelled to ask “with what” when confronted with celebrations of “total patients treated.”

Finally, Stavudine is not unique—Triomune, the developing world’s most prescribed HAART co-formulation, also includes Azidothymadine (AZT). Like Stavudine, doctors in the developed world do not recommend AZT, which suffers from significant toxicities and decreased efficacy when compared with other nucleoside reverse transcriptase inhibitors. As early as 2000, the drug was associated with neutropenia, anemia, nausea, vomiting, headache, myopathy, and nail pigmentation. Providers choosing between Stavudine or nothing face a Hobson’s Choice, and their patients suffer the consequences of inadequate treatment.

B. Missing Formulations

1. Licensing and Co-Formulations

An active pharmaceutical ingredient is formulated into a particular dosage for a particular patient population. The paucity of licensing prevents creation of formulations appropriate to resource-limited settings. Due to variations in the epidemic’s effects, and differences in infrastructure and local capacity, resource-limited countries need formulations different from the formulations used in developed settings. Developing successful LMI formulations by PEPFAR suppliers requires an increase in voluntary licensing, as the Indian public domain does not contain sufficient therapies to synthesize new formulations. The lack of particular formulations significantly hampers efforts to globalize treatment for HIV infections, and is related to the unwillingness of originators to license their compounds for PEPFAR-sale, reformulation, and distribution.

Early HAART cocktails required dozens of pills dosed at distinct times, leading to diminished adherence and accelerated mutations. Ideal formulations now combine medicines into a once-daily “co-formulation.”

104. See generally Lawrence Long et al., The High Cost of Second-Line Antiretroviral Therapy for HIV/AIDS in South Africa, 24 ACQUIRED IMMUNE DEFICIENCY SYNDROMES 1, 2 (2010) (“[T]he number of second-line patients will increase steadily.”).
105. See generally UNAIDS Progress Report, supra note 61.
106. Braitstein et al., supra note 92, at 256.
107. Carpenter et al., supra note 79, at Appendix 1.
Synthesizing multiple therapies into single tablets requires the acquisition of many patent rights, each with distinct expiration dates. With dozens of approved HIV medicines, manufactured by more than half-a-dozen producers, the inherent difficulty and cost of these acquisitions is substantial. Co-formulation demands licensing, typically from competitors, each of whom can “block” the end product. The downstream product could include “upstream” technologies—for example, Merck’s Raltegravir, Gilead’s Tenofovir, and Glaxo’s Lamivudine—owned by numerous separate entities. Any interested party with associated patent rights may prevent the creation of such a downstream product. Because these co-formulations often involve distant producers, the high costs of negotiations can also prevent the creation of downstream products. This may explain the existence of a single once-daily formulation in the United States and European Union. Atripla is the developed world’s first once-daily co-formulation, consisting of NRTIs Tenofovir and Emtricitabine and the NNRTI Efavirenz. With a minimal pill burden, no need for refrigeration, and a minimal side-effect profile, it is the standard of care for new patients in the United States.

The high transaction costs associated with the licensing efforts that occur between competitors complicates successful development of co-formulations. Given the diversity of actors and producers, and the number...
of manufacturers required for efficient generic competition, generic co-formulations are generally limited to drugs lacking patent protection. A generic producer wishing to re-produce Atripla faces high transaction costs, involving at least seventeen sets of licenses from at least two companies: Gilead Sciences (for Tenofovir and Emtricitabine) and Merck (for Efavirenz). Additionally, mass producing a drug of known efficacy and safety, like Atripla, is cheaper than creating an innovative cocktail. New co-formulations, due to associated costs of development and testing, cost significantly more. A manufacturer might desire to co-formulate (1) Atazanavir, a protease inhibitor made by Bristol-Myers Squibb; (2) Ritonavir, made by Abbott, and two more drugs not contraindicated for tuberculosis (TB) therapy; (3) Tenofovir, made by Gilead; and (4) Emtricitabine, manufactured by Gilead. Such a combination would implicate dozens of patents. Licensing costs would become prohibitive for a single manufacturer to complete the acquisition of rights. Refusal of any patent holder, or simply the high costs of entry, could block development of the product.

Within the PEPFAR dataset, more than 80 percent of the 164 active ingredients that appear in 104 formulations are unprotected and therefore do not require licenses. Among co-formulations within the PEPFAR dataset, public domain therapies also predominate. The FDA, for PEPFAR, approved forty-two formulations containing more than one compound—twenty are triple-therapy, and twenty-two are dual-therapy. Of these co-formulations, twenty-eight (66 percent) contain only license-independent compounds. Compounds—the acquisition of which does not require a license—are two times more likely to appear in a co-formulation. Whereas limited licensing caused the omnipresence of toxic and ineffective Stavudine, limited licensing similarly prevents the creation of safe and effective formulations for impoverished populations.


113. Bristol-Myers Squibb distributes Efavirenz domestically, and Merck internationally.


115. See supra, note 42.
2. Pediatric AIDS Failures

The world’s two million pediatric HIV patients may provide the best illustration that LMI markets may not effectively manifest demand or produce incentives to innovate. Developed countries have nearly eliminated mother-to-child-transmission of HIV with comprehensive prenatal testing and administration of ARVs shortly before, during, and after birth. Developing countries remain highly burdened, and 90 percent of pediatric HIV patients live in sub-Saharan Africa. Globally, HIV infected approximately 370,000 children and infants in 2007, six times the number of Americans infected in that year (56,300). Scaling-up prophylaxis for pregnant women has reduced the incidence of pediatric infections—33 percent of pregnant women in need of ARV prophylaxis received it in 2007.

116. See generally COMM’N ON INTELLECTUAL PROP. RIGHTS, INTEGRATING INTELLECTUAL PROPERTY RIGHTS AND DEVELOPMENT POLICY (2002).


a 400 percent increase from 2004. Despite improvement in reducing pediatric infections, the pediatric epidemic rages, and HAART reaches only 15 percent of infants in need, almost all of whom live in sub-Saharan Africa.

Given the prevalence of pediatric HIV infections, one might predict the existence of appropriate therapies, if the patients were not impoverished children with impoverished parents. In fact, HAART contains tools almost entirely for adults—dosing and treatment schedules are optimized for adult body sizes and medicines are formulated as pills, with complex timing and food requirements. Because adults can swallow pills, palatability is rarely considered. Dissolving drugs in water is a common means of pediatric administration, but many pills designed for adults are insoluble. Crucial data for pediatric patients is rare. Pediatric clinical, bioavailability, and medicinal chemistry data are largely non-existent, making safe and effective pediatric dosing speculative. The WHO’s Treatment Guidelines for Children reflects the inadequacy of existing ARVs: when an HIV-infected infant resists Nevirapine, the authors recommend a protease inhibitor, but “recognize . . . that currently, in many resource limited settings, lopinavir/ritonavir is not available, affordable, or, due to cold chain requirements, not feasible for [pediatric] use. . . . [This recommendation] compromises the potential to construct a potent second line regime.”

Although high demand for pediatric medicines in LMI settings reflects patent constraints, the non-existence of appropriate treatments for pediatric patients cannot be solely tied to patents. Inadequate prenatal and antenatal testing, weak health care infrastructures, and other factors prevent effective scale-ups of pediatric HIV interventions. Yet the non-existence of pediatric co-formulations is a highly significant independent variable in the analysis of high pediatric HIV mortality. The US Global AIDS Coordinator indicated as

120. UNAIDS, supra note 118, at 15.
121. Antenatal prophylaxis in Botswana increased to 91 percent, from zero, in five years, averting 10,000 pediatric infections. John Stover et al., Estimated HIV Trends and Program Effects in Botswana, 3 PLOS ONE e3729, 3 (2008).
122. UNAIDS, supra note 118, at 25.
123. Synthesizing co-formulations for children is complex. As with any pediatric medicine, clinical trials are more challenging, and these circumstances are even more challenging because most HIV-infected children succumb to AIDS and death early in their lives. Additionally, many more steps are involved beyond simply shrinking the pill by the ratio of a child’s weight. Michael Dunne, Antiretroviral Drug Development: The Challenge of Cost and Access, 21 ACQUIRED IMMUNE DEFICIENCY SYNDROME S73, S74-5 (2007).
much to Congress: “[a] lack of formulations for pediatric regimens appropriate for resource-limited regions of the world has posed a significant barrier to reaching the millions of children impacted by HIV/AIDS.” The single pediatric co-formulation in existence is not heat-stable, contains medicines no longer recommended for use in the United States, and suffers from substantial resistance in pediatric patients. For infants that cannot tolerate the side effects of that therapy, survival requires impractical acquisition and use of second-line solid pills. This is complicated by “poor palatability, high pill burden or liquid volume, frequent dosing requirements, dietary restrictions and side effects [that] hamper the regular intake of required medication.” The swiftness of disease progression in infants demands stringent and unrealistic adherence to dosing schedules, making these contingency plans unfeasible. Producers wishing to synthesize therapies for PEPFAR-assisted pediatric patients have few compounds from which to choose. Lacking license to develop new formulations of newer medicines, producers cannot provide clinics with therapies to sustain pediatric AIDS patients.

Pediatric AIDS patients in developing countries face a difficult reality—few medicines exist to keep them alive. Whereas effective public health interventions have largely eradicated the incidence of pediatric infections in the United States and European Union, millions of pediatric patients in LMI countries continue to suffer the fates of patients before HAART. Pediatric co-formulations, like heat-stable formulations, are so-called missing

127. Jean-Chrysostome Gody et al., High Prevalence of Antiretroviral Drug Resistance Mutations in HIV-1 Non-B Subtype Strains from African Children Receiving Antiretroviral Therapy Regimen According to the 2006 Revised WHO Recommendations, 49 J. ACQUIRED IMMUNE DEFICIENCY SYNDROME 566, 566 (2008) (observing that 77 percent of infants presenting at a hospital in the Central African Republic were infected with virus resistant to at least one ARV).
formulations. Pills that do not require refrigeration are highly preferred to those requiring cold-chains of refrigerators, electricity, and infrastructure.

Given the ability of the U.S. and E.U. biomedical community to effectively cure HIV fifteen years after the first patient presented, the continued failure of pediatric ARV therapy reflects poorly on mechanisms developed to abate disease burdens. Within fifteen years of presentation, medical science ended the scourge of AIDS among a subgroup of patients, but the world’s most vulnerable patients remain largely unassisted. This outcome is related to the burdened group’s ability to incent creation of pharmaceuticals particular to its needs. A manufacturer’s costs of developing and producing appropriate pediatric formulations may be recoverable from high-volume sales to PEPFAR, UNITAID, and UNAIDS, but this scenario still brings us back to square one: without a license from an originator, the product cannot exist. Whether they seek an adult co-formulation, or a pediatric dispersible, the most cost-effective producers can only tinker with compounds in the public domain.

III. TRENDS & PROJECTIONS

The number of patients in need of HAART will increase an order of magnitude by 2031. Currently, almost half of LMI patients needing HAART receive it (four million of nine million);\textsuperscript{130} by 2030, the projected number in may pass 55 million.\textsuperscript{131} Given the inability of existing licensing and manufacturing arrangements to meet current demand, the projections for heightened demand suggest current mechanisms will fall even further short in the future. To date, only eleven\textsuperscript{132} of the thirty-two FDA-approved ARVs\textsuperscript{133} are sold to PEPFAR, a 60-billion-dollar buying facility. The opportunity cost for these decisions is high, as one-third of Stavudine-receiving patients should switch off it immediately but cannot access a replacement.\textsuperscript{134}

Some licensing behavior indicates that the future availability of effective treatments will improve. In 2006–07, Gilead Sciences, the manufacturer of two preferred NRTIs (Tenofovir and Emtricitabine), entered negotiations with generic producers in India. Gilead, a highly successful but small company, executed thirteen licenses with these producers, which allow it to earn royalties on high-volume sales. Given the company’s finite

\textsuperscript{130} AIDS EPIDEMIC UPDATE, supra note 1, at 21.
\textsuperscript{132} FOOD AND DRUG ADMINISTRATION, supra note 42.
\textsuperscript{133} FOOD AND DRUG ADMINISTRATION, supra note 58.
\textsuperscript{134} Braitstein et al., supra note 92, at 256.
manufacturing capacity, Gilead’s decision guarantees revenue streams with minimal up-front investment, serving patient needs and its own. The licenses empower generic producers to sell Tenofovir in ninety-five countries\(^{135}\) without price floors or ceilings.\(^{136}\) The “Licensed Territory” includes 83.5 percent of people currently living with HIV,\(^ {137}\) including the highly-burdened and middle-income countries South Africa and India, as well as Least Developed Countries, other highly-burdened and resource-limited areas. Gilead’s technology transfer included know-how and involved substantial assistance from the company to speed production and ensure quality. Finally, the licenses permit development of any Tenofovir-based fixed-dose combination or pediatric formulation, and the manufacture and sale of Tenofovir’s active ingredient in India with no royalty payment.\(^ {138}\)

Gilead’s peers do not comprehensively license their medicines. Although other companies may refuse to license for many reasons, some may fear the transfer of generic drugs into their primary markets, a rarely observed phenomenon known as pharmaceutical arbitrage.\(^ {139}\) Some fear a lack of domestic enforcement of intellectual property protections within sub-licensing countries, but any Member State’s accession to the WTO requires compliance with TRIPS. Additionally, the Dispute Settlement Board, within the WTO, exists for the purpose of protecting intellectual property when a state’s efforts are insufficient. Given that many arguments in support of TRIPS indicated countries like India would benefit from technology transfers because of the agreement’s intellectual property enhancements,\(^ {140}\) it is peculiar that India is not the site of more manufacturing for PEPFAR. The U.S. government is a $60 billion buyer, but few pharmaceutical originators are willing to sub-manufacture therapies for American procurement. Although some companies contracted with individual generic producers to manufacture ARVs for LMI countries, the existence of a single generic

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135. A license between Gilead and its generic partners is on file with the author.
partner does not predict price drops. Rather, competition between producers
in the number of licenses predicts accessibility, not the existence of a single
generic partner. Gilead’s efforts are likely to accelerate the end of
Stavudine, but the decisions of Gilead’s peers not to license their preferred
compounds constrains the ability of LMI practitioners and providers to
construct safe, effective, and potent anti-retroviral cocktails. The economies
of scale among generic producers provides PEPFAR and other buyers with
rates facilitating the scale-up, but the scale-up cannot survive on the small
number of therapies within India’s public domain.

In 2009, UNITAID, which has an international pharmaceutical
buying facility with programming similar to PEPFAR, announced the
formation of a patent pool for ARVs. Model terms are not yet available,
though some firms expressed interest in licensing their compounds to an
administrator responsible for sub-licensing to generic producers and
returning royalties to licensors.

Current licensing trends alone will not abate existing inadequacies in
therapy availability. Licensing of the newest ARVs, especially first-in-class
integrate inhibitors and CCR5 antagonists, cannot be predicted. GlaxoSmithKline, in February 2009, announced price reductions on its ARV
sales to LMI countries and the creation of a price ceiling for its products in
the Least Developed Countries, at 25 percent of their primary market cost.
Most likely, these reductions will not pull prices to the level of competitive
generic manufacture. Glaxo’s Pricing Guide reflects this reality—its middle-
income country prices are “set at levels that meet [Glaxo’s] cost.”

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141. See supra note 57.
142. Ellen ’t Hoen, Special Advisor on IP, UNITAID, Presentation at Berkeley Law
HIV & Neglected Disease Patent Pool Workshop (Nov. 6, 2009), http://www.law.ber
keley.edu/institutes/bclt/patentpools/presentations/1030_thoen.pdf.
143. REGG ALTON, GILEAD SCIENCES, INC., UNITAID PATENT POOL SUMMARY
tions/alton%20unitaid%20wha%20patent%20pool%20summary%20statement%20gilead%20.pdf; Letter from Chris Strutt, Senior Vice President GlaxoSmithKline, GSK is in Talks on
146. Andrew Witty, CEO, GlaxoSmithKline, Speech to Harvard Medical School: Big
media/Witty-Harvard-Speech-Summary.pdf); see also GLAXOSMITHKLINE, FACING THE
feb08.pdf.
147. Id at 1. Glaxo sub-licensed its therapy Combivir (Lamivudine and
Azidothymadine), and since 2006, its sub-licenses have produced more of the compound
IV. CONCLUSION

PEPFAR saved over 1.2 million lives and reduced AIDS mortality in target countries by ten percent.\(^{148}\) The program and the accompanying scale-up’s effects are historic. Although the scale-up occurred more quickly than any previous public health intervention, every aspect of the scale-up proceeds too slowly. It undoubtedly marks great progress that the biopharmaceutical, academic, government, and not-for-profit sectors so effectively, and speedily, developed compounds to suppress HIV. That the scientific community synthesized nine drugs within fourteen years of the first patient visit, and eleven years from identification of the virus itself, is itself a testament to scientific innovation.

Currently, the majority of HIV patients do not benefit from significant advances against HIV. Four million now benefit from the dimensions of India’s public domain, and the American taxpayer’s support. But outside of small, wealthy markets, price trumps side effects, toxicity, and efficacy of compounds, resulting in the “first-line” therapy now failing a third of its adherents. One Geneva-based physician described his and his patient’s choices for initial anti-retroviral therapy as an “embarrassment of riches.”\(^{\text{149}}\) The normative point here is not to diminish the Geneva physician’s ability to construct a safe, tolerable, and efficacious cocktail. Rather, the point is that the Geneva patient should be less exceptional. Instead, as this Note demonstrates, the vast majority of people with HIV take Stavudine-containing Triomune. While a Stavudine-containing regime is superior to none at all, the reasons to jettison Stavudine for Tenofovir are financially and medically compelling. Furthermore, administration of a chemical lacking efficacy is not superior to administration of no compound, when the impotent compound is linked to lethal, disfiguring, expensive, and disabling side effects. Stavudine will eventually fall off pharmacy shelves, and Gilead’s licenses accelerate that outcome. The ongoing persistence of Stavudine in low- and middle-income patients, nonetheless, reflects a remarkable medical disparity.

Distinct standards of care for HIV treatment frequently cause great harm to patients, as the compounds used to suppress an infection in San Francisco differ markedly from those used in Kenya. In fact, the Kenyan patient suffers the toxicities, reduced efficacy, and sometimes even pill burden of a 1995-era

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\(^{148}\) Walensky & Kuritzkes, supra note 27, at 273.

San Francisco patient. That Kenyan patient, like the vast majority of similarly situated patients in the developing world, has not benefited from the last fifteen years of scientific innovation, advancement and progress. One could argue TRIPS is the single cause of this circumstance, as undoubtedly India's ascension to the WTO required protection for post-1995 products. The existence of thirteen Gilead licenses argues with this point, as the company's technology transfer is beneficial to it, the producer, and Stavudine-receiving patients.

In addition to compelling use of ineffective and toxic therapies, inadequate voluntary licensing contributes to a dearth of formulations specific to LMI settings. Timely acquisition of rights to manufacture and improve recent compounds could enable manufacturers to synthesize formulations suited to LMI populations and settings, and to co-formulate once-dailies from different originators. While there is no reason an innovator company cannot reduce prices to the level of a generic producer—thus removing any reason to sub-license manufacture—Indian, South African, and Chinese producers are demonstrably better positioned to manufacture mass quantities of low-margin ARVs. A pharmaceutical innovator producing pills for pennies could not recoup his enormous costs of research, development, and employment. Likewise, while there is no reason why a sub-manufacturer could best formulate dispersible co-formulations for pediatric patients, originators have not collaborated to do so. For whatever reasons, originators spurn the multi-billion dollar, low-margin ARV market. Consequently, old medicines are scaled-up, as are their associated side effects, toxicities, and inefficiencies.

Limited availability of non-toxic, effective medications for HIV patients in LMI settings frustrates PEPFAR and its international partners. Scarce licensing of newer compounds causes reliance on disfavored therapies, and associated side effects in LMI patients. Resulting poor adherence and sub-optimal viral suppression leads to transmission of ARV-resistant viruses, and increased mortality. HAART that is unsuitable for Western patients is no more suitable for LMI patients, but the scale-up depends on this dual-standard of care. The strategy is inherently unsustainable, as patients require switching therapies, and as existing therapies fail many patients, particularly children. PEPFAR, the Global Fund, WHO, UNITAID, UNAIDS, and thousands of other agencies and groups continue the scale-up. Reaching Universal Access remains their goal, a task that daily increases in size and complexity. Regularly, and cheaply, procuring the safest and most effective therapies is fundamental to the endeavor.
Congress aims to create an incentive structure in the biotechnology industry that will increase competition and drive down the costs of protein-based therapeutic drugs known as biologics.1 Faced with these analogous goals, Congress enacted the Hatch-Waxman Act in 1984,2 which successfully created incentives for the introduction of generic small-molecule drugs. The Hatch-Waxman Act implemented an accelerated Food and Drug Administration (FDA) approval process for generic drugs, allowing for substantial costs savings in drug development.3 This cost savings encourages the market entry of generic competitors, which in turn lowers costs of small-molecule drugs by as much as eighty percent.4

Several bills under consideration in Congress would adapt aspects of the Hatch-Waxman Act to the approval process for follow-on biologics (FOBs). The current legislation must address two key issues: (1) the requisite amount of demonstrable similarity to take advantage of an abbreviated approval process for similar biologics; and (2) the length of the period of data exclusivity that allows the original drug developer to recoup development costs.

The current legislative proposals highlight the balance that Congress must strike between innovation and competition, and between lower prices and public safety. Three key differences between biologics and small-molecule drugs suggest that a statutory framework for FOBs should depart from the Hatch-Waxman framework. First, because biologic development costs exceed those for small molecules, innovator companies may require additional time to recoup development costs. Second, technical difficulties hinder the determination of whether an FOB is truly the same as an innovator biologic. Third, the structure of a biologic will vary depending on

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the conditions of manufacture. The second and third points lead to serious safety and efficacy concerns regarding abbreviated FDA testing.

This Note surveys the major concerns lawmakers face in creating an abbreviated pathway for FOB approval. Part I defines biologics and FOBs, explains the importance of biologics, and highlights the major differences between biologics and traditional small-molecule drugs. Part II summarizes current laws regulating biologics in the United States. It also describes the existing European approval process for FOBs as well as provisions of the Hatch-Waxman Act that may serve as the template for an abbreviated FOB approval process in the United States. Part III examines the legislative proposals for instituting an abbreviated FOB approval process currently before Congress.

I. BIOLOGICS AND FOLLOW-ON BIOLOGICS

A. WHAT ARE BIOLOGICS?

Traditional drugs typically consist of small molecules produced by chemical processes. In contrast, biologics are protein-based therapeutic drugs—including many vaccines and purified proteins—produced by biological processes. Modern biologics created via biotechnology, the focus of this paper, first emerged with the FDA’s approval of recombinant human insulin in 1982. Since then, over four hundred biologic drugs have been developed to treat over two hundred ailments, including heart attacks, strokes, multiple sclerosis, leukemia, hepatitis, rheumatoid arthritis, breast cancer, diabetes, congestive heart failure, lymphoma, kidney cancer, and cystic fibrosis. The biologics development pipeline also includes over six hundred new drugs, with over two hundred and fifty of these targeting cancer alone.

Biologics employ a multitude of strategies to treat disease. Most early biologics treated relatively simple protein deficiencies and were produced by splicing genes into bacteria to produce proteins such as insulin, blood clotting factors, and erythropoietin human for treating disorders such as diabetes, hemophilia, and anemia, respectively. Biologics have since grown and diversified tremendously, including the following examples: (1)

8. Id.
9. See generally id.
monoclonal antibodies are laboratory-made versions of the antibodies that comprise the body’s natural defense against invaders; (2) interferons affect a cell’s ability to reproduce, and can treat osteoporosis, chronic granulomatous disease, genital warts, multiple sclerosis, hairy cell leukemia, and other diseases; (3) antisense technology can shut off the production of specific unwanted proteins; (4) therapeutic vaccines jump-start the immune system to fight disease; and (5) gene therapy can treat disease by augmenting, replacing, or inactivating existing genes.  

B. THE GROWTH AND EXPANSION OF BIOLOGICS IN THE UNITED STATES

The promise of biologics comes with a significant catch: biologics average twenty times the cost of small-molecule drugs.11 The breast cancer drug Herceptin costs up to $48,000 per year;12 the colon cancer drug Avastin costs up to $100,000 per year.13 Cerezyme, which treats Gaucher disease (a life-threatening enzyme deficiency), typically costs between $200,000 and $500,000 per year.14 For comparison, treatment of arthritis with even the most expensive small-molecule drug would cost around $300 per year, while a biologic treatment for arthritis with Enbrel costs upwards of $20,000 per year.15

Even with their expense, the market share for biologics is expected to grow. In 2002, biologics sales accounted for eleven percent of all U.S. drug sales.16 By 2006, spending in the U.S. on “specialty drugs,” which includes biologics, totaled $54 billion, or about twenty percent of total spending on pharmaceuticals.17 Estimates suggest that biologics will expand to twenty-six percent of the total cost of pharmaceuticals in 2010, which represents

10. Id.
12. Id.
14. Id.
16. Id.
17. JOHNSON, supra note 5, at 2.
spending of around $99 billion in the U.S.\textsuperscript{18} By 2012, experts expect half the drugs approved by the FDA to be biologics.\textsuperscript{19}

C. **Complications to Producing “Generic” Follow-On Biologics**

Because biologics are protein-based drugs, significant differences exist between biologics and typical small-molecule drugs in terms of both complexity and manner of production. While small-molecule drugs normally comprise just dozens of atoms, biologics can easily consist of millions of atoms. Most importantly, unlike small-molecule drugs made via chemical synthesis, biologics are made via biological processes inside living organisms.\textsuperscript{20} Biological production leads to higher production cost and complexity.\textsuperscript{21} Biological production introduces a measure of unpredictability in the structure of the therapeutic drugs, and variations in the manufacturing conditions results in variation of the biologic structure. For example, minor structural variations will arise between two supposedly identical biologics because of differences in processing conditions and starting materials.\textsuperscript{22} In short, the sensitivity of biological production to manufacturing conditions far exceeds that of chemical production.

FOBs possess structural similarity but often lack structural identity with the innovator biologic. By comparison, small-molecule generics often achieve structural identity with their innovator drug. The complexity of the biologic molecules, production in living organisms, and sensitivity of end-product structure to changes in the manufacturing process render exact FOB replication nearly impossible.\textsuperscript{23}

Moreover, due to the large size and complex structure of biologics, current scientific analysis cannot resolve all discrete structural differences

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\textsuperscript{18} Id.


between an FOB and an innovator biologic for a direct comparison.24 At most, scientific analysis can determine that an FOB is similar to the innovator biologic. In short, because FOBs can only achieve similarity rather than identity, FOBs cannot become “generic” biologics.

Structural similarity does not guarantee identical therapeutic properties because small differences in structure affect the functioning of the biologic.25 Even though an FOB may have structural similarity to the innovator biologic, treat the same medical condition, and utilize the same mechanism of action, subtle differences may nevertheless lead to variations in safety or efficacy compared to the innovator.26

That FOBs differ at least slightly with the innovator biologic creates unique regulatory concerns absent for small-molecule drugs. One such concern is immunogenicity: the ability of the biologic to stimulate an immune response in the body.27 Even though clinical tests may find an innovator biologic safe and effective, the different manufacturing process employed by an FOB manufacturer could render that FOB ineffectual or even dangerous.

24. As Janet Woodcock, the Deputy Commissioner and Chief Medical Officer of the FDA testified before Congress:

Current technologies, such as peptide mapping, protein sequencing, and mass spectroscopy enable manufacturers to determine, with certainty, the amino acid sequence of a recombinant protein. However, the amino acid sequence is the most rudimentary characteristic of a protein. Conclusive analysis of other aspects of a protein’s structure requires much more sophisticated technologies and is fraught with uncertainties that are proportional to the size and complexity of the protein itself. Such complexities include: folding of the protein’s amino acid chain into highly organized structures, post-translational modification of the protein with a broad range of biochemical additions (e.g., glycosylation, acetylation, phosphorylation, etc.), and association of multiple protein molecules into aggregates. It is the combination of the protein’s amino acid sequence and its structural modifications that give a protein its unique functional characteristics. Therefore, the ability to predict the clinical comparability of two products depends on our understanding of the relationship between the structural characteristics of the protein and its function, as well as on our ability to demonstrate structural similarity between the follow-on protein and the reference product. Although this currently may be possible for some relatively simple protein products, technology is not yet sufficiently advanced to allow this type of comparison for more complex protein products.

Woodcock Statement, supra note 22, at 10.


26. See Woodcock Statement, supra note 22, at 12.

27. Id. at 10–12.
when used. Currently, only expensive and time-consuming clinical trials are able to detect whether the subtle structural differences among biologics will lead to changes in safety or efficacy.

Biological production methods also raise concerns about interchangeability. Interchangeability refers to the ability to safely substitute an FOB for the innovator biologic in the course of treatment. Interchangeability does not present a significant issue for small-molecule generics because generics are structurally identical to the innovator. Because FOBs lack structural identity with the innovator, they may also lack interchangeability. Therefore, clinical trials must specifically address the interchangeability of FOBs.

II. REGULATION OF BIOLOGICS

Because of the high cost of biologics, Congress is exploring legislation to facilitate the development of FOBs. Many policymakers expect that accelerated approval for FOBs would create an economically favorable environment for their production and bring down the costs of innovator biologics via competition in the marketplace. In essence, Congress hopes to emulate the successes of the Hatch-Waxman Act, which led to increased incentives for the pharmaceutical industry to produce generic drugs and cost reductions up to eighty percent.

Congress is currently considering a number of bills. Estimates of the potential savings vary, but the Obama Administration estimates that an FOB approval pathway would lead to government savings of $9.2 billion
over the next ten years. Total consumer savings in that time may reach between $71 and $108 billion.

A. CURRENT REGULATION—THE PUBLIC HEALTH SERVICE ACT

The FDA currently approves “biological products” under the regulatory framework provided by the Public Health Service (PHS) Act of 1944. This pathway for biologic approval resembles the approval process for small-molecule drugs under the Federal Food Drug and Cosmetic (FDC) Act.

Although the original innovator faces similar hurdles for approval of biologics (under the PHS) and drugs (under the FDC), subsequent applicants seeking to reference the innovator drug under the two regimes face significantly different requirements. Approval of a new drug under both pathways begins with an FDA application, followed by clinical trials to determine safety and efficacy. Clinical trials progress from small-scale human testing to large scale human testing with costs increasing at each level. For small-molecule drugs under the FDC, the Hatch-Waxman Act created an abbreviated approval process for the subsequent market entrant where the second entrant could rely on the innovator’s clinical data. No such provision exists for biologics under the PHS. Thus the subsequent biologic market entrant must bear costly and time-consuming trials prior to FOB approval.

B. A LEGISLATIVE TEMPLATE—THE HATCH-WAXMAN ACT

The Hatch-Waxman Act is a “balancing of interests.” On one side, innovator drug companies hope to profit after sinking tremendous amounts of money on the development of new drugs. On the other side, generic drug companies seek to bring generic drugs to the market. In the middle, the public benefits both from the lowering of costs for older drugs via

36. JOHNSON, supra note 5, at 3.
37. Tumulty & Scherer, supra note 11.
39. JOHNSON, supra note 5, at 6.
43. JOHNSON, supra note 5, at 6.
competition and from the development of new therapies by innovator drug companies.45

Under the Hatch-Waxman framework, when an innovator drug initially enters the market, two mechanisms help an innovator enjoy a period of market exclusivity: patent extension and data exclusivity. During this period, innovators recoup development costs through supracompetitive profits. Balanced against this, the Hatch-Waxman framework also encourages generic competition with an abbreviated FDA approval process that bypasses costly clinical trials. In an ideal situation, an innovator enjoys just enough market exclusivity to justify the expense of drug development, after which the market opens to competition that drives down costs.

The Hatch-Waxman Act offers innovators the possibility of patent extension.46 A patent provides its owner with the right to exclude others from making, using, or selling the patented invention.47 In the drug industry patents cover drug compositions, manufacturing processes, or methods of use. Patents are usually filed in the initial stages of drug discovery and last twenty years from the date of filing. However, clinical trials may take over six years, and FDA approval may require a year or two more.48 Therefore, a substantial portion of patent life may lapse before the drug reaches the market. To compensate, the Hatch-Waxman Act can add up to five years of patent term extension for the time lost seeking FDA approval.49 As a result, an average innovator small-molecule drug retains around eleven to thirteen years of patent protection after FDA approval.50

45. See id.
47. 35 U.S.C. § 271(a) (2006) (“Except as otherwise provided in this title, whoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States, or imports into the United States any patented invention during the term of the patent therefore, infringes the patent.”).
48. See DiMasi & Grabowski, supra note 41, at 475.
49. The Hatch Waxman Act allows for restoration of half the time spent in clinical trials and the full time spent by the FDA during final approval. The Hatch Waxman Act also caps the maximum patent life after restoration at fourteen years, so the full five year restoration is not available if the manufacturer retains a patent term of greater than nine years prior to Hatch Waxman patent term extension. 35 U.S.C. § 156 (2006).
In addition to patent extension, the Hatch-Waxman Act provides a five year period of data exclusivity for new drugs.\(^{51}\) While the Hatch-Waxman Act grants generic manufacturers the ability to borrow the innovator’s clinical trial data, this grant is not immediate. The data exclusivity period requires that generic manufacturers wait five years after the approval of the new innovator drug before filing an application that relies on the innovator’s clinical data for approval.\(^{52}\) During the data exclusivity period, the innovator enjoys a form of market protection from generic competition. Without access to the innovator’s data, the high cost of clinical trials can deter market entry by generic manufacturers. If a competitor proceeds with its own clinical trials, however, that competitor can still enter the market.\(^{53}\)

Compared to an average effective patent life of around twelve years, data exclusivity persists for a relatively short amount of time. Therefore, patent protection acts as the primary means by which small-molecule drug innovators prohibit entry of generic competition into the marketplace. Only when a drug has a very limited patent term remaining after FDA approval does data exclusivity provide meaningful market protection.

For generics manufacturers, the Hatch-Waxman Act established a pathway to attain abbreviated approval. Specifically, § 505(j) of the FDC Act allows generic drug makers to rely on an innovator drug manufacturer’s FDA filings to demonstrate safety and effectiveness, provided that the generic is “bioequivalent” to the innovator drug.\(^{54}\) A generic achieves bioequivalence if a subsequent applicant shows identical chemical structure for the active ingredient, as well as other characteristics like dosage and therapeutic formulation, and the generic manufacturer can rely on the innovator’s clinical trials in the application process.\(^{55}\) Since showing bioequivalence costs far less than conducting clinical trials on humans, the Hatch-Waxman Act excuses the generic applicant from a substantial burden in drug development.

In the Hatch-Waxman regime, an innovator must list each patent relevant to its drug with the FDA. For the subsequent applicant, applicants must file one of four certifications, known as Paragraph I through Paragraph IV certifications, in order to gain the benefit of an abbreviated approval process. A Paragraph I certification is filed if the innovator failed to file that
A Paragraph II certification is filed if the innovator’s patent has expired. A Paragraph III certification is filed if the innovator has a valid patent and the subsequent applicant would like to approval on the date after patent expiry. A Paragraph IV certification is filed if the innovator’s patent is either invalid or not infringed by the subsequent applicant. A Paragraph IV certification also adds the incentive of a 180 day market exclusivity period to the first applicant to successfully challenge the innovator’s patent in court. This award not only encourages generic manufacturers to file first, but also encourages design-around innovation as well as the challenge of invalid patents.

The Hatch-Waxman Act undoubtedly promotes the introduction of generics into the United States market. Generics comprised only nineteen percent of prescriptions when the Hatch-Waxman Act took effect in 1984. Now, generics represent sixty-nine percent of United States prescriptions. Estimates suggest that consumers save around $8 to $10 billion dollars through the use of generics. As a result, the Hatch-Waxman Act serves as an attractive legislative template for an abbreviated approval process for FOBs.

C. ANOTHER LEGISLATIVE TEMPLATE—REGULATION OF BIOSIMILARS IN THE EUROPEAN UNION

In 2005, the European Medicines Agency (EMEA), the European equivalent of the U.S. FDA, published guidelines for the abbreviated approval of FOBs (termed “biosimilars”). In April 2006, the EMEA authorized the human growth hormone Omnitrope as the first biosimilar in the European Union, and twelve additional authorizations followed. Although biosimilars only recently entered the market in Europe, early

57. Id.
58. Id.
59. Id.
62. Id.
64. Id.
indications show twenty-five to thirty percent price reductions for certain biologics.67

The EMEA regulations arose because “[d]ue to the complexity of biological/biotechnology-derived products[,] the generic approach is scientifically not appropriate for these products.”68 Instead, the EMEA follows the “similar biological medicinal products” approach, which is based on a comparability exercise.69 In demonstrating similarity to a reference innovator biologic, the biosimilar manufacturer must (1) show analytical data comparing the biosimilar against the reference biologic, and (2) demonstrate comparable safety and efficacy.70

The EMEA determines the need for clinical studies of safety and efficacy on a case-by-case basis.71 However, the EMEA publishes a tiered system of guidance documents to supplement this general framework.72 These guidance documents describe the specific requirements manufacturers must meet for approval of biosimilars. The top tier consists of quality, clinical, nonclinical, and additional overarching guidelines that apply to all biosimilars.73 The middle tier contains product guidance documents for classes of biologics such as vaccines and antibodies.74 Finally, at the lowest tier, the EMEA provides guidelines describing the data requirements for the approval of specific proteins, such as recombinant human erythropoietin, recombinant human granulocyte colony-stimulating factor, recombinant human insulin, and recombinant human growth hormone.75

In Europe, biologics innovators enjoy ten years of data exclusivity, with the possibility of a one year extension.76 Also, the biosimilar authorization process in Europe only covers similarity between an innovator biologic and

68. EUR. MEDS. AGENCY, supra note 65, at 4.
69. Id.
72. See Nowicki, supra note 21, at 269.
73. See EUR. MEDS. AGENCY, supra note 65, at 5.
74. See id. at 6–7.
75. See Nowicki, supra note 21, at 269.
76. See Greenwood, supra note 71, at 1.
the follow-on biosimilar, and does not address interchangeability.\textsuperscript{77} The EU process leaves the interchangeability assessment for biosimilars to individual governments. In fact, countries such as France, Italy, and the Netherlands have explicitly stated that biosimilars will not be substitutable.\textsuperscript{78}

III. UNITED STATES LEGISLATION REGULATING FOLLOW-ON BIOLOGICS

The Hatch-Waxman Act is credited with reducing prices for small-molecule drugs, increasing access to these drugs, and hastening the pace of innovation in the drug industry.\textsuperscript{79} Because of the success of the Hatch-Waxman framework, Congress will likely create an analogous model to facilitate FOB entry and reduce the costs of biologics for patients.

In November 2009, the United States House of Representatives passed House Bill 3962, the Affordable Health Care for America Act, which includes a provision for the abbreviated approval of FOBs.\textsuperscript{80} In December 2009, the Senate passed the Patient Protection and Affordable Care Act, House Bill 3590,\textsuperscript{81} which contained almost identical language on an abbreviated approval pathway for FOBs.\textsuperscript{82}

Proposals to regulate FOBs must address two key issues. The first concerns the balance between public safety and FOB development costs. Current technology requires the use of expensive clinical trials to determine the safety and efficacy of an FOB. The legislative proposals task the FDA with determining the clinical testing needed for approval. This testing should protect the public but also permit FOB developers to realize a cost savings during development.

The second issue concerns the balance between lowering costs for established biologics and ensuring continued investment toward innovation. Encouraging the entry of FOBs into the market creates competition that drives down prices, but at the same time innovator companies require an exclusivity period sufficient to justify their considerable upfront investments.

\textsuperscript{77} See Rossignol Statement, supra note 23, at 7.
\textsuperscript{78} See Urlep, supra note 66.
\textsuperscript{79} See FED. TRADE COMM’N, EMERGING HEALTH CARE ISSUES: FOLLOW-ON BIOLOGIC DRUG COMPETITION 4 (2009).
\textsuperscript{80} Affordable Health Care for America Act, H.R. 3962, 111th Cong. (2009).
\textsuperscript{81} Patient Protection and Affordable Care Act, H.R. 3590, 111th Cong. (2009).
\textsuperscript{82} Since the text is nearly identical the House bill provisions will be referenced in this Note for simplicity.
A. FOB Development Costs vs. Safety

1. Bioequivalence and Biosimilarity

For small-molecule generics, the Hatch-Waxman Act allows the FDA to rely on the innovator drug manufacturer’s findings on safety and efficacy, requiring a subsequent generic applicant only to demonstrate “bioequivalence” between its generic and the referenced drug. To show bioequivalence, the generic applicant must first demonstrate that the generic drug has the same active ingredient, route of administration, dosage form, strength, and proposed labeling as the original innovator drug. Then, the generic manufacturer must show that the rate and extent of absorption of the generic drug does not significantly differ from that of the reference drug when administered at the same dosage. Once the generic demonstrates bioequivalence with the innovator drug, the generic may rely on prior data for approval under the assumption that the generic is as safe and effective as the innovator drug.

Because of the size and complexity of biologics, however, current technology cannot show bioequivalence in an FOB. While available analyses can reliably compare the protein sequence of an FOB and the innovator biologic, that sequence does not reveal the biologic’s complete structure. A biologic’s therapeutic properties also depend on structural factors such as local folding, three-dimensional folding, the addition of modifications, and the clumping of individual biologics proteins into aggregates. Current techniques cannot detect and compare these more complex structures and modifications. Therefore, FOB producers cannot show that an FOB has the identical active ingredient as the innovator biologic.

Other duplication methods for biologics are unlikely to succeed. Even an attempt to copy each of an innovator biologic’s production steps would not guarantee an identical FOB product. Even small variations in manufacturing conditions cause structural differences in the biologics produced. Because

84. Id.
85. Id.
86. See Mossinghoff, supra note 53, at 191.
87. See FEDERAL TRADE COMM’N, supra note 79, at 8.
88. Post-translational modifications include phosphorylation, glycosylation, and acetylation. See Woodcock Statement, supra note 22, at 10.
89. Id.
90. See id. at 8.
91. See Roger, supra note 25, at 342.
the FOB manufacturer usually lacks access to the innovator’s exact manufacturing process or cell lines, structural differences between the FOB and the innovator will generally occur. For example, the European Union approved the FOB growth hormone Valtropin, which referenced the innovator biologic Humatrope. Even though the EMEA found Valtropin to be similar to Humatrope, because different cell lines were used for the production of the two products (yeasts for Valtropin and *Escherichia coli* for Humatrope), the two require different precautions and indications.

Because existing technology cannot show bioequivalence, the currently proposed legislation calls only for “biosimilarity.” Biosimilarity occurs when the “biological product is highly similar to the reference product notwithstanding minor differences in clinically inactive components” provided that “there are no clinically meaningful differences between the biological product and the reference product in terms of the safety, purity, and potency.”

The legislative proposals require clinical trials for FOBs in order to demonstrate safety, purity, and potency. As a consequence, although a showing of similarity can save clinical testing expenses compared to a full series of clinical trials, demonstrating similarity nevertheless requires substantially more expense than demonstrating bioequivalence of small-molecule generics. While small-molecule generic drug manufacturers can show bioequivalence through simple analytic testing, FOB manufacturers must perform expensive and time-consuming studies on clinical safety and efficacy. Additionally, because clinical testing ideally takes place after product manufacturing processes are finalized, FOB manufacturers also must bear the expense of seeking approval and validation of their commercial manufacturing facilities at or before initiation of clinical trials.

2. *Immunogenicity*

Immunogenicity, the ability to stimulate an immune response in the body, is a major safety concern for biologics. This issue poses a comparatively trivial obstacle to traditional drug development because small

93. See Nowicki, *supra* note 21, at 270.
95. See *FED. TRADE COMM’N*, *supra* note 79, at 9.
96. See *id.*
molecules are far less likely to generate an immune response than proteins.\textsuperscript{97} Immune reactions to biologics can range from the production of detectable, but not clinically significant, antibodies, to an immune response that compromises drug safety or effectiveness.\textsuperscript{98} If the immune system produces neutralizing antibodies, these antibodies will bind to the biologic and reduce the biologic’s effectiveness. Even worse, hypersensitivity responses include symptoms such as severe allergic reactions, rashes, fevers, or kidney problems. For example, several patients developed a rare brain condition after taking Efallzumab, a biologic used to treat psoriasis.\textsuperscript{99} In another case, because of a subtle change in the manufacturing process of recombinant erythropoietin, patients developed epoetin-resistant anemia requiring blood transfusions, immunosuppressive treatment, and, eventually, kidney transplantation.\textsuperscript{100} Thus, immune responses present a serious concern because they may reduce a biologic’s efficiency or even become life threatening for patients.

To assure safety for FOBs, immunogenicity tests will need to be done for each individual FOB.\textsuperscript{101} The inevitable structural differences between the innovator biologic and the FOB mean that even after an innovator biologic is known to be safe and effective in terms of immunogenicity, there is no assurance that the corresponding FOB will not create immune-mediated problems.\textsuperscript{102} This individualized testing for immunogenicity can represent substantial costs for FOB manufacturers.

In addressing immunogenicity, the current bills leave the proper amount of clinical safety data required to FDA discretion on a case-by-case basis.\textsuperscript{103} Earlier versions of the bills included more stringent requirements for the FDA, and recommended that the FDA publish product class guidance documents which would detail immunogenicity requirements during clinical trials.\textsuperscript{104}

\textsuperscript{97} See Letter from Frank M. Torti, M.D., M.P.H., Principal Deputy Comm’r and Chief Scientist, FDA, to the Honorable Frank Pallone, Jr., Chairman, House Subcomm. on Health, Comm. on Energy and Commerce, at 1 (Sept. 18, 2008).
\textsuperscript{98} See Woodcock Statement, supra note 22, at 11.
\textsuperscript{100} Nowicki, supra note 21, at 270.
\textsuperscript{101} See Woodcock Statement, supra note 22, at 12.
\textsuperscript{102} See id.
\textsuperscript{103} Affordable Health Care for America Act, H.R. 3962, 111th Cong., at 1531 (2009).
\textsuperscript{104} Pathway for Biosimilars Act, H.R. 1548, 111th Cong., at 18 (2009).
3. **Interchangeability**

Interchangeability refers to the ability of an FOB to directly substitute for the innovator biologic. For example, if a patient begins treatment with the innovator biologic, the introduction of an FOB may lead a patient to consider a switch to the FOB. Similarity between the FOB and the innovator assures that the FOB has similar safety and efficacy, but this only represents safety and efficacy for the FOB working independently. There is still an “interchangeability” issue because of the potential for unforeseen reactions when a patient switches to an FOB after starting with the innovator biologic.\(^{105}\) The true test for safety when switching between the reference biologic and the FOB occurs during interchangeability tests in clinical trials.

Interchangeability may play a critical role in the market for an FOB because a determination of interchangeability would greatly ease market penetration. Without interchangeability, both physicians and patients would remain skeptical about the safety and efficacy of substituting an FOB for an innovator biologic.\(^{106}\) Demonstrable interchangeability played a significant role in physician behavior when small-molecule generics entered the market. Manufacturers of generic small-molecule drugs benefit from state substitution statutes that allow pharmacists to dispense generics when presented with a prescription for a branded drug, unless directed otherwise by the physician or the consumer.\(^{107}\) Additionally, pharmacy chains prefer dispensing the generic because generics typically carry higher margins.\(^{108}\) Together, these two factors can lead to a loss of market share for a branded small-molecule drug within one year of the entry of generics.\(^{109}\)

An FOB achieves interchangeability with the reference biologic if the “risk in terms of safety or diminished efficacy of alternating or switching between use of the biological product and the reference product is not greater than the risk of using the reference product without such alteration or switch.”\(^{110}\) If an FOB is interchangeable with the reference product, the FOB “may be substituted for the reference product without intervention of the health care provider who prescribed the reference product.”\(^{111}\) The FDA

\(^{105}\) See Woodcock Statement, supra note 22, at 12.


\(^{107}\) See id. at 13.


\(^{110}\) Affordable Health Care for America Act, H.R. 3962, 111th Cong., at 1533 (2009).

\(^{111}\) Id. at 1558.
determines interchangeability, like biosimilarity and immunogenicity, on a case-by-case basis.\textsuperscript{112}

4. Role of the FDA

In the bills under consideration in Congress, the FDA would retain substantial control of the FOB approval process. Specifically, the FDA would determine which clinical trials are necessary for approval.

Allowing the FDA to assess the need for clinical data would provide more flexibility than predefined statutory mandates for clinical testing. In general, the amount and type of new data necessary to demonstrate the safety and effectiveness of an FOB will depend on the level of demonstrable similarity between the FOB (either structurally, functionally, or clinically) and the corresponding approved biologic. Clinical uses and the amount and type of accumulated clinical experience regarding the approved product will influence the amount and type of data required by the FDA for FOB approval.\textsuperscript{113} With its experience in the approval of biologics, the FDA would be the agency best suited to consider and weigh the multiple factors that influence the appropriate scope of clinical trials.

However, the best way to evaluate an FOB application may not involve case-by-case determination. To be sure, case-by-case determinations enjoy the important advantage of flexibility and adaptability to advancing technologies. But, because immunogenicity and similarity are largely unpredictable with current technology, public safety may demand the certainty provided by strict statutory guidelines requiring specific clinical trials.\textsuperscript{114} Innovator drug manufacturers would also benefit from the predictability that such a system could provide.

The current bills accordingly implement a compromise between statutory requirements and case-by-case assessment. The bills call on the FDA to produce guidance documents, similar to those under the EMEA, that would provide FOB manufacturers with categorical estimates of the requirements for FDA approval, while still allowing the FDA to make case-specific determinations as necessary.\textsuperscript{115} Although producing guidance documents may substantially burden the FDA,\textsuperscript{116} the FDA supported this approach.\textsuperscript{117} The

\begin{footnotesize}
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\item \textsuperscript{112} Id. at 1532–33.
\item \textsuperscript{113} See Woodcock Statement, supra note 22, at 9.
\item \textsuperscript{114} See Kaldre, supra note 6, at 33.
\item \textsuperscript{115} See Affordable Health Care for America Act, H.R. 3962, 111th Cong., at 1540 (2009).
\item \textsuperscript{116} See JOHNSON, supra note 5, at 12.
\item \textsuperscript{117} See generally Woodcock et al., supra note 92.
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FDA has long analyzed related protein products, from the first therapeutic proteins purified from natural sources through the rise of recombinant proteins in the 1980s. Another context in which the FDA has demonstrated expertise in directly comparing protein products is when a biologic’s manufacturing processes requires modification. This may arise in contexts such as a new manufacturing plant, a change in equipment used at a current plant, or a change in the steps of manufacture. The FDA must approve modifications to the manufacturing process, and this entails an evaluation of the current protein product against the product of the previous manufacturing process. In 1999, the FDA published a draft guide for abbreviated approval under § 505(b)(2) of the FDC Act, which covers small-molecule drugs similar, but not identical, to the reference innovator drug.

Although unfinished, these guidelines could serve as a basis for drafting new FOB guidelines. In sum, the FDA has considerable experience and expertise with the analytical and regulatory issues surrounding biosimilarity.

Under the proposed framework, an FDA rejection would, for practical purposes, signify the loss of millions of dollars of investment in FOB development and clinical trials. Even in cases where the FDA grants approval, the amount and extent of the required clinical trials would be subject to considerable FDA discretion. As a result, the FDA would wield substantial power over drug innovation policy in the United States.

The central role proposed for the FDA in an approval process that implicates perhaps billions of dollars prompts some concerns regarding the agency’s decision making processes. Under the “agency capture” theory, a regulatory body may, through close ties or political pressure, become controlled by the industry it regulates, resulting in that regulatory body serving the special interests of the industry instead of serving the public.

In the past, the FDA has shown “relaxed” standards for the approval of generics compared to the standards for innovators. In a recent case, the

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118. Id. at 438.
119. 21 C.F.R. § 314.70 (2009).
120. Woodcock et al., supra note 92, at 438–41.
123. See Andrew E. Costa, Negligence Per Se Theories in Pharmaceutical & Medical Device Litigation, 57 Me. L. Rev. 51, 87 (2005).
124. See Mossinghoff, supra note 53, at 191.
FDA even acknowledged that political pressure influenced its approval of Menaflex, a knee repair device.\footnote{Knee Device Approval Exposes Pressure on FDA, MSNBC, Sept. 25, 2009, http://www.msnbc.msn.com/id/33025867/ns/health-more_health_news/ (last visited Dec 23, 2009).}

5. Effect on Market Pricing

Although the proposed bills allow for FDA discretion in determining the necessity and scope of clinical trials for safety and efficacy, it is unlikely that the FDA will allow approval of any FOB without at least some clinical testing. Current technology can only determine the similarity of an FOB to its reference innovator through clinical trials. Neither preclinical nor nonhuman studies can fully predict immunogenicity.\footnote{See Nowicki, supra note 21, at 270.} Although severe immune reactions may escape detection even in clinical trials,\footnote{See Medicare Payment Advisory Comm’n, supra note 99, at 108.} public safety demands at least some level of human clinical trials for immunogenicity.

As a result of these safety concerns, the effectiveness of an abbreviated FOB approval pathway depends heavily on the scope of clinical trials required by the FDA. Even relatively small trials of biologics in a few hundred patients would likely cost tens of millions of dollars and take several years to complete.\footnote{See Henry Grabowski, Iain Cockburn & Genia Long, The Market For Follow-On Biologics: How Will It Evolve?, 25 Health Aff. 1291, 1293 (2006).} One study surmises clinical trials for FOBs would cost eight to one hundred times more and take twice as long as development for a generic small-molecule drug.\footnote{See Neil Turner, Biogenerics: A Difficult Birth, IMS, http://www1.imshealth.com/web/content/0,3148,64576068_63872702_70261000_71026746,00.html (last visited Oct 27, 2009).} For European approvals, clinical trial costs ranged between $10 and $40 million. This contrasts with the $1 to $2 million cost and approximately two year time span necessary to demonstrate bioequivalence for generic small-molecule drugs.\footnote{See Grabowski et al., supra note 128, at 1293.}

Thus, clinical trials for immunogenicity and interchangeability will add tremendous expenses for FOB manufacturers. Moreover, some FOBs may even require more clinical trials than their reference innovator biologic.\footnote{See Christopher Webster et al., Biologics: Can There Be Abbreviated Applications, Generics, or Follow-On Products?, Biopharm Int’l. 28 (2003).} Testing for a new FOB would require testing of the FOB not only against the innovator biologic but also against each previous FOB referencing the same innovator for potential cross-reactions.

\footnote{126. See Nowicki, supra note 21, at 270.}
\footnote{127. Medicare Payment Advisory Comm’n, supra note 99, at 108.}
\footnote{129. See Neil Turner, Biogenerics: A Difficult Birth, IMS, http://www1.imshealth.com/web/content/0,3148,64576068_63872702_70261000_71026746,00.html (last visited Oct 27, 2009).}
\footnote{130. See Grabowski et al., supra note 128, at 1293.}
\footnote{131. See Christopher Webster et al., Biologics: Can There Be Abbreviated Applications, Generics, or Follow-On Products?, Biopharm Int’l. 28 (2003).}
High costs for clinical trials pose serious hurdles for the companies seeking to create FOBs. The Federal Trade Commission (FTC) predicts that clinical testing will lead to high development costs, reducing the number of companies seeking to develop FOBs to a small pool of large companies.\(^{132}\) Additionally, the potential price reduction for biologics may only be ten to thirty percent.\(^{133}\) This represents a substantial savings, but cannot match the savings of up to eighty percent seen after generic competitors enter the market for small-molecule drugs.

B. PRESERVING INNOVATION INCENTIVES VS. PUBLIC SAVINGS

Data exclusivity acts as a separate, complementary protection to patents for innovator drug manufacturers. When the innovator initially applies for FDA approval, it submits data from its testing of safety and efficacy. Data exclusivity prevents a subsequent competitor from relying on this data for its own FDA approval for a specified time period.\(^{134}\) Competitors must either wait for the exclusivity period to end or finance the high costs to replicate the data themselves.\(^{135}\) In effect, the high cost barrier to creating clinical testing data protects innovators from the entry of competitors, and this results in a time period in which the innovator usually enjoys exclusive control of the market.\(^{136}\)

Patents typically protect innovations in the biotechnology industry. However, the patent system for biologics innovators suffers from numerous drawbacks. With increasing development times for new drugs and the tendency for the PTO to issue composition of matter patents in the early stages of development, innovator biologics companies may find themselves in a situation with little or no patent term left to protect their investment when the product enters the market.\(^{137}\) On average, biologics require ten to fifteen years\(^{138}\) to progress from initial discovery to FDA approval.\(^{139}\) As an example, the biologic cancer drug Avastin required fifteen years to reach patients.\(^{140}\) Unable to rely on composition of matter patents, a biologics innovator would need to depend on secondary process patents and method

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\(^{132}.\) See Fed. Trade Comm’n, supra note 79, at 15.

\(^{133}.\) Id. at 23.

\(^{134}.\) See Johnson, supra note 5, at 13.

\(^{135}.\) See Eisenberg, supra note 122, at 360.

\(^{136}.\) See id.

\(^{137}.\) See id. at 348.


\(^{139}.\) Tauzin, supra note 7, at 59.

of use patents. But competitors can easily design around these types of patents. Even more, questions of patent validity and infringement create significant uncertainty.

Data exclusivity can address these perceived inadequacies of the patent system for the innovator biologics companies. For drugs with long development times and thus little useful patent life, data exclusivity provides a measure of protection to bring these drugs to market. Data exclusivity indirectly addresses design-around issues because the competitor cannot rely on the innovator's clinical data. Even if the FOB manufacturer could design around an innovator's patent, high financial barriers created by clinical trials restrict the entry of FOB manufacturers. Furthermore, FOB manufacturers cannot challenge data exclusivity as they could a patent, which renders the protection provided by data exclusivity effectively stronger than that provided by patents.

The trade off for any form of exclusivity, whether patent or data, is decreased competition. By imposing the financial barrier of clinical trials on competitors, data exclusivity would give innovators a relatively assured time period to enjoy exclusive control of the market and allow planned recovery of development costs. During this time, prices would remain relatively high for consumers due to lack of competition in the market.

But the current legislation ultimately seeks to increase competition, thereby expanding access to biologics and driving down costs. This implicates the delicate balance between innovation and competition. Therefore, the proper time span for data exclusivity is a critical issue in the current legislative debate. An optimum time for exclusivity theoretically occurs when the benefits of encouraging biologics development equal the costs of delaying competition. An analysis of the costs involved in biologics development estimates that an innovator company may need 12.9 to 16.2 years to break even on the costs of development for a biologic drug. Based on these studies, the current biologics legislation in Congress calls for a data exclusivity period of twelve years.

141. See id. at 480.
143. See Grabowski, supra note 140, at 481.
144. See Eshoo Statement, supra note 1, at 1.
145. See Woodcock Statement, supra note 22, at 5.
146. See Grabowski, supra note 140, at 481.
147. Id. at 487.
The twelve-year exclusivity period in the current FOB bills represents a major change from the Hatch-Waxman framework. This extended grant of data exclusivity for the innovator biologic manufacturer could potentially shift the principal form of protection in the biologics market from patents to data exclusivity. Unlike the generic small-molecule drug industry where patent protection generally outlasts the period of data exclusivity, for biologics, the data exclusivity period may run even longer than patent protection. This is potentially troubling as data exclusivity is unchallengeable in court.

The opponents of extended data exclusivity include the FTC and generic drug makers. The FTC argues that Hatch-Waxman-like incentives such as exclusivity would not encourage any more innovation than that already encouraged by patent protection and market forces. Patents disallow the same free riding on discoveries that exclusivity would provide, and there is no evidence that patents in biologics are more easily invalidated or designed around. Generic drug manufacturers call a twelve-year exclusivity period “arbitrary and excessive” unjustifiably delaying access to affordable competition and choice for consumers. A prior proposal in the House of Representatives, House Bill 1427, called for a much shorter period of five years, identical to the length of data exclusivity in the Hatch-Waxman Act.

Another criticism of the “12.9 to 16.2 years to break even” analysis argues that a break even period should not necessarily equate to a data exclusivity period. Even after competitor FOB entry, an innovator would almost certainly retain a sizable market share and generate profit, although those profits would likely decrease. Therefore, setting a data exclusivity period at the break-even point may overcompensate the innovator company.

On the other hand, a recent analysis suggests that patent protection may inadequately protect even small-molecule drugs. Currently, the Hatch-Waxman framework incentivizes patent challenges that, in turn, may result in

149. See Fed. Trade Comm’n, supra note 79, at 38.
150. See id. at 36.
152. Johnson, supra note 5, at 13–14.
153. For example, Eprex, the innovator epoetin alpha in Germany, still retained about half of the market almost a year after entry of biosimilars. See Hospira, Hospira Responses to FTC Questions on Biosimilars (2009), http://www.ftc.gov/os/comments/healthcarecompissues/090519hospirasupplementonbiosimilars.pdf.
154. See Brill, supra note 142, at 10.
reduced patent life for innovator companies.155 For example, the osteoporosis drug Fosamax lost about four years of patent life after a patent challenge.156 A recent increase in patent challenges has been correlated with a decrease in one indicator of innovation in the drug industry: FDA drugs approvals of new molecular entities. 157 In order to encourage innovation and assure innovator drug companies a period to recoup development costs, commentators have recommended an increase of the data exclusivity period for small-molecule drugs to ten or twelve years.158 Criticism of the five year length of Hatch-Waxman data exclusivity for small-molecule drugs as inadequate strengthens the justification for a twelve year length of data exclusivity for biologics.

IV. CONCLUSION

The production of biologics and subsequent FOBs represents a unique industry with unique concerns. Innovator companies fear that the patent system will not adequately protect their investments in biologics, either because patents will be designed around or because of a lengthier development timeline. Therefore, data exclusivity may provide the mechanism for the market protection required to foster innovation and assure innovators an opportunity to earn back their investments. Under the currently proposed legislative framework, biologics innovators will enjoy twelve years of data exclusivity, a length of time supported both by an economic break even analysis and by experience in the small-molecule drug industry. Although there are criticisms of the exact economic modeling, to foster innovation it is reasonable to base the data exclusivity period directly on the time required to recoup investments.

Problems unique to FOBs also include the inability to determine bioequivalence compared to the innovator biologic and the safety concern of immunogenicity. Both can potentially lead to much higher development costs for FOBs compared to small-molecule generics. The amount of these increased development costs will be directly proportional to the level of clinical testing required for each FOB approval by the FDA.

Ultimately, the future of FOBs lies with the FDA. The FDA will set the bar for clinical trials, controlling entry into the market. If set too high, clinical

155. See Grabowski & Kyle, supra note 50, at 497.
158. Higgins & Graham, supra note 156, at 371.
testing costs will stifle FOBs, meaning no costs savings or actual increased access to drugs for the public. If set too low, reduced costs will facilitate market entry by FOBs, but at the risk of compromising both safety and innovation. In other words, the FDA will not only regulate FOB safety, but the growth of the entire biologics industry. Congress should consider if the FDA is equipped to make these kinds of decisions before delegating the FDA this level of discretionary power.
RISE OF THE PATENT INTERMEDIARIES

Allen W. Wang

Patents are evolving from purely exclusionary instruments into intellectual property assets that play a part in business strategy and have value as transactional goods. Businesses operating in the intellectual property marketplace have experienced an unprecedented explosion of activity involving these intangible but valuable assets. The new market for intellectual property has inspired entrepreneurial legal professionals and business professionals alike to create new companies and expand existing ones to act as middlemen, encouraging the continued proliferation of patent transactions. These entities operate and thrive in the intermediary market between buyers and sellers of intellectual property as well as auxiliary markets related to the protection of intellectual property.


This discussion categorizes these intermediate entities into three groups: brokers, defensive aggregators, and offensive aggregators. Brokers are companies that serve a connective and advisory function in linking patent sellers with potential buyers. Defensive aggregators, on the other hand, are services that acquire patent rights and license them to subscriber companies. Finally, offensive aggregators acquire and develop patent portfolios for the purpose of collecting licensing fees from alleged infringers. The “intermediary” classification for these entities is appropriate because their business models treat patents as transactional assets, meaning that their activities are one level removed from typical market participants, whose patent strategies are more likely to revolve around obtaining patents as up-front protection for the research, development, and production of actual goods and deriving competitive advantage.5

This Note discusses patent intermediaries, how they affect the market, and how their behavior relates to the goals of the patent system. Part I describes the background and original purpose of the patent regime. Part II explains how the differences between information assets and traditional physical assets make patents difficult for businesses to understand and manage. Part III profiles the three different categories of patent intermediaries mentioned above and their roles in the patent market. Part IV hypothesizes the catalysts driving the formation of patent intermediaries. Part V discusses the possibility of legislation, regulation, or private ordering to ensure that these intermediaries act in harmony with the patent system. Finally, this Note concludes with observations on the future of patent intermediaries.

I. PURPOSE OF THE PATENT SYSTEM

Determining how patent intermediaries may adhere to or deviate from the patent law requires a contextual foundation. Accordingly, this Part considers the historical reasons for implementing a patent regime, and highlights United States Supreme Court decisions that have directly addressed the goals of the patent system.

The Constitutional Convention of 1789 established the patent system, modeled after the English Statute of Monopolies, in order to provide patent rights that represented “strong, enforceable incentives for innovation,” not

merely “cultural obsessions with novelty.” The patent system is embodied in the Patent Clause from Article I, Section 8 of the Constitution, which gives 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 Writing and Discoveries.” The first part of the Clause plainly states that one purpose of the patent system is to encourage innovation. Accordingly, entities acting to incentivize innovators are doing so in alignment with the goals of the patent system. On the other hand, entities that only engage in other activities such as litigation or rent-seeking may be operating outside or even against the intended purpose of the patent system. The latter portion of the Clause regarding “exclusive Right[s]” indicates that those who advance the field have a monopoly in their work product, and the Supreme Court has characterized this monopoly as a property right. Like other property rights, patent rights may be transferred to new owners through assignment or license, giving them the freedom to exercise those patent interests as they see fit.

Several Supreme Court cases have articulated the purposes of the patent system along these lines. In *Quanta Computer, Inc. v. L.G. Electronics, Inc.*, the Court stated that “the primary purpose of our patent laws is not the creation of private fortunes for the owners of patents but is ‘to promote the progress of science and useful arts.’” In *Eldred v. Ashcroft*, the Court described the patent system as “a carefully crafted bargain that encourages both the creation and the public disclosure of new and useful advances in technology, in return for an exclusive monopoly for a limited period of time.” This wording suggests that the primary purpose of the patent system is the advancement of technology, and granting temporary monopolies is a necessary sacrifice to provide an economic incentive for the individuals

7. U.S. CONST. art. I, § 8, cl. 8.
10. Patents have the attributes of personal property and may be assigned by a written instrument. 35 U.S.C. § 261 (2006).
producing those advances. Otherwise, without a means to prevent competitors from profitably exploiting a company’s innovations before it even recoups research and development costs, companies would not invest in developing new technologies. This is a sacrifice on the part of the public, because monopolies can harm consumers and discourage second-generation innovators from building on first-generation technology.

The Supreme Court characterized this trade-off as a balancing act between two opposing parties: (1) inventors, who need assurances from the law in the form of exclusive rights; and (2) the public, who should be encouraged to innovate and create in the area outside of those exclusive rights. Practically, the public should benefit from the actual products and advances derived from these inventions. The public should also expect to use and be enriched by the formerly protected knowledge once it enters the public domain.

II. UNIQUE FEATURES OF INFORMATION ASSETS

The emerging market for intellectual property has expanded significantly over the past decade, and commentators believe that intellectual property assets have supplanted traditional, tangible assets as the most powerful and valuable asset class. Whereas traditional physical assets still make up a significant portion of more traditional companies in industries like

14. See id. at 38–39.
16. Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 151 (1989) (“[T]he ultimate goal of the patent system is to bring new designs and technologies into the public domain through disclosure.”).
17. See Monk, supra note 1, at 469–70 (describing the market as “a recent development” but also noting an earlier prediction of this “paradigm shift[] in the economic environment” (citing P. B. Evans & T. S. Wurster, Strategy and the New Economics of Information, 75 HARVARD BUS. REV. 70 (1997))).
18. See Milien & Laurie, supra note 3, at 1037 (stating that intangible assets have overtaken the traditional capital assets of real property, plants, and equipment as the most powerful asset class); RIVETTE & KLINE, supra note 15, at 1–2 (arguing that in the “new knowledge based economy[,] . . . ideas and innovation rather than land or natural resources have become the principal wellsprings of economic growth and competitive business advantage”); Monk, supra note 1, at 470 (“intellectual property lies at the center of the modern company’s economic success or failure” (citing L.C. Thurow, Needed: A New System of Intellectual Property Rights, 75 HARVARD BUS. REV. 96 (1997))).
manufacturing and distribution, intellectual property assets lie at the forefront of company valuation and strategic decisions in high-growth fields like software, electronics, and biotechnology. Intellectual property has “transformed from a sleepy area of law and business to one of the driving engines of a high-technology company.”

Patents, as information assets, possess unique features that make them more complicated to analyze and value than traditional physical assets. For example, one party’s possession of a tangible good necessarily excludes another party from possessing that same good. Without appropriate manufacturing facilities and detailed plans, tangible assets are also difficult to replicate. On the other hand, patents are information goods that can be shared, allowing parties to benefit from arrangements like non-exclusive licenses that do not inhibit the original owner’s ability to generate revenue through licenses to other parties. Patents are also “nonexcludable,” because it is inherently difficult to prevent others from using knowledge even if someone claims ownership. This added complexity mandates a different type of analysis in transactions involving information goods as opposed to traditional assets.

Despite the new perception of high value in information assets, even industry participants consider the overwhelming majority of patents ineffective at preserving value. Only a small percentage of patents end up generating great value through monetization opportunities like licensing or sale, resulting in a very low expected value for each individual patent; accordingly, commentators have likened patents to lottery tickets.

Why, then, does the number of patent filings continue to increase? Why are patents, as an asset class, now perceived to be so valuable? One

19. See Monk, supra note 1, at 482 (stating that business managers now view patents as “an important asset class that can be monetized to generate income”).
compelling argument is simply that patents, through aggregation into a portfolio, acquire a value greater than they would alone. This theory could explain the increased interest of businesses in the development and growth of patent portfolios.

Regardless, the new focus on patent assets has not corresponded to a rise in sophistication among parties to intellectual property transactions — it is a “rare company . . . that has any clue whatsoever about how to value, analyze, and structure . . . IP asset transfers.” Companies attempting to apply the usual acquisition strategies suitable for tangible assets may later stumble into unexpected problems, and the need to guard against these pitfalls generates high transaction costs. Patent rights that have been sold could end up returning to harm the seller; for example, a business divestiture might be acquired by a competitor planning to assert patent rights against the original parent company. Even in situations where tangible asset business strategies can be applied to intellectual property, some adaptations are in order. Consider as an example the complexities of intellectual property asset securitization. The granting of security interests in personal property is governed by UCC Article 9, but non-exclusive patent licenses are not considered personal property. Thus, a party seeking to securitize a non-

24. Wagner & Parchomovsky, supra note 22, at 27 (arguing that the true value of patents lies in their strategic combination into portfolios, which then “confer an array of important advantages upon the patent holder”).

25. Professors Wagner and Parchomovsky describe several examples of this growth: (1) a sharp increase each year for Qualcomm’s U.S. patents issued during 1999–2003; and (2) IBM’s numerous records for number of patents received each year in the time span from 1995–2005. Id. at 46–47.

26. RIVETTE & KLINE, supra note 15, at 163. See also Mario Benassi & Alberto Di Minin, Playing in Between: Patent Brokers in Markets for Technology, 39 R&D MANAGEMENT 68, 70 (2009) (stating that for patents, “with no standardized tools with which to gauge [their] . . . value and potential usage . . . , browsing through an overcrowded technology market is indeed a difficult task and requires specialized know-how”).

27. See RIVETTE & KLINE, supra note 15, at 170 (describing possible limitations to the rights sold, such as by line of business, by product, or even by geography, to avoid precisely this problem).

28. See Peter S. Menell, Bankruptcy Treatment of Intellectual Property Assets: An Economic Analysis, 22 BERKELEY TECH. L.J. 733, 822 (2007) (stating that numerous problems exist that hinder the use of securitized intellectual property as collateral, stemming from fragmented systems with high transaction costs); Ariel Glasner, Making Something out of “Nothing”: The Trend Towards Securitizing Intellectual Property Assets and the Legal Obstacles that Remain, 3 J. LEGAL TECH. RISK MGMT. 27, 27 (2008) (stating that “[w]hile the mechanics of structuring traditional asset securitizations are well-established, intellectual property (IP) securitizations raise a host of complex issues that must be resolved before this particular asset class can be leveraged on a more regular basis”).

exclusive patent license must take care to contract around this limitation.\textsuperscript{30} Further complicating these transactions, the landscape of information available to market players is also quite limited. Transactional partners have only minimal sets of data to work with and lack a standard context for negotiation.\textsuperscript{31}

The increased importance of intellectual property assets like patents and patent portfolios, along with the added complexity of valuing and analyzing risk for these information goods, has created a marketplace populated by players ill-equipped to handle the high transaction costs and information asymmetries representative of intellectual property transactions. Accordingly, entities that can lower net transaction costs and improve information access will be able to take advantage of the unique nature of these assets.

\textbf{III. ROLES THAT INTERMEDIARIES PLAY IN THE PATENT MARKET}

Do patent market intermediaries play a role in furthering the goals of the patent system, or are they a disruptive force? An answer to this question must be framed in the context of the reward-sacrifice distinction inherent in the patent system—that in exchange for the temporary grant (or sacrifice) of a limited monopoly to patent rights holders, the public can obtain a beneficial disclosure and eventual release of valuable advances in technology.\textsuperscript{32} The majority of intermediaries focus on connecting parties that wish to monetize existing patent rights, which has little to do with benefiting the public through disclosure and more to do with rights holders exploiting their patents. Therefore, in terms of the goals of the patent system, intermediaries operate more heavily on the side of private incentive rather than that of the advancement of public knowledge.\textsuperscript{33} Though intermediaries share this characteristic, the different ways in which they interact with the producers and consumers of technological innovation indicate that a proper answer to the question posed above must distinguish between the major types of

\textsuperscript{30} \textit{Id.} at 52–53.

\textsuperscript{31} See infra Part III.A (describing this lack of context in relation to demand for brokers).

\textsuperscript{32} See supra Part I.

\textsuperscript{33} Admittedly, some entities do contribute to the public knowledge, like offensive aggregators that conduct research or defensive aggregators that grant to their members the generally beneficial effect of enhanced freedom to operate. However, most of this is still closer to the goal of providing incentives rather than furthering the public level of technology.
intermediaries. There are many ways to categorize intermediaries; for simplicity, this discussion splits them into those that assist in patent acquisitions and those that acquire patents, and the latter group is further divided based on motivations for purchase. Consider the following categorization of entities into three broad groups: (1) brokers, who play a bridging or market-making role for producers and consumers of intellectual property; (2) defensive aggregators, who acquire patents to provide their subscribers with freedom of operation and safety from litigation; and (3) offensive aggregators, who develop and acquire patents to realize revenue through licensing or asserting their portfolios.

Whether an intermediary advances the goals of the patent system depends on the category to which it belongs. Ultimately, patent brokers do appear to support innovation by encouraging transaction fluidity and improving the incentive value of obtaining a patent. Offensive aggregators appear more disruptive because their activities have only a minimal effect on the incentive balance while increasing the demand for brokerage services and defensive aggregators. Though defensive aggregators are in part a response to offensive aggregators, they also help defend against litigious competitors and increase the amount of resources that can be devoted to innovation. On balance, defensive aggregators appear to be aligned with the goals of the patent system.

Following is a discussion of specific roles that each type of intermediary plays in the patent market. For each category, a short list of companies is provided for reference. Though the lists are by no means exhaustive, they indicate key players based on their representation in the business and legal media.35

34. Millien and Laurie divide the intermediaries into seventeen highly detailed categories, including distinctions between Patent Licensing and Enforcement Companies and IP/Technology Development Companies (even if they also license). See Millien & Laurie, supra note 3, at 1038–54.

A. **Brokers**

Brokers play key roles in establishing market value for patents and removing information asymmetry from transactions. They assist sellers of intellectual property find buyers, obtain a fair price, and conduct an efficient transaction. At the same time, an unscrupulous broker might take advantage of the information gap and abuse its position as the go-between for transacting parties by withholding or selectively disclosing information. However, this type of broker is likely to fade away as public information in the market steadily grows, and the majority of brokers focus on building solid reputations to continue conducting business well into the future.

The activities of brokers are generally consistent with the goals of the patent system because brokers provide a safety net for inventors, supplementing other incentives like reputation or financial success. This safety net makes it easier for inventors to monetize the intangible results of their labor in light of possible setbacks. Even if an inventor, when trying to reduce his invention to practice in the form of a marketable product, fails outright or otherwise falls short of establishing a sustainable business model, the inventor can recoup his investment by licensing or selling the rights with the help of a broker.

Another way that brokers act in accordance with patent system goals is by establishing a more consistent system for determining market value, something that is notoriously difficult to do for intellectual property. For patents, this is difficult because so few of them result in profitable licensing

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36. See Benassi & Di Minin, supra note 26, at 72 (stating that “[b]rokers can . . . provid[e] reliable, trustworthy information, and offer[] legal assistance and control for free-riding behavior”).

37. See id. (stating that opportunistic brokers are “doomed to disappear as industry matures”).


or are found valid and infringed at trial.\textsuperscript{40} Even those that are licensed are likely to be part of a cross-licensing deal, which may indicate the value of a patent portfolio in the aggregate but not the value of individual patents. Furthermore, a company looking to divest a portion of its patent portfolio generally does so based on one of three reasons: (1) it is in distress and needs to deal with financial difficulties;\textsuperscript{41} (2) the patents that it wishes to sell are not correlated with its core business; or (3) it has a surplus of patents in one area and intends to divest a portion of them to save on maintenance costs.\textsuperscript{42} In the first scenario, the weakened bargaining position makes it likely that the company, without protective assistance from a broker, will not receive true market rate for the patents. In the second and third scenarios, the patents may be considered “extra” and could suffer from an inherent bias devaluing their worth. In these cases, a broker could assist by providing a neutral value assessment.

However, another problem with any attempt to determine market value for patents is that there may be a discrepancy in value depending on the valuation context if, for instance, the patent is being considered for securitization or for a sale.\textsuperscript{43} This supports simply letting the market do the calculations. Then again, for market players to arrive at a truly fair valuation of an asset, the buyer and seller must be “acting . . . in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.”\textsuperscript{44}

The intellectual property market prevents fair market valuation on multiple

\begin{itemize}
\item \textsuperscript{40} See Mark A. Lemley \& Carl Shapiro, Probabilistic Patents, 19 J. ECON. PERSP. 75, 79–80 (2005) (“Only 1.5 percent of all patents are litigated, and only 0.1 percent are litigated to trial . . . . Of patents litigated to a final determination, . . . 46 percent are held invalid.”); Martin \& Watson, supra note 23, at 3 (stating that “over 95% of all patents are of no appreciable business value” (citing Mark A. Lemley, Rational Ignorance at the Patent Office, 95 NW. U. L. REV. 1495 (2001)) and that the “vast majority [of patents] provide little basis for use as financial instrument constituents”); Dennis Crouch, Patent Lotteries: A Question for the Crowd, PATENTLY-O, Sept. 11, 2006, http://www.patentlyo.com/patent/2006/09/patent_lotterie.html (stating that getting a patent is like buying a lottery ticket because so many of them are worthless).
\item \textsuperscript{41} See Stevens, supra note 2; see also John Letzing, Silicon Valley Woes Create Buyer’s Market for Ideas, MARKETWATCH, Apr. 9, 2009, http://www.marketwatch.com/story/silicon-valley-woes-create-buyers (describing how failed start-ups are flooding the market with patents).
\item \textsuperscript{42} See RIVETTE \& KLINE, supra note 15, at 67 (recommending an IP audit to discover whether patents are integral to products planned for current and future production or if those patents do not have room in the company plan and should be licensed or sold to reduce management costs).
\item \textsuperscript{43} See Martin \& Watson, supra note 23, at 4.
\item \textsuperscript{44} Id. at 5.
\end{itemize}
counts: a buyer may be compelled to purchase to protect against patent assertion, a seller in distress may be compelled to sell, and neither party may have sufficient information about the value of the patent as seen by other peers in the market. Even in the best case where a party does have good information, it cannot possibly predict the lottery outcome of each patent. 45

Aside from the largely unavoidable exception of the patent-as-lottery information gap, other gaps can be mitigated for the most part, provided that each party to a transaction conducts sufficient due diligence. 46 However, due to the circumstances under which most intellectual property transactions arise, compulsion and duress for purchase or sale will probably persist. Therefore, a truly fair market value may not be attainable, and a buyer and seller will need to rely on a broker’s experience to determine the most accurate value achievable under the circumstances. Thus, broker-assisted valuation appears to be a valuable service in enhancing the overall fluidity of the patent market, and the increased number of successful transactions in such a market serves as a powerful incentivizing force in line with the goals of the patent system.

In addition to offering valuation assistance, brokers also serve to bring other useful third party information to the negotiation table. Even though an inventor may know more about a patent’s worth than a potential buyer, a broker handling a higher volume of transactions than a typical industry participant would be even more familiar with the relevant patent market sector; such a broker could bring a wealth of relevant contextual knowledge to the bargaining table. Without the assistance of a broker, transacting parties would need to face the patent market’s notorious lack of transparency on their own. 47 In a situation like this, a large purchaser of patents (such as an offensive aggregator) could use its prior transactional experience to out-negotiate a smaller first-time seller (such as a startup in distress), who would have little information on which to base a decision. As with fair price determination, a broker performs an important service by mitigating this information imbalance. Again, enabling transactions in this manner appears to align with the goals of the patent system.

45. Id.; see sources cited supra note 40.
46. The patent-as-lottery information gap may only be avoidable in cases where the patent under consideration has already been proven valid in court or has a successful history of profitable licensing.
47. Ron Laurie, Foreword to Matthew Y. Ma, Fundamentals of Patenting and Licensing for Scientists and Engineers, at xvi (2009), available at http://www.worldscibooks.com/etextbook/6993/6993_foreword.pdf (“The current patent trading market is inefficient and immature, due to the lack of transparency and liquidity as compared with real estate or corporate securities.”).
The following are examples of brokers, based on representation in the media:

- **Inflexion Point Strategy**
  Inflexion Point helps its clients monetize their patent portfolios and buttress their defensive positions through patent acquisitions. Inflexion Point also advises on intellectual property-based mergers and acquisitions as well as other business transactions like corporate spin-offs.

- **iPotential**
  This company has three main services: strategic consulting for intellectual property portfolio management, a patent brokerage, and licensing. iPotential consults on how to use intellectual property assets offensively as well as how to respond to asserted patents, including acquiring patents through the brokerage service for defensive purposes.

- **Ocean Tomo**
  A self-titled “merchant bank” of intellectual capital, Ocean Tomo provides a wide range of services related to intellectual property investment and protection. The comparison is apt because merchant banks, historically, were entities that not only dealt in commodities but also advised clients on transactions. Similarly, Ocean Tomo engages in patent brokerage and valuation and provides other related services, including expert testimony for damages, patent valuation-based investment indexes, and intellectual property insurance. Ocean Tomo has also pioneered the patent auction model, although the economic downturn has dampened auction activity causing Ocean Tomo to recently sell its auction unit.

- **PatentFreedom**
  Focusing exclusively on information and advisory services, PatentFreedom provides information on non-practicing entities (NPEs) to

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improve transparency in the market and assist operating companies with business strategies to counter NPE assertions. Its subscriber services include access to a database of NPEs and their subsidiaries, information on their patent holdings and litigation histories, email alerts for proactive monitoring, and advice on best practices. The founder and chairman of PatentFreedom, Dan McCurdy, is also the founder and former CEO of Thinkfire and present CEO of Allied Security Trust.

- **Thinkfire**

  This broker provides a variety of services, including analysis of patent portfolios, due diligence for potential investors, patent licensing, and litigation management. In 2005, Thinkfire Executive Vice President Peter Spours indicated that because it had become too difficult for companies to rely on “internal patent generation,” patent acquisitions were necessary to maintain the flexibility of existing patent portfolios. As a result, Thinkfire officially created a brokerage division.

**B. DEFENSIVE PATENT AGGREGATORS**

Some of the larger companies that face patent assertions by offensive aggregators and especially NPEs banded together to invest in defensive patent aggregation groups, while others have signed on as members.
Whereas counter-suits or cross-licensing can ward off a standard operating company asserting a patent, these strategies are ineffective against NPEs because they have neither potentially infringing products nor any use for patent licenses. Defensive aggregation groups frustrate litigious NPEs by acquiring or licensing patent interests before the NPEs can. Alternatively, they may buy patents or licenses from NPEs and in turn sub-license them to their members for protection. Membership in a defensive aggregation group protects organizations against rent-seeking NPEs at a cost lower than litigation and settlement. The resources saved can be redirected to research and development, promoting innovation.

Member organizations also gain increased freedom to operate. In this age of patent thickets, an organization must tread carefully lest it infringe countless patents just by doing business, and an aggregate license to a large cluster of patents in the appropriate field of technology can provide peace of mind. Moreover, an aggregate license lowers the search costs for a member company planning to embark on a plan of research and development in a particular field. Defensive aggregation services strive for complete adoption by all players in the market and the resulting obsolescence of expenditures on patent searches and license negotiations. Though this scenario may never actually come to pass, companies are likely to have great interest in partnering with an entity able to bring them closer to this ideal.

Importantly, these defensive aggregators are profit-seeking businesses and are generally not motivated by altruism or some other sense of public duty. For instance, they can perform a “catch and release” by first licensing acquired patents to their members and then turning around and selling the patents to other entities that may wish to monetize them through litigation.

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61. This is an example of an intellectual property anticommons, as described by Heller and Eisenberg. See Michael A. Heller & Rebecca S. Eisenberg, Can Patents Deter Innovation? The Anticommons in Biomedical Research, 280 SCIENCE 698, 699 (1998) (highlighting the difference between the necessary societal cost of a patent monopoly and the “more complex obstacles that arise when a user needs access to multiple patented inputs to create a single useful product”).

62. Elinson, supra note 35; see Hansell, supra note 59.
Not only does this recoup some of the acquisition cost, it also rewards early membership because the release sales are encumbered with grant-back provisions protecting current members. At the same time, this may result in fueling offensive aggregators, which could be a net negative result.63

Despite the potential pitfalls, defensive patent aggregators may have the most beneficial effect on the market for intellectual property out of all the intermediary entities. The way they operate, by purchasing patent rights and licensing them to fee-paying members, provides a two-fold benefit. First, these aggregators serve as buyers of intellectual property assets, driving demand for and consequently raising the market values of assets. Second, they also reduce their members’ potential costs by precluding patent assertions against them. In the long term, if enough members buy in to the idea of defensive patent aggregation, they may form entities fulfilling a role similar to what the American Society of Composers, Authors, and Publishers (ASCAP) does in the copyright space.64

ASCAP is an association representing composers, authors, and publishers in order to protect their public performance rights by licensing and distributing royalties.65 Payment collections are categorized by licensee types, and then distributed to members in amounts proportional to the number of performances for each licensee type.66 This greatly reduces the number of transactions that would otherwise need to occur before parties could enter into a licensor-licensor relationship, making it more convenient for people to use copyrighted material and for copyright holders to receive payments for the use.

ASCAP claims that “the public interest demands that such an organization exist,” and it is “the only practical way to give effect to the right of public performance which the Copyright Law intends creators to have.”67

63. See infra Part III.C and note 112.

64. See Lohr, supra note 3 (indicating that a partner at a venture capital firm backing RPX has a long term vision of RPX becoming a “marketplace or clearinghouse, perhaps the way ASCAP is for copyrighted music, collecting fees and distributing payments to artists”).


66. For example, payments from restaurants would be distributed to artists holding rights for works that were performed at restaurants, to be determined by census or sample surveys. See ASCAP: About ASCAP: How You Get Paid at ASCAP, http://www.ascap.com/about/payment/paymentintro.html (last visited Dec. 23, 2009); ASCAP: About ASCAP: Keeping Track of Performances, http://www.ascap.com/about/payment/keepingtrack.html (last visited Dec. 23, 2009).

Defensive aggregators could be ASCAP analogues in the patent system, meeting public interest demands and balancing inventors’ incentives with the growth of public knowledge through accession. Of course, there are many major differences between the copyright and patent systems: the number of copyrighted works far exceeds the number of patents;\(^\text{68}\) the number of potential infringers of copyrighted works also far exceeds the number of potential infringers of patents;\(^\text{69}\) copyrights are far easier and less costly to acquire and maintain than patents;\(^\text{70}\) copyrights have a much longer duration than patents;\(^\text{71}\) and finally, copyrights cannot be infringed without copying, whereas patents can be infringed even by completely independent activity.\(^\text{72}\)

All these differences make it much more difficult for a defensive patent aggregator to acquire enough momentum to evolve into a service like ASCAP. In particular, while ASCAP can provide a solid guarantee that members will not run afoul of the law if they perform music produced by certain studios from which ASCAP has acquired licenses, a defensive

\(^{68}\) About half a million voluntary copyright registrations are filed with the Copyright Office each year, with probably many millions of new copyrighted works created each year that remain unregistered, and billions of existing copyrighted works. Edward Lee, *Warming up to User-Generated Content*, 2008 U. ILL. L. REV. 1459, 1478 (2008). Because patents must be filed with and issued by the USPTO to be valid legal instruments, and filings have not broken the half million per year mark as of 2008 after a decade of steady increases, there are clearly far fewer patents out there than copyrighted works, even before considering the fact that copyrighted works have far longer durations. See infra Figure 1.

\(^{69}\) To make a reproduction of a copyrighted work is very easy these days, especially with computers, but it generally takes some additional know-how and resources to infringe a patent.

\(^{70}\) Copyrights have only a minimal originality requirement, nothing like the novelty, non-obviousness, and disclosure requirements of patents. Compare 17 U.S.C. § 102 (2006) (describing copyright’s originality requirement) with 35 U.S.C. §§ 101–103 (2006) (describing patent law’s significantly more involved patentability requirements). As for cost, a copyright is free and obtained as soon as the work is “fixed in any tangible medium of expression,” though registration is required to file infringement suits and derive other benefits. See 17 U.S.C. §§ 102, 411–12 (2006). The registration fee is minimal, ranging from $35 for basic online registration to $220 for registration of a claim in a vessel hull. U.S. Copyright Office: Fees, http://www.copyright.gov/docs/fees.html (last visited Feb. 7, 2010). In contrast, an individual looking to get patent protection would need to pay much more than that for prosecution, application, and maintenance fees. See Greg Blonder, *Cutting Through the Patent Thicket*, BUSINESSWEEK, Dec. 20, 2005, available at http://www.businessweek.com/technology/content/dec2005/tc20051220_827695.htm (describing a “$50,000 to $100,000 lifetime cost of patent application, protection, and maintenance”).

\(^{71}\) Copyrights last for 70 more years after the author’s death, whereas a utility patent lasts merely 20 years from the filing date. Compare 17 U.S.C. § 302(a) with 35 U.S.C. § 154(a)(2).

\(^{72}\) Copyright infringement is any violation of an exclusive right granted to copyright holders, all of which require some form of copying. See 17 U.S.C. §§ 106, 501.
aggregator has no analogous patent “playlist” to grant its members a guarantee of sufficient freedom to operate.  

Defensive aggregators also share some traits with patent pools, which are agreements between patent owners to cross-license their patents or license to third parties. Unlike defensive aggregators, pools do not generally have a membership program to supply capital for acquiring and licensing patents and instead focus on earning royalties from the patents owned by pool participants. However, pooling has some benefits similar to those of defensive aggregation. Pools allow companies to obtain the basic licenses required to practice in a particular field and avoid the effects of blocking patents, while also reducing license transaction costs. At the same time, anticompetitive concerns about pools appear less applicable to defensive aggregators because defensive aggregators are less about sharing and extending their members’ exclusive rights than acquiring useful patent rights from other sources.

Along the same lines as ASCAP and patent pools, defensive aggregation seems to have largely beneficial effects on the patent marketplace that are consistent with the goals of the patent system, though this practice has probably gained traction mainly as a response to litigious NPEs. This is not to say that defensive aggregators could not have negative effects on the market. A successful defensive aggregator with a massive portfolio would possibly have only the conscience of its leadership to prevent it from becoming an aggressive and litigious licensor and NPE in its own right, though contractual safeguards would protect members from litigation.

73. Even if a company has rights to a given set of patents, its processes or products could infringe a patent not held or licensed by the defensive aggregator and of which the company (or aggregator) may be completely unaware. This can occur when a broad patent on a process or product covers a later-developed improvement. ROBERT P. MERGES, PETER S. MENELL & MARK A. LEMLEY, INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 126–27 (4th ed. 2007) (describing blocking patents, where “the holder of an improvement patent has the right to exclude everyone from her improvement — including the holder of the broad patent — while at the same time being barred from use of the improvement herself unless the holder of the broad patent authorizes such use”).


75. Id. at 8–9.

76. Some concerns are that patent pools allow cost inflation, price fixing, and shielding of invalid patents. For example, a company may wish to introduce a patent of questionable validity or value to a pool to earn royalties in the aggregate. Id. at 10. A defensive aggregator would not bother acquiring such a patent in the first place, so this problem does not apply in that context.

77. See infra Part V.B.
Following are some examples of defensive patent aggregators, based on representation in the media:

- **Allied Security Trust**
  Started by a consortium of eleven high technology companies, AST plans to combat the NPE problem by purchasing patents and granting licenses to its members before NPEs can get to them. AST claims that it is “not an investment vehicle” and will not assert any of these patents, litigate them, or seek to generate patent royalties. Instead, it is funded by members that want to develop a purely defensive portfolio. One interesting practice that AST engages in is using an independent legal entity to conduct transactions, preventing other parties from recognizing the large businesses behind AST’s name and adjusting prices accordingly.

- **Open Invention Network**
  The Open Invention Network is solely focused on one narrow area: the promotion and defense of Linux. CEO Jerry Rosenthal has stated that the goal of OIN is to promote “a positive, fertile ecosystem for the Linux operating system and to drive innovation and choice into the marketplace.” Instead of requiring a membership fee, the patents owned by OIN are available to any company royalty-free so long as the company agrees not to assert its patents against Linux. The patents may also be used for defensive cross-licensing.

- **RPX**
  Like AST, RPX seeks to reduce its members’ exposure to nuisance patent suits from NPEs by acquiring patents and patent rights and granting licenses to members. RPX also states that it is not a patent licensing pool and does

81. See Merritt, supra note 79.
86. One method that RPX uses to acquire patents is purchasing at auction. See Hansell, supra note 59.
not litigate the rights in its portfolio. RPX claims a dual advantage to its service: (1) it reduces the number of patents available for trolls to acquire; and (2) it reduces the cost of acquiring patents by spreading it across all members of its defensive patent aggregation service. One difference between RPX and AST is that RPX is venture funded rather than backed by a consortium of investor-members.

C. OFFENSIVE AGGREGATORS

Offensive aggregators acquire patents with the goal of licensing to or asserting against companies trying to bring actual products to market. These entities seemingly contribute nothing in terms of innovation while profiting at the expense of others (often, operating companies and innovators), and have therefore acquired a negative reputation in the press. In short, they seem to exemplify the classic case of wealth redistribution without any net gain in innovation for the public. A counter-argument is that such entities offer compensation for smaller inventors who may not otherwise “have the resources to assert a patent alone.” As willing buyers, offensive aggregators may provide a modicum of service to sellers finding their patents difficult to sell, though the fact that offensive aggregators

88. Id.
89. For example, NTP, Inc., an offensive aggregator with no manufacturing capabilities itself, sued the makers of Blackberry communications devices for infringing its patents. See NTP, Inc. v. Research In Motion, Ltd., 418 F.3d 1282 (Fed. Cir. 2005).
91. Intellectual Ventures is a notable exception. Though it does have its own R&D division and has focused on licensing and not litigation, it does own an enormous patent portfolio and could easily turn into the largest patent troll and offensive aggregator the world has ever seen if the management decides to turn to litigation. See Glyn Moody, Don’t Feed the Super-Troll, COMPUTERWORLDUK, June 30, 2009, http://www.computerworlduk.com/community/blogs/index.cfm?entryid=2317. Recently, Intellectual Ventures has edged closer to the line with what it terms a “customer-friendly” approach, assigning one of its patents to member company Verizon Communications to serve as “ammunition in a lawsuit.” Zusha Elinson, Verizon Patent Case Marks a First for Intellectual Ventures, RECORDER, Feb. 26, 2010, http://www.law.com/jsp/article.jsp?id=1202444656758.
93. Nathan Myhrvold, founder of Intellectual Ventures, states that Intellectual Ventures helps small-time inventors by providing them with an aggressive buyer to whom
generally exist to extract license fees by threat of litigation likely outweighs this limited benefit.  

Ultimately, the argument that offensive aggregators create a market for unwanted patents may be a smokescreen: these entities instead take advantage of imbalanced bargaining to create an industry populated with inefficient transactions.

Aside from the costs of litigation, industry participants also face the costs of preventative investment to defend against offensive aggregators. Companies are likely to find these precautionary measures inherently difficult to plan, because the lack of transparency in the patent market and the absence of public records for transactions make it impossible to predict when an offensive aggregator may acquire rights to patents that are relevant to the company’s business activities. Further exacerbating the situation is the lack of an efficient method for companies to identify which patents they may infringe in the first place.

Without offensive aggregators as buyers, the owners of supposedly unwanted patents might otherwise decide not to monitor and enforce their rights, effectively releasing them into the public domain, or even abandon them outright by failing to pay the maintenance fees. Offensive aggregators may artificially prolong the effective terms of these patents and simply seek rent for rights that should have already dissipated. This is against the patent system’s goal of public benefit, and seems to outweigh any incentive that the market-building function of offensive aggregators might provide to innovators.

One effect of offensive aggregators, especially the more litigious ones, is that companies have started to consider their patent portfolios with more care and devote more resources to defending their right to conduct business

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activities. In an effort to prevent offensive aggregators from continuing to assert patents against them, larger companies seek lower litigation costs so that they can consider fighting in court rather than settling primarily out of cost concerns. Increased efficiency of litigation matters could be beneficial to all members of the intellectual property market: there would be a decrease in the number of frivolous patent infringement lawsuits, an increase in the feasibility of monetization through enforcement, and a corresponding rise in the value of patent portfolios as their expected returns increase.

While law firms work on reasonable methods of making their clients’ litigation more efficient, some companies seek to address the matter themselves by trying to limit their damages liability in the event they lose a lawsuit. Others try to weaken the exclusive rights of patents in an effort to render the offensive aggregators toothless, though the Supreme Court has largely addressed this concern with its ruling in *eBay, Inc. v. MercExchange, L.L.C.*, which eliminated categorical grants of injunctions where a court finds infringement of a valid patent.

Upon further inspection, offensive aggregators appear to play a more complicated role than previously thought. Increasing litigation efficiency seems to be consistent with the goals of the patent system. However, this result seems too far removed to give them credit as a beneficial force. In response to offensive aggregators, operating companies are likely to incur

96. See David Bohrer, *Trolling for Efficiency*, DAILY JOURNAL, June 24, 2009, available at http://www.confluencelaw.com/pdf/DailyJournal_Trolls.pdf (indicating that most companies, under threat from trolls, find that the best defense is to fight back by “becoming the rabid dog that is too expensive and dangerous for the trolls to get near”).

97. See id.


100. See *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 394 (2006) (stating that “the Court of Appeals erred in its categorical grant of [injunctive] relief”). Prior to the eBay ruling, courts rarely denied permanent injunctions after finding infringement. MERGES, MENELL & LEMLEY supra note 73, at 355; see also Steve Seidenberg, *Troll Control*, ABA JOURNAL, Sept. 24, 2006, at 50–55, available at http://www.abajournal.com/magazine/article/troll_control/ (describing how the eBay decision makes it much harder for patent trolls to get injunctions but also providing the opposite viewpoint that this harms innovation by taking injunctions out of the small inventor’s toolbox).
expenditures on legal defense costs or defensive aggregation memberships, countering any positive effect.

Following are some examples of offensive patent aggregators, based on representation in the media:

- **Acacia Technologies**
  
  Acacia generates revenue by acquiring patents or exclusive licenses and then aggressively licensing to or asserting against alleged infringers. Its mission statement focuses on the benefits it can provide to patent holders, especially individual inventors or small patent holders with limited resources to bring infringement suits themselves, offering cash up front in addition to revenue shares. Acacia actually has numerous subsidiaries, all with different names. This allows Acacia to obfuscate and gain the upper hand in its transactions and lawsuits by perpetuating the information imbalance.

- **Constellation Group**
  
  A classic example of an NPE, this group of shell companies run by Erich Spangenberg acquires patents and targets major companies with lawsuits alleging infringement. Unlike Acacia's statement about benefitting the individual inventor, the Constellation Group's motivation is simply that its actions are "economically right;" its primary method of operation is settling infringement disputes with multi-billion dollar companies. In some cases, the group's actions have gone too far, but it is still rare for Constellation to bear the cost of settlement.

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103. The number of subsidiaries was at least fifty according to Acacia's 10-Q report in August 2007, after which Acacia stopped listing subsidiaries in its filings. See Acacia Research Corporation, Quarterly Report (10-Q) (Aug. 6, 2007), available at http://www.hoovers.com/freeuk/co/secdoc.xhtml?ID=&ipage=5345342&doc=1.
• Intellectual Ventures

Former Microsoft CTO Nathan Myhrvold founded Intellectual Ventures in 2000 as a new type of organization that would focus on building value by accumulating intellectual property, whether developed internally or acquired from outside sources. As of June 2009, Intellectual Ventures possessed about 27,000 patents and has started targeting technology companies for massively profitable licensing agreements. Some of the larger technology companies (including big names like Microsoft, Apple, and Google) have secured safe passage by investing in Intellectual Ventures; in this way, Intellectual Ventures operates like a defensive patent aggregator. However, some fear that the company is none other than a “super troll” that is starting to wake up and may soon start asserting its patents offensively through litigation. Intellectual Ventures has also started implementing the catch and release method of licensing, offering licenses on patents for a limited time and then selling the patents to a buyer with a more offensive monetization strategy.

107. Id.
110. See Moody, supra note 91; Sharma & Clark, supra note 93 (“There is an ‘implicit threat’ that if companies don’t agree to a licensing deal with Intellectual Ventures, they could face costly patent-infringement lawsuits . . . .”).
strategy.\textsuperscript{111} This could make Intellectual Ventures a “super troll” that feeds other trolls.\textsuperscript{112}

D. **Roles Played by Patent Intermediaries in General**

Based on this brief overview, it appears that the majority of these new market entities share the objective of rewarding inventors, large and small, which satisfies at least one goal of the patent system.\textsuperscript{113} There is little evidence, however, that their activities fulfill the other goal of the system by encouraging members of the public to innovate outside of exclusive rights. In fact, offensive aggregators instead may prompt innovators to leave a needlessly wide berth around marginally relevant patents for fear of falling into costly lawsuits.

IV. **WHY HAVE INTERMEDIARIES FORMED NOW?**

In contrast with the advent of the Internet filtering out certain functions of intermediaries in other markets such as real estate or travel,\textsuperscript{114} the patent

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\textsuperscript{111} See Elinson, supra note 35 (describing a company using catch and release as delivering this threat: “Take a license because we’re going to sell the patent on the open market – and you never know what unscrupulous and lawsuit-prone troll is going to buy it.”).

\textsuperscript{112} See Posting of Peter Zura to 271 Patent Blog, Now It Begins? Litigation Rumors Surface over Intellectual Property, http://271patent.blogspot.com/2009/09/now-it-begins-litigation-rumors-surface.html (Sept. 1, 2009 20:36 CST); see also Elinson, supra note 91 (describing Intellectual Ventures’ assignment of a patent to a member, though an operating company and not an NPE, that intends to use the patent offensively in a patent fight).

\textsuperscript{113} This does not indicate that rewarding inventors is a main goal for any of these entities.

\textsuperscript{114} Real estate agents have not been completely replaced by technology, but the multitude of websites that provide real estate information are allowing consumers to inform themselves, “doing what Realtors used to do” and apply pricing pressure to agent fees. Elizabeth Rhodes, Web Reveals Once-Secret World of Real-Estate Data, SEATTLE TIMES, Aug. 12, 2006, available at http://seattletimes.nwsource.com/html/realestate/2003192472_in man13.html. Travel websites have been around long enough that even the transactional travel websites are themselves being pushed out by non-transactional travel websites, at least for consumers’ initial travel research. PhoCusWright FYI: No Reservations: The Rise of The Nontransactional Travel Web Site, http://www.phocuswright.com/library/fyi/835?utm_campaign=No Reservations%3A The Rise of The Nontransactional Travel Web Site (last visited Oct. 28, 2009). Of course, real estate and travel websites are just another type of intermediary, and there are web-based patent intermediaries as well. See Milien & Laurie, supra note 3, at 1038 (listing several examples of web-based patent intermediaries like The Dean’s List, Tyhmax, and Yet2.com). However, the market has not matured to the point where these web-based patent intermediaries can simply stand in to take the reins for one step of a standardized transactional process in the way that intermediaries in real estate and travel can.
market has seen an influx of intermediaries.\textsuperscript{115} Middlemen are now entering the picture despite improved availability of information via the Internet and other technological innovations because they provide valuable functions that other market players are willing to pay for. This current demand for intermediaries has at least three sources: (1) functional requirements of the patent market; (2) need for assistance with valuation; and (3) general industry trends.

A. FUNCTIONAL REQUIREMENTS OF THE PATENT MARKET

The nature of the patent market creates several hurdles for a company engaging in a transaction. The difficulty for sellers to find willing buyers is one obstacle. After finding a buyer, the lack of transparent historical transaction data removes the opportunity for parties to negotiate pricing based on known quantities. These two issues also compound the inherently weak bargaining platform of companies new to a field; such companies may find it difficult to locate appropriate licensors or sellers and may have trouble obtaining fair prices even if they can.

As in other markets, players in the patent market may cluster into disjointed groups that only cluster-spanning entities seeking to bridge the gaps can connect; this represents the existence of “structural holes,” to use network theory terminology.\textsuperscript{116} Like Hollywood talent agents or professional sports agents, intermediaries in the patent market have an unparalleled view of the players in the marketplace and the experience to connect buyers with sellers and close transactions.\textsuperscript{117} In addition to the inherent complexity of

\textsuperscript{115} See Eric Young, Patent Marketeers, SAN FRANCISCO BUSINESS TIMES, Mar. 21, 2008 (describing the recent expansion of patent brokers on the market for intellectual property), available at http://sanfrancisco.bizjournals.com/sanfrancisco/stories/2008/03/24/focus1.html; Ron Laurie, Strategic Patent Acquisition (Jan. 22, 2007) (unpublished presentation, presented at the Best Practices for Buying, Selling, and Licensing Patents Seminar), at 5, available at http://ip-strategy.com/downloads/LSL_Strategic_Patent_Acquisition.pdf (stating that there were about five active brokers in 2000, and around thirty by 2006); Millien & Laurie, supra note 3 (stating that the new era of the evolving IP marketplace is “characterized by the rise of ‘market-maker’ intermediaries who seek to make IP a liquid asset class and, of course, profit from it”).

\textsuperscript{116} See Benassi & Di Minin, supra note 26, at 73 (discussing a possible second theory to explain the existence of brokers based on the concept of structural holes).

\textsuperscript{117} See, e.g., Rosita Wolfe, Tony Meenaghan & Paul O’Sullivan, The Sports Network: Insights into the Shifting Balance of Power, 55 J. BUS. RESEARCH 611, 620–21 (2002) (stating that the position of sports agents “in the network is secured through the power, based on expertise, that they hold” which is “being called on increasingly to create and maintain an appropriate and workable balance in the relationships between major actors”); Claire Hoffman, Talent Agents Get into Film Fundraising, Los Angeles Times, Nov. 3, 2006, available at http://articles.latimes.com/2006/nov/03/business/fi-agents30 (describing how talent
structuring an intellectual property transaction, including the transfer of patent rights, the limited pool of potential buyers whose needs match a seller’s specific offering makes it very difficult for a lone seller to act without a broker’s assistance.

Even if companies can find transaction partners, their lack of access to transactional information for patents creates information gaps that entities may position themselves to exploit. These asymmetries and the corresponding transaction risks create a demand for transactional guidance. In markets like real estate sales are a matter of public record, and the travel market sees package deals widely advertised in all forms of media; this kind of transparency and access to information reduces the consumer need for brokerage services. On the other hand, many patent transactions are conducted in private and not recorded in a manner that would allow agencies have made the necessary connections to work around decreased financing from movie studios and acquire private equity investment in their clients’ movies).

118. A patent right carries unique risks including the chance of patent invalidity, the chance that a court will construe claims in a manner that renders an infringement claim invalid, and the chance that a competitor may be able to design around the claims; these risks are not ones that can be quantified using reliable methods. Laurie, supra note 47, at xvii.

119. Even in an auction setting, where buyers and sellers gather for the purpose of transacting, it can be difficult for them to connect. See Michael Kanellos, Few Buyers at Patent Auction, CNET NEWS, Apr. 6, 2006, available at http://news.cnet.com/Few-buyers-at-patent-auction/2100-1014_3-6058737.html (describing a 2006 Ocean Tomo patent auction with only around twenty-five lots sold out of seventy-four offered). Given that patents generally focus on narrow subject areas, they fail to have general appeal among buyers, who are unlikely to purchase without achieving a delicate intersection between knowledge of the field and a specific need that can be addressed by a particular patent. See Andrew Payne, Ocean Tomo Patent Auction, WIKI.PAYNE.ORG, Apr. 6, 2006, http://www.payne.org/index.php/Ocean_Tomo_Patent_Auction.

120. Michael Pierantozzi, COO of Gathering 2.0, a San Francisco Bay Area intellectual property group, states that “[i]t’s very difficult for buyers and sellers to get comparative data to make good decisions on whether they are paying the right amount for what they are buying” and that businesses want to “improve transparency and efficiency in the process.” Young, supra note 115.

121. High search costs, bargaining asymmetries, and difficulty in valuation are some of the market imperfections that make market players look to brokers for assistance. See Benassi & Di Minin, supra note 26, at 72–73 (raising a possible theory for the existence of patent brokers using transaction cost economics).

interested parties to search for relevant information. In a market that suffers from a lack of information, intermediaries that possess the knowledge and experience from conducting their own patent transactions stand to benefit the most.

This knowledge and experience may also assist companies manufacturing complex devices that potentially infringe numerous product and process patents. Although a company may own or license some of the relevant patents, it may still lack rights to others, especially where the area of technology is crowded with patents. Dense groups of intellectual property rights are difficult to navigate without the help of a knowledgeable party, and the increasing difficulty of ascertaining the boundaries of modern patents further complicates the task. Especially in recent years, the intricate subject matter of high technology may have led to a substantial increase in the ambiguity of patent claims. Furthermore, the sustained growth in numbers

123. See Mark Lemley, Remarks at the Federal Trade Commission Hearing on The Evolving IP Marketplace 147–48 (Apr. 17, 2009) (transcript available at http://www.ftc.gov/bc/workshops/ipmarketplace/apr17/transcript.pdf) (“Nobody knows the price at which patents are sold or licensed or the terms under which those prices or licenses take place.”); Suzanne Harrison, Comps Data for Patent Transactions (Feb. 6, 2009) (unpublished presentation, presented at the Berkeley Center for Law & Technology: Theory and Practice of Patent Valuation), at 2, available at http://www.law.berkeley.edu/institutes/bclt/patent-valuation/presentations/harrison.pdf (stating that the “patent transaction market is not transparent” and there is not even a “way to verify annual transaction volume”); Laurie, supra note 47, at xvi–xvii (stating that there is a lack of publicly available data regarding sales of comparable patents). Some possible exceptions to the lack of transparency are open auction data and companies that may choose to include some patent acquisition or divestment related data in their SEC filings. Interestingly, the transparent open auctions could really be paving the way for private deals post-auction. See Joe Mullin, The Buzz Begins at Ocean Tomo Patent Auction; Will Deals Follow?, THE PRIOR ART, Mar. 27, 2009, available at http://thepriorart.typepad.com/the_prior_art/2009/03/ocean-tomo-auction-march-27.html. The rare litigation proceeding about license deals may occasionally expose bits and pieces of valuation-related information, but this would only give insight into the narrowest slivers of the market. See Lucent Techs., Inc. v. Gateway, Inc., 580 F.3d 1301, 1328–32 (Fed. Cir. 2009) (describing expert testimony about cross-license agreements between Microsoft, Apple, Hewlett-Packard, and other companies).

124. See Ian D. McClure, The Significance of Intellectual Property Auctions Today, IP PROSPECTIVE, Sept. 25, 2009, available at http://www.ipprospective.com/burgeoning-business/the-significance-of-intellectual-property-auctions-today/ (suggesting that intellectual property auctions like those held by Ocean Tomo have “opened eyes to other market players that there is opportunity in this marketplace to lend transparency to potential buyers and sellers”).

125. See supra note 60 (describing patent thickets).


127. See id. at 56 (stating that “in an earlier time, when technology was simpler, . . . the ambiguity of patent claims was not so great” but that “there are reasons to think that this
of patent applications and grants over the last two decades can only have exacerbated the situation.  

Based on the high density of patent rights, it is unsurprising that many large companies operating in the same technological space use each other’s patented technology.  

In some situations, companies may be able to identify and license the patents most valuable to them. However, because many more patents would otherwise remain undiscovered until the unwelcome notice of alleged infringement, companies also enter into portfolio cross-licensing deals for specific fields of use. Such a deal gives established members of a technological clique increased freedom to operate without incurring the high search costs of individual patent identification. This is not the case for new entrants to the field, who are unable to transact on even grounds and are likely to find it far more difficult to penetrate the thicket without financially overextending themselves through costly licensing and search-related expenditures. However, without such expenditures they risk even more expensive litigation.  

These functional issues have varying effects on the different types of intermediaries. Brokers are likely to be the main beneficiaries of the ambiguity has been increasing substantially in recent years”). Note that this ambiguity (and indeed, the thicket phenomenon) is largely centered on the high technology industry and not on the biotechnology industry. See Debbie Strickland, Patent Reform Battle Pits Biotech against High-Tech, GENETIC ENGINEERING & BIOTECHNOLOGY NEWS, Mar. 6, 2009, http://www.genengnews.com/news/BNitem_print.aspx?name=50688785. High technology companies generally use a large number of components in a single product, each of which may be covered by a patent, but biotechnology companies typically develop drugs that have one active ingredient, which may only be covered by one composition patent and one method-of-use patent. Id.  

128. See id. at 68–69 (describing how clearance costs are worsened by a large number of property rights held by different owners, and how patent applications have more than tripled from 1980 to 2004); infra Figure 1.  

129. For example, participants in the hard disk drive industry cross-licensed each other’s entire patent portfolios in order to avoid the cost of suing one another for patent infringement. See Graham & Sichelman, supra note 5, at 1066 (citing cross-licensing deals involving Samsung, Hitachi, Seagate, and Western Digital, among others).  

130. See, e.g., Andrés Guadamuz González, The Software Patent Debate, 1 J. INTELL. PROP. L. & PRACTICE 196, 204 (2006) (stating that “patent thickets . . . encourage inefficiency through the creation of complex cross-licensing relations between companies, and they may even stop newcomers entering the market if they fail to penetrate the thicket”). One example of an entrant facing difficulties “penetrating the thicket” is a story from 1993 involving a young Microsoft. See Graham & Sichelman, supra note 5, at 1076–77. Their portfolio at the time consisted of only 24 patents, which placed them at a heavy competitive disadvantage against IBM, which had over 1000 patents; they ended up having to pay licensing fees of $20–30 million. See id. Beyond the plight of entrants, even established players risk displacement from a favorable cross-licensing position if they fail to maintain sufficient numbers of patents to keep pace with other players. See id. at 1066.
increased demand for network connections and transparency. Most individual companies should be willing to pay for the expertise and superior connections of a broker in a particular field, given that the broker has probably handled a greater volume of transactions than the company has. Brokers may also assist in navigating patent thickets by advising on potential licensing targets, though defensive aggregators provide the most direct service of this nature by supplementing their members’ existing cross-licensing practices. As for defensive and offensive aggregators, each can use its wealth of experience to obtain lower purchase prices in the absence of full transparency. Offensive aggregators can further exploit the nature of thickets to find potential licensees.

For these reasons, the patent market’s functional imperfections appear to directly catalyze the formation of intermediaries. The current rise in brokers and defensive aggregators could be an entrepreneurial response to the increased number of companies willing to pay for services to address the serious structural barriers to fair pricing and general market fluidity. In addition, both defensive and offensive aggregators may find that the exploitative opportunities in the patent market make their purchasing strategies advantageous.

B. CONCERNS RELATED TO VALUATION

Two types of demand for intermediaries arise from the difficulty in estimating the value of patents, which are more likely to be valueless than not.131 First, companies need patent valuation guidance to ensure that their estimates are reasonable and that their offer prices are justified. Second, companies may desire larger patent portfolios to increase their overall portfolio value and their chances of owning a valuable patent.

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131. Wagner & Parchomovsky, supra note 22 (“The vast majority of U.S. patents pass their lives in complete idleness, gathering dust rather than revenues.”).
Narrow subject matter, difficulty of enforcement, or a low chance of surviving a validity challenge leaves most patents with little value. Despite the steady increase in the volume of patent applications over the last decade, shown in Figure 1, businesses still face substantial uncertainty about the quality of patents for potential acquisition. In other words, there is an enormous volume of patents out there that may not be worth very much. Because expected values for these patents are low, potential buyers might not be able to determine which target patents or portfolios are truly worth acquiring without outside assistance.

One mitigating strategy is to build a larger patent portfolio, which dilutes the risk of any individual patent being low-value, improves freedom of operation, and also provides a defensive boost against litigation in a mutually-

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133. See Lemley & Shapiro, supra note 40, at 81.

134. See id. at 83 (“Uncertainty . . . is endemic in [the] patent system.”); Benassi & Di Minin, supra note 26, at 70 (arguing that the rush to increase patent quantity resulted in a “significant amount of overlapping patents of questionable quality” and that most companies across industries are obtaining patents of “little or no commercial relevance” (citing Bronwyn H. Hall, et. al., Market Value and Patent Citations: A First Look 101–28 (NBER Working Papers, no. 7741, 2000))).
assured-destruction sense by covering a wider range of technologies. Accumulating a mass of patents for each particular area of technology in a patent portfolio also has the advantage of redundancy, minimizing the risk of harm to the overall portfolio even if some of its patents are found invalid in patent office or court proceedings. To achieve these benefits, businesses may grow their patent portfolios by filing for patents on self-made innovations or by acquiring the patents of others. Larger businesses operate at a scale of acquisition far exceeding that of smaller firms, though smaller firms are more critical about the quality of patents that they do acquire. Larger firms have therefore increased the volume of patent acquisitions, and smaller firms demand advisory services to maximize return on investment.

Patent valuation concerns present an opportunity for brokers with deep knowledge in a field to assist with value assessments. The increased volume of acquisitions triggered by larger firms means more business opportunities for brokers; small firms seek expert advice from knowledgeable brokers to guide their acquisition strategy to establish market positions, protect business activities, and bolster their licensing negotiations. Defensive aggregators sell to a captive audience: large firms are looking for convenience and small firms are looking for value, both of which defensive aggregation services can provide. As with functional issues inherent in the patent market, both defensive and offensive aggregators may also be able to exploit patent valuation difficulties to reduce purchase costs.

As described, the difficulty of patent valuation and the importance of developing patent portfolios create a ripe market for middlemen. Companies are driving the demand for valuation assistance and strategic acquisition guidance. This increased demand continues to cultivate the growth of

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135. See Graham & Sichelman, supra note 5, at 1065 (describing defensive purposes for patent acquisition, including the stockpiling of patents as a shield that permits accused infringers to file counterclaims against a plaintiff accusing them of infringing patents in a game of “mutually assured destruction”). Along with benefits to freedom of operation and defensive strength, larger patent portfolios grant other scale-related benefits like improved bargaining positions, greater chances of success in cases that are litigated, influence in the patent system, and attractiveness to investors. See Wagner & Parchomovsky, supra note 22, at 33–37. The diversity of a larger portfolio also strengthens a company’s ability to deal with uncertainty. See id. at 37–39.

136. See Lemley & Shapiro, supra note 40, at 81 (explaining how patent owners may hedge against the risk of invalid patents by filing numerous patents on related technologies).

137. See Wagner & Parchomovsky, supra note 22, at 53–55 & n.184 (explaining that, when compared to smaller firms, larger firms “get less innovative bang for their patenting buck” because their focus is more on increasing portfolio size rather than seeking specific patent protection).
brokerage services and defensive aggregators, while the uncertainty of patent valuation rewards informed patent purchasers.

C. INDUSTRY TRENDS

Trends in the patent market and intellectual property-intensive industries may also spur the creation of patent intermediaries. The growing belief that intellectual property assets hold significant untapped value, the increasing demand for intermediary services, and the example of one extraordinarily successful intermediary have all served to inspire entrepreneurs to launch their own services.

The increased perception of value in intellectual property is symbiotic with the rise of new businesses working with the market for intellectual property. Without the increased perception of value, no one would have been enticed to create new entities that make it easier to derive value from intellectual property; at the same time, without the existence of these entities to help drive the increased interest and lower transaction costs, the change in perceived value of intellectual property would not have manifested as readily. Secondary relationships also exist between intermediaries. For example, some brokers and defensive aggregators have formed to combat offensive aggregators.

These feedback loops have increased the number of companies willing to invest in maintaining, acquiring, and licensing patents. Historically, entrepreneurs have always sought to take advantage of the latest demand trends. Intellectual property’s meteoric rise to importance in the business world and the accompanying massive profit potential have proven tempting enough for people to make career changes. Professionals in the intellectual property field have left law firms or businesses to start numerous patent

138. Though lower than they might otherwise be without the existence of brokerage services, transaction costs are still high, because the market value of patents is so difficult to ascertain. See Martin, supra note 39. This foreshadows an increase in the number of entities that will aim to collect and provide better information in order to establish market values for patents.

139. PatentFreedom and RPX specifically mention NPE activity as a reason to use their services. See supra note 52; supra note 85.

140. See Benassi & Di Minin, supra note 26, at 75 (explaining the rise of patent brokers in the Silicon Valley by the “high concentration of unexploited IP up for grabs among the ruins of many failed startups”); Mark Frankel, When the Tulip Bubble Burst: Tulipomania – The Story of the World’s Most Coveted Flower, BUSINESSWEEK, Apr. 24, 2000, available at http://www.businessweek.com/2000/00_17/b3678084.htm (relating 17th century Holland’s tulip bulb craze to the growing technology bubble at the time).
intermediaries and capture the market from a new angle.\footnote{For example, Ron Laurie left Skadden Arps’ Palo Alto office to co-found Inflexion Point Strategy, a brokerage and advisory service. Inflexion Point Strategy: Leadership Team, \url{http://www.ip-strategy.com/Leadership.html} (last visited Oct. 28, 2009). Ron Epstein, former general counsel at Brocade Communications Systems and former Director of Licensing at Intel Corporation, founded IPotential, a consulting, brokerage, and licensing service. IPotential: Company Overview: Management Team, \url{http://www.ipotential.com/overview/index.htm#team} (last visited Oct. 28, 2009).} With their insider knowledge and industry experience, they are able to perceive and exploit gaps in the patent market. However, as with any other asset bubble, many of the new companies out there might be considered speculators engaging in “irrational exuberance.”\footnote{Alan Greenspan, Chairman, Fed. Reserve Bd., Address at the American Enterprise Institute (Dec. 5, 1996) (transcript available at \url{http://www.federalreserve.gov/boardDocs/speeches/1996/19961205.htm}) (proposing the possibility that “irrational exuberance has unduly escalated asset values” in the stock market); see Richard J. Lutton, Jr., Remarks at the Federal Trade Commission Hearing on The Evolving IP Marketplace 91 (May 4, 2009) (transcript available at \url{http://www.ftc.gov/bc/workshops/ipmarketplace/may4/090504transcript.pdf} (“A new culture of patent abuse has . . . fueled a bubble of investment that’s far removed from the common sense underpinnings of the patent system.”); Brian Kahin, \emph{The Patent Bubble . . . Still Growing}, HUFFINGTON POST, Sept. 26, 2008, \url{http://www.huffingtonpost.com/brian-kahin/the-patent-bubble-still-g_b_129232.html} (describing the possibility that we are in the midst of a patent bubble, using Intellectual Ventures and its practice of “[a]rbitrage in exotic assets” as a barometer).}

It is not clear how many will remain standing after the dust settles.

The well-publicized success of Intellectual Ventures may also have drawn new participants to the field.\footnote{Among others, BusinessWeek’s cover article surely drew attention to the financial success of Myhrvold’s company. \textit{See}, e.g., Michael Orey, \textit{Inside Nathan Myhrvold’s Mysterious New Idea Machine}, \textsc{BusinessWeek}, July 3, 2006, at 54–60, available at \url{http://www.businessweek.com/magazine/content/06_27/b3991401.htm} (describing the “cash-rich firm” and its avant-garde business model).} Though Intellectual Ventures bills itself as an invention company with its own laboratory and science consultants working on “invention sessions” attended and transcribed by patent lawyers, leading to hundreds of patent applications a year, this is not its only mode of portfolio growth.\footnote{\textit{See} Malcolm Gladwell, \textit{In the Air: Who Says Big Ideas Are Rare?}, NEW YORKER, May 12, 2008, at 50–60, available at \url{http://www.newyorker.com/reporting/2008/05/12/080512fa_fact_gladwell?currentPage=all} (describing Intellectual Ventures’ prolific invention process resulting in five hundred patent applications a year); Stone, supra note 109 (describing the original purpose of Intellectual Ventures to think “wilder, crazier thoughts than anyone else,” but also mentioning how “the company is out buying existing patents in droves”).} More relevant to the intermediary market, Intellectual Ventures has also been a voracious purchaser of patents,\footnote{\textit{See} Stone, supra note 109 (stating that Intellectual Ventures had purchased about 1,000 patents by 2004). To get an idea of the high rate at which Intellectual Ventures has}
portfolio with seed money from investor companies like Microsoft, Intel, Sony, Nokia, Apple, Google, and eBay. Its volume of patent purchases in the last several years has been so high that as a result brokers may have enjoyed a swell of work. Furthermore, as other players in the market see Intellectual Ventures use its momentum to negotiate profitable licensing deals, they are likely to seek comparable returns using a similar offensive portfolio building strategy.

Standout examples like Intellectual Ventures illustrate the returns that can result from capitalizing on industry trends towards a new appreciation and higher valuation of intellectual property assets. These trends have laid the groundwork for and have fostered the development of a new market, with more companies looking for assistance on making intelligent choices about intellectual property acquisitions and divestitures. The new intermediary entities are reacting to this new demand for intermediary services and the new perception of value for this asset class.

V. LEGISLATION, REGULATION, AND PRIVATE ORDERING

The various business models of the intermediaries have similarly various effects on the market that converge to or diverge from the goals of the patent system. Though they all address the same set of market demands, each type of intermediary has a distinctive catalog of services. One question to consider: as these services mature and evolve, is there a need for legal regulation to ensure that they do not exceed the purposes and boundaries of the patent system? Additionally, is legislation the only way to ensure that these intermediaries will not abuse the patent system for their own gain, or is private ordering sufficient to correct aberrant behavior? Companies are dedicating more attention to patent-related matters and investing more capital in patent applications and acquisitions. With so much investment in

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146. See Sharma & Clark, supra note 93 (reporting on Verizon and Cisco paying in the range of $200 million to $400 million for license fees and equity stake in Intellectual Ventures).

147. Ron Laurie, managing director of Inflexion Point Strategy, says of Intellectual Ventures “If they went away, that would not be a good thing.” Id. This raises the possibility that other players in the patent market may be relying on Intellectual Ventures to succeed in an effort to validate their business models.

148. See Wagner & Parchomovsky, supra note 22, at 76 (stating that “engaging in the patent system is viewed as a worthwhile endeavor by most firms” and “firms are increasingly participants in the patent system”).
the patent system, any policy changes will significantly affect how people run their businesses.149

That said, ignore for a moment the possibility that patent intermediaries are merely an ephemeral side effect of the patent market’s growing pains, and assume that they are here to stay. Legislation or agency regulation could be beneficial to encourage the intermediary behavior that furthers the goals of the patent system and to keep counter-productive activity in check. Along these lines, the following specific proposals include the establishment of a central database of transaction information or the legislative governance of intermediaries. The non-invasive status quo of private ordering appears more moderate, but agency regulation may expedite the maturation of the patent market.

A. CENTRAL DATABASE

Recording transaction information in a central database could benefit the public by increasing the level of transparency in the patent market.150 Whether established through legislation or a private entity, the service’s success would depend primarily on widespread adoption, though a free-to-use publicly mandated recording system would provide far more benefit than a private pay-to-use model.151 Such a system might track patent filings, litigation, licensing agreement, active participants in the field, and most importantly, transaction prices. Legislative action is ideal for building such a complex system, because the high coordination cost and vast number of players make it unlikely that the private sector could develop a standardized centralized repository without legislative assistance.

149. Id. (stating that “policy changes to the patent system are likely to have substantial impact” on firms).
A publicly accessible database for patent transaction information would affect each intermediary class in different ways. To begin with, brokers might focus more on providing strategic advice than patent sleuthing, because the improved access to information would let their clients do more background searching and context building for a given transaction.

Brokers contribute overhead to the cost of a transaction, but as long as transacting parties welcome their services, brokers do promote liquidity and value in the patent market. Rational parties looking to transact in patents will use the services of brokers as long as the additional value they provide is greater than the cost of entry. Two main concerns would decrease the likelihood that an entity will enlist a broker on its transaction: (1) brokers could selectively disclose or use information for their own gain; and (2) inefficiencies in each broker’s data storage and retrieval system could add to the overhead cost.

Legislation to make patent transactions a matter of public record would address both of these concerns by removing the temptation to hoard information and streamlining brokerage activities. A centralized system would allow transacting parties to achieve information parity, or at least establish a relatively accurate historical context for the transaction. This would be a major improvement over the current situation, where parties have great difficulty locating good information because the majority of patent transactions are private.\(^{152}\) The collection and publication of transactional information would also represent a migration to a collaborative method of operation, a change that would no doubt find much support among many of the players in the technology market.\(^{153}\)

Nonetheless, a database would not necessarily remove the need for brokers in the patent market; parties might still seek bridging and advisory services to help make sense of all the data. Furthermore, brokers would benefit from a unification of their patchwork recording systems into a single repository that would have far fewer gaps than any one private database. This would lower their own search expenditures, so they could present more attractively priced deals to clients.

\(^{152}\) See supra note 123 (discussing private patent transactions).

\(^{153}\) The Silicon Valley represents a major concentration of technology firms and patent intermediaries alike. Professor Saxenian argues that the cooperative nature and free-flowing information of the early 1970s formed a strong “technological community” which built a foundation for the commercial success that the region has experienced. See AnnaLee Saxenian, Regional Advantage: Culture and Competition in Silicon Valley and Route 128 30–34 (1994). The patent market could see a huge increase in liquidity by creating a similar sort of collaborative information network.
As for defensive patent aggregators, a centralized database would enable them to ensure that they are acquiring rights at fair prices. Because an entity considering the services of a defensive aggregator would be concerned primarily with how well costs are managed, anything that lowers the cost of patent acquisitions or searches would benefit defensive aggregators by attracting more clients. A central repository of patent transactions would assist defensive aggregators directly by allowing them to conduct efficient searches on licensing and acquisition activity, and indirectly by improving their access to transactional information as they look for additional patents to purchase or license, perhaps with the help of brokers. At the same time, they might find it more difficult to avoid paying premiums for truly top-shelf patents once sellers can educate themselves more readily, though they would also be able to acquire lesser-valued patents at lower prices or avoid them altogether.

Like brokers, defensive aggregators add an overhead fee to transactions. However, distributing these fees across the participants in an aggregation group minimizes the per-transaction overhead cost. Due to the non-rivalrous nature of intellectual property, the object of the transaction does not lose effectiveness on distribution, making the overhead cost more palatable. Also, because some degree of executive control is necessary for any group to make decisions about licenses and acquisitions, the overhead fee is a cost that members would have needed to contribute even if they were to form their own defensive aggregation groups without seeking out a third party.

Offensive aggregators do not add fees in the same sense as defensive aggregators and brokers; they are pure purchasers. Like any other seller, a party planning to sell patents to an offensive aggregator has the primary goal of obtaining at least a fair value in return. A centralized repository would enhance the likelihood of this result for the reasons discussed earlier in this Part regarding improved transactional context. Compared to the other types of intermediaries, offensive aggregators stand to benefit the least from such legislation because they exploit opacity to gain leverage in licensing transactions. Therefore, a central system would do much to elevate the positions of other market players to bargain with offensive aggregators on

154. A defensive aggregator purchases a patent or license using money from the pooled resources of the group, and grants all members (sub)licenses to those acquired rights.

155. The effectiveness may decrease to the extent that competitors are part of the same defensive aggregation group, because this precludes them as potential targets for licensing or assertion; however, greater freedom of action and competition is generally beneficial for the public good and should outweigh this.
more even ground. An offensive aggregator could no longer rely on its superior experience and knowledge of the field to make aggressive purchases and licensing deals.

The largest problem with the centralized approach, however, is the high probability that market players will resist the call for disclosure of sensitive business information. This renders a voluntary private solution almost completely unworkable, although a membership-based approach where participants contribute transactional information in return for access to a database may be feasible, even if the system might face difficulties with enforceability and gaining traction.156 Therefore, a legislative approach appears to be in order. Unfortunately, it would be very difficult to pass such a law without some way to garner the support of powerful industry groups. Such entities would only lend their support if they could determine that the cost of information disclosure would be outweighed by the benefits of having easy, centralized access to the transactional information of other market players.

B. CONSTRAINTS ON ACTIVITY

For each of the different ways in which an intermediary might abuse the patent market, legislative boundaries could serve the system well. These boundaries might include disclosure requirements and obligations to deal in good faith. One advantage of addressing problems piece by piece instead of all at once in a scheme such as a central database is that policymakers may find it easier to support a bill with a smaller footprint.

First, consider the possibilities for brokers to exploit their status as gatekeepers of transactional information given the deficiencies in the market. Purchasers and sellers that have little access to information outside of their own few transactions could be left without any way to verify what brokers tell them about the market landscape or about patents they may be considering for divestment or acquisition. Legislation imposing transparency on the seller would curb the risk of broker abuses.157 One possibility is the

156. Gaining traction would be a problem because entities would have little incentive to join early on, when the database is only sparsely populated with information.

157. In other markets with brokerage activity like real estate, there are statutes that require full disclosure of defects on the part of sellers and agents. See, e.g., CAL. CIV. CODE §§ 1102–1102.15 (2009) (describing the requirements of real estate disclosure statements for transfers in California). A broker dealing in patents should be held to standards that require full disclosure of known prior art, possibility of blocking patents, difficulty of workarounds, records of maintenance fees, and other related risks. Though buyers could benefit from brokers providing this information as a matter of law, they should still conduct diligence covering these topics to be thorough. See Mike McGurk, Lack of Patent Due Diligence Can Be a
creation of a governing agency analogous to the Securities and Exchange Commission (SEC) to oversee and regulate patent transactions. Though the transaction volume of the patent market is unlikely to approach that of the securities market, many of the reasons for which the SEC was created apply to patent transactions as well—market participants would benefit from reporting regulations, restraints on fraudulent or bad faith conduct, and access to mandatory disclosure filings.

In contrast to brokerages, defensive and offensive aggregators are generally patent purchasers and share some of the same means for exploitation. They are likely to be the more experienced party in a given patent transaction and can take advantage of that to obtain unfairly low prices. A defensive aggregator has the additional option of charging membership prices high enough to exclude new potential members. The existing members of the group could then choose to assert aggregated patents against those companies unable to pay the requisite fees. Though these actions would probably raise questions about antitrust abuse, a law requiring defensive aggregators to register and adhere to rules regulating their patent assertions could further limit this problem and also reduce excess litigation. An agency overseeing patent transactions could require registration of these two other types of intermediaries as well as brokers.


158. Created by the Securities Exchange Act of 1934, the SEC has authority to “register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation’s securities self-regulatory organizations . . . .” U.S. Securities and Exchange Commission: The Laws that Govern the Securities Industry, http://www.sec.gov/about/laws.shtml (last visited Nov. 18, 2009). As an alternative to a government agency, a private member-based regulatory agency (akin to the National Association of Realtors) is a possibility as well. See infra Part V.C.

159. This is due to a much smaller group of interested parties and a far lower volume of transactable material in the market. The related topic of intellectual property securitization is about a separate layer of transactions based on future patent income streams, which would not directly contribute to an increase in the volume of patent transactions. See generally Glasner, supra note 28.


161. However, an offensive aggregator is likely considered a single entity, which would alleviate the antitrust problem. See American Needle v. Nat'l Football League, 538 F.3d 736, 744 (7th Cir. 2008) (holding that NFL teams act as a single entity in licensing intellectual property for the purposes of antitrust).

162. The defensive aggregators all claim that they do not intend to assert patents; even Nathan Myhrvold of Intellectual Ventures explains that litigation would prove too costly and he hopes he will never have to sue anyone. See Sharma & Clark, supra note 93. However, this type of statement is no contract with the public. There is nothing stopping defensive
C. PRIVATE ORDERING

Is it possible that the market, through private ordering, will solve the problems that legislators might target? If so, it may not be worth the costs of establishing new laws or regulatory agencies to corral errant intermediaries acting towards their own advancement. For example, direct-to-purchaser transactional services could supplant patent intermediaries as they exist today.\textsuperscript{163} Even if they are not replaced, intermediaries could still adopt a set of norms that might achieve results similar to that of legislation or regulation.

One method of private ordering is natural market selection. Sellers shopping for representation in the market will go back to brokers who have helped them put together successful transactions in the past. Sellers without a history of transactions to rely on will seek out brokers that have a proven track record of candor and service quality. Brokers making the type of bad faith decisions that legislation would have addressed will probably be unable to attract enough business to keep pace with their competitors.\textsuperscript{164}

Another type of private ordering is self-governance through private membership-based agencies, such as the National Association of Realtors in the real estate market. These agencies can provide registration services, quality of service guarantees, and even ethics requirements to ensure moral conduct and prohibit fraudulent activities.\textsuperscript{165} Currently, the patent market is missing an organization that has enough membership and influence to catalyze a true change in the way that patent intermediaries do business.\textsuperscript{166}

\textsuperscript{163} Services like Tynax, an online patent brokerage and exchange, are actually building their business at another level of abstraction on top of brokers, buyers, and sellers. See Tynax: About Tynax, http://www.tynax.com/about.php (last visited Nov. 18, 2009). Given enough adoption by buyers and sellers, this type of super-bridging service may result in lower demand for standard brokerage services.

\textsuperscript{164} See supra note 37 (describing the fate of opportunistic brokers).


\textsuperscript{166} It may be worth keeping an eye on the Patent & Intellectual Property Intermediary Association, which currently appears to be in the infancy of organizational development. See Patent & Intellectual Property Intermediary Association, http://www.pipia.org/ (last visited Nov. 19, 2009).
D. **Legislation, Regulation, and Private Ordering in Combination**

Whether norms of business conduct are instantiated through regulation or private ordering methods, any new norms would force existing intermediaries to adapt or face market obsolescence. Regardless of any evolutionary step market participants may take, they could still benefit from a centralized repository of transactional information, to the extent they do not simply capitalize on informational opacity. A direct access website, for example, could tap into a national database and allow users to retrieve data relevant to their field of business. Even for parties that do not make use of this thin middle layer, those seeking to complete a transaction could use a centralized repository for due diligence processes and historical context for negotiations. A private agency regulating norms of business conduct could require forms of disclosure updating a central repository. Realistically, any complete solution is likely to involve components of legislation, regulation, and private ordering.

VI. **Conclusion**

Though stakeholders in the patent market believe intermediaries are here to stay,\(^{167}\) it is also possible that some of them may fade away as the patent market matures and the demands they satisfy cease to exist.\(^{168}\) The three primary types of entities in this discussion can be placed on a continuum of projected longevity. Of the three types, offensive aggregators operate under the most controversial business models, appear to deviate most from the goals of the patent system, and have attracted sufficient ire, which almost guarantees they will be the first to fall under any sort of directed legislation. Even without government intervention, the market has already seen entities that have risen to combat them directly. Defensive patent aggregators may have a longer life if they are widely joined, and could eventually evolve into standards-setting licensing bodies. Finally, brokers will probably be the longest lasting. The complex valuation nature of intellectual property is something that will remain no matter how transparent the market becomes; parties that wish to deal in this market will always be looking for those that

\(^{167}\) See Millien & Laurie, *supra* note 3, at 1054 (stating that the “newly-established and emerging IP business models . . . are not going away” based on an economic justification argument).

\(^{168}\) Erich Spangenberg, of the Constellation Group offensive aggregator, predicts that the NPE patent litigation business may dwindle to nothing within five or six years, at which point patents may trade as commodities, and patent quality assessments may become easier. See Skyler, *supra* note 104.
can take over the reins or, at the very least, provide a second set of eyes to assist in the relevant transactional analysis.

Any legislation regulating the intermediary patent market would greatly accelerate its maturation and close any gaps that intermediaries may be exploiting. Such a culling of businesses would catalyze a further mutation in the patent market, bringing about new services and entities of a previously unseen nature. In a field built on innovation, it is fitting that the most creative and innovative intermediaries will be the ones that manage to capitalize on the immense economic value imbued in the patent market.
ADDITIONAL DEVELOPMENTS—
PATENT LAW

ACUMED LLC v. STRYKER CORP.
551 F.3d 1323 (Fed. Cir. 2008)

The United States Court of Appeals for the Federal Circuit held that a patentee's past willingness to grant licenses of its patent is one factor in determining whether a reasonable royalty is sufficient to compensate the patentee for infringement. The court affirmed a district court decision to regard Acumed LLC's (Acumed) prior licensing of its patent as one factor to consider in deciding whether the evidence favored a grant of permanent injunction against Stryker Corporation's (Stryker) infringement.

The district court had applied the first two prongs eBay Inc. v. MercExchange's four-factor test for injunctive relief. Despite Acumed's previous licensing of the patent in question, the district court concluded, after weighing relevant factors—including the identity of past licensees, identity of the new infringer, and the patentee's experience in the market since the previous license, the court held that the harm to the patentee would be irreparable.

On appeal, Stryker argued that Acumed's past willingness to grant licenses demonstrated that an injunction was not necessary because money damages had already proven to be adequate compensation. However, the Federal Circuit affirmed the lower court's decision, reasoning that “the essential attribute of a patent grant is that it provides the right to exclude competitors from infringing the patent.” By adding a new competitor to the market through licensing, the new license may create irreparable harm that the prior licenses did not. Therefore, “a patentee's past willingness to license its patent is not per se sufficient to establish lack of irreparable harm if a new infringer were licensed.” However, the court narrowed the scope of its decision by declining to consider whether a denial of injunction would be appropriate in other circumstances where the patentee licensed the patent to other competitors.
Aristocrat Technologies Australia Pty Ltd. v. International Game Technology Inc.
543 F.3d 657 (Fed. Cir. 2008)

The United States Court of Appeals for the Federal Circuit held that an “improper revival” of a patent application, unintentionally abandoned due to the late payment of filing fees to the United States Patent and Trademark Office (USPTO), is not a valid defense to claim of infringement. The United States Court of Appeal for the Federal circuit denied rehearing on November 17, 2008.

Aristocrat Technologies (Aristocrat), competes with International Game Technology (IGT) in the market for electronic gaming machines and is the assignee of U.S. Patents No. 7,056,215 (the ’215 patent) and No. 7,108,603 (the ’603 patent), which both relate to a “slot machine game and system with improved jackpot feature.” Because the USPTO received Aristocrat’s U.S. national filing fee of the PCT application one day after the filing deadline, the Patent Office mailed the applicant a notice of abandonment. Aristocrat later filed a petition to revive the ’215 patent application under 37 C.F.R. §1.137(b), claiming that the delay in paying the fee was “unintentional.” After the PTO granted a petition to revive the ’215 patent on the basis of this provision, Aristocrat filed the ’603 patent application as a continuation of the ’215 patent application.

Later on, Aristocrat filed suit against IGT for infringing the ’215 and ’603 patents in the District Court for the Northern District of California. The court held that IGT was permitted to raise the PTO’s alleged improper revival as a defense to infringement.

The Federal Circuit disagreed and held that under 35 U.S.C § 282, the “improper revival” of a patent application cannot be raised as an invalidity defense in an action involving the infringement or validity of a patent and remanded the case.

It explained that Section 282 provides a catalog of defenses available in actions involving the validity or infringement of a patent. Two categories of defenses listed in Section 282 are at issue in this case: (1) an invalidity defense based “on any ground specified in part II of this title as a condition of patentability” (Section 282(2)) and (2) “(a)ny other fact or act made a defense by this title” (Section 282(4)).

A defense falling under Section 282(2) has two prerequisites: it must fall within part II of Title 35 and it must be a “condition for patentability.” As the district court held, “because Section 133’s six-month deadline for prosecuting an application is specified within part II of Title 35, it necessarily
provides an available defense where a patentee has abandoned, and failed to lawfully revive, a patent application.”

However, with respect to the question of whether the proper revival of an abandoned application is a “condition for patentability” or not, the Federal Circuit interpreted the sections referring to the conditions of patentability in the statute, namely Sections 101, 102 and 103, and found that “…utility and eligibility, novelty, and nonobviousness are the only so-called conditions for patentability.” As a result, for the purpose of the ‘215 patent, the court found that Section 282(2), “by virtue of its applicability to ‘conditions for patentability,’ relates only to defenses of invalidity for lack of utility and eligibility, novelty, and nonobviousness, and does not encompass a defense based upon the alleged improper revival of a patent application.”

The court also interpreted Section 282(4) as requiring an act or a fact that is actually “made” a defense by Title 35. As the court notes, “Congress made it clear in various provisions of the statute when it intended to create a defense to invalidity or noninfringement, but indicated no such intention in the statutes pertaining to revival of abandoned applications.”

The Court thus held that because the proper revival of an abandoned application is neither a fact or act made a defense by title 35 nor a ground specified in part II of title 35 as a condition for patentability, improper revival may not be asserted as a defense in an action involving the validity or infringement of a patent. With respect to the ‘603 Patent, which was filed as a continuation application of the ‘215 patent application, the Court reversed the district’s court grant of summary judgment of anticipation. The Court did not reach the issue of whether the Patent Act permits revival for “unintentional,” as opposed to “unavoidable,” delay in paying the filing fees.
In *Ball Aerosol*, the United States Court of Appeals for the Federal Circuit reversed the district court’s summary judgment of patent validity and infringement of a candle holder patent by applying the Supreme Court’s holding in *KSR Intern. Co. v. Teleflex Inc.* (*KSR*) that a patent that combines elements of prior art is obvious if the improvement is no better than the predictable use of prior art elements according to their functions.

Ball Aerosol and Specialty Container, Inc. (BASC) owns U.S. Patent No. 6,457,969 (the ‘969 patent). The ‘969 patent claims a candle tin with a removable cover, which is designed to fit under the candleholder to minimize scorching of a surface underneath the holder. The ‘969 patent also claims legs or “protrusions” that rest on the removable cover. Limited Brands, Inc. (Limited) designed the accused Travel Candle, which is a square-shaped candle tin with a removable cover and four protrusions on the bottom of the candleholder. BASC brought an action against Limited alleging infringement of the ‘969 patent. The United States District Court for the Northern District of Illinois held that Limited had infringed ‘969 patent and denied Limited’s motion for reconsideration, stating that the court’s finding of patent validity was a proper application of the clear and convincing standard and consistent with *KSR*. Limited filed an appeal.

In *KSR*, the Court explained:

> When there is a design need or market pressure to solve a problem and there are a finite number of identified, predictable solutions, a person of ordinary skill has good reason to pursue the known options within his or her technical grasp. If this leads to the anticipated success, it is likely the product not of innovation but of ordinary skill and common sense.

In this case, all of the elements of the claims could be found in the combination of two prior patents: U.S. Patent No. 6,398,544 (Wright) disclosed legs or “bumps” on the bottom of a candle tin to minimize scorching the underlying surface, and U.S. Patent No. 3,285,694 (Marchi) disclosed a candle holder with a cover that could be used as a base. In addition, the problem of candle-tin scorching was well known in the art, and the “technology is simple and easily understandable.” The Federal Circuit thus concluded that combination of putting legs on the bottom of the candleholder and using the cover as a base for the candleholder was a predictable variation and obvious.
The Federal Circuit also clarified the Supreme Court’s statement in KSR that the motivation to combine analysis “should be made explicit.” The court explained that this statement refers not to the teachings in the prior art of a motivation to combine, but to the court’s making explicit its own analysis. In addition, the Federal Circuit concluded that the minimal indications of commercial success do not outweigh the clear indication of obviousness apparent from the prior art.

**Clock Spring, L.P. v. Wrapmaster, Inc.**

560 F.3d 1317 (Fed. Cir. 2009)

The Court of Appeals for the Federal Circuit Court held that the experimental use defense to a finding of invalidity due to prior public use did not apply when durability testing was for purposes of regulatory approval and not for the patent application.

In *Clock Spring*, Clock Spring filed a lawsuit against Wrapmaster, alleging patent infringement. In response, Wrapmaster filed a summary judgment motion arguing that the patent claims were invalid, which the lower court granted on the grounds of obviousness. On appeal, Wrapmaster argued that the lower court’s decision could be sustained on the separate ground of prior public use.

Specifically, Wrapmaster argued that a 1989 demonstration by Clock Spring documented in a report by the Gas Research Institute (GRI), a non-profit research and development organization, constituted a public use of the patented method because the demonstration took place about three years before the filing date of the patent application. Clock Spring argued that the demonstration of its invention was an experimental use and argued that the public demonstration was designed to determine durability of the method.

The court concluded, however, that even if the invention’s durability had been being tested, the testing was not for the purposes of applying for a patent and thus did not fall under the experimental use exception. The court found that the GRI report even made clear that the durability testing was for acceptance by regulators and the pipeline industry. The Federal Circuit affirmed the invalidity of the patent claims on the basis of prior public use under 35 U.S.C. §102.
**Epistar Corp. v. International Trade Commission**

*566 F.3d 1321 (Fed. Cir. 2009)*

On May 22, 2009, the United States Court of Appeals for the Federal Circuit held that a successor company, which had merged with a company that previously agreed not to challenge the validity of a patent, retains its contractual rights to contest the validity of a patent with respect to products not inherited in the merger. This decision reversed the International Trade Corporation’s (ITC) decision that Epistar Corp. infringed on Philip Lumileds Light Co.’s (Lumileds) patent for a light-emitting diode (LED).

Lumiled’s patent, U.S. Patent No. 5,008,718 (the ‘718 patent) claimed a particular type of LED that utilized an opaque electrical contact that was both brighter and more efficient than previous LEDs. The ITC ruled that Epistar was precluded from challenging the validity of the ‘718 patent because Epistar merged with United Epitaxy Company (UEC), another company producing LED technology, during the course of the proceedings between Epistar and Lumileds and therefore was bound to the previous settlement between UEC and Lumileds, wherein UEC promised not to challenge the validity of the ‘718 patent. The ITC did not consider, however, that the settlement between Epistar and Lumileds was reached before the Epistar-UEC merger, in which Epistar retained the right to challenge the validity of the ‘718 patent if Lumileds sued Epistar for infringement.

Reversing the ITC’s decision to estop Epistar, the Federal Circuit held that Epistar’s previous agreement with Lumileds preserved Epistar’s contractual rights to contest the validity of Lumileds’ patent with respect to products not inherited in the merger. According to the court, “UEC’s settlement agreement has a preclusive effect on Epistar only ‘to the same extent as UEC itself.’” This result ensured that “Lumileds cannot fortuitously gain rights against Epistar that it could not secure pre-merger.”

The court utilized contract reasoning similar to that of the Third Circuit in Medtronic AVE, Inc. v. Advanced Cardiovascular Systems, Inc. There, the Third Circuit refused to expand an arbitration agreement between two corporations after one corporation merged with a third company because “the assignment does not modify the terms of the underlying contract.” The court also recognized Suessen-Schurr v. Schubert, in which a company that purchased a patent—and was thereby bound to the patent seller’s agreement not to sue a patent licensee for infringement with respect to that patent—was allowed to sue the licensee for infringement on a separate patent.
Lucent Technologies, Inc. v. Gateway, Inc.
580 F.3d 1301 (Fed. Cir. 2009)

The Federal Circuit Court of Appeals vacated a $358 million jury award against Microsoft Corp. (Microsoft) on the ground that it was not supported by substantial evidence and was against the clear weight of evidence. In Lucent, a patent by Lucent Technologies, Inc claimed a method for entering data into fields of a software form. The primary infringing portion of Microsoft’s Outlook program was the “date picker” calendar function. Based on the evidence of record, Microsoft sold approximately 110 million units of the infringing software products for a total sale value of approximately $8 billion.

At trial, Lucent based its theory of damages on a reasonable royalty amount. After hearing the evidence, the jury awarded Lucent an eight percent royalty on the entire market value of the infringing sales of the accused software products. Microsoft challenged the calculation of the damage award. The court reviewed the damage award within the Georgia-Pacific Corp. v. U.S. Plywood Corp. framework and remanded the case for a new trial on the sole issue of damages.

The Patent Act requires that a court award damages no less than a “reasonable royalty.” The determination of a reasonable royalty is “based not on the infringer’s profit, but on the royalty to which a willing licensor and a willing licensee would have agreed at the time the infringement began.” This royalty is often determined through an approach based on the Georgia-Pacific factors, which attempts to ascertain the royalty the parties would have agreed on had they successfully negotiated an agreement before the infringement.

In Lucent, the court considered several Georgia-Pacific factors as well as the entire market value when evaluating the damages award against Microsoft. First, the court noted that there was little evidentiary basis under the Georgia-Pacific factors for the jury’s lump-sum damages award of $358 million. Second, the court acknowledged the flaw of applying the entire market value rule in the present case, noting that the date-picker tool in Outlook was only a small component of a much larger software program. There court also found no evidence demonstrating Lucent’s patented method as a substantial basis for consumer demand of Outlook. The Court remanded the case for more specific guidance for reasonable royalty calculations.
QUALCOMM INC. v. BROADCOM CORP.
548 F.3d 1004 (Fed. Cir. 2008)

The United States Court of Appeals for the Federal Circuit held that Qualcomm Inc. had a duty to disclose its relevant patents during participation in a standards setting organization (SSO). Expanding on its Rambus Inc. v. Infineon Technologies AG decision on misconduct in an SSO, Qualcomm clarifies the court’s willingness to find a duty to disclose in the SSO context as well as the penalties for failing to do so.

Qualcomm owns U.S. Patent No. 5,452,104 (the ‘104 patent) and No. 5,576,767 (the ‘767 patent). It was a participant in the Joint Video Team (JVT) SSO, which was created to develop a single “technically aligned, fully interoperable” industry standard for video compression technology, and did not disclose the ‘104 and ‘767 patents to the JVT prior to release of the H.264 standard.

Qualcomm brought an action against Broadcom Corp. alleging that Broadcom infringed the ‘104 and ‘767 patents by making products compliant with the H.264 video compression standard. The United States District Court for the Southern District of California held that Qualcomm breached its duty to disclose the ‘104 and ‘767 patents to the JVT SSO. As a remedy, the district court ordered the ‘104 and ‘767 patents unenforceable against the world. In addition, the court determined that both Qualcomm’s JVT misconduct and its misconduct during litigation was an exceptional case and awarded Broadcom attorney fees.

On appeal, the Federal Circuit held that even though the JVT’s intellectual property right policies arguably did not expressly require disclosure of the patents, the policies required participants to make “best efforts” to provide information concerning IPR in the development of the standard. The court also examined the treatment of JVT’s policies by its participants and found that Qualcomm a duty to disclose. Relying in part on Qualcomm’s own attempt to assert its patents after the SSO had been implemented, the court found that the patents fell within Qualcomm’s duty to disclose patents that reasonably might be necessary to practice the standard.

However, the Federal Circuit limited the scope of the remedy. Rather than making all of Qualcomm’s patents relating to video compression technology unenforceable against the world, the court held that the remedy of unenforceability was limited to products compliant with the video compression standard. The court stated that the remedy for waiver in the SSO context should not be automatic, but should be fashioned to give a fair,
just, and equitable response reflective of the offending conduct by the patentee.
PATENT INFRINGEMENT AND PERSONAL JURISDICTION

MEDICAL SOLUTIONS, INC. V. C CHANGE SURGICAL LLC
541 F.3d 1136 (Fed. Cir. 2008)

CAMPBELL PET CO. V. MIALE
542 F.3d 879 (Fed. Cir. 2008)

In two recent Federal Circuit decisions regarding personal jurisdiction in patent infringement suits, the court held that mere demonstration or display of an accused product did not qualify as a “use” under § 271(a) for the purpose of making a prima facie showing of jurisdiction. In contrast, when a patent holder’s conduct went beyond simply informing the alleged infringer of his or her infringing activity by taking steps to interfere with the alleged infringer’s business, a patentee was found subject to personal jurisdiction in a foreign forum.

In Medical Solutions, Inc. v. C Change Surgical LLC, patentee MSI sued CCS for patent infringement and claimed that personal jurisdiction was proper because CCS had “used” or “offered to sell” the accused infringing device at a trade show. The district court found that MSI failed to make a prima facie showing of personal jurisdiction and dismissed the suit. The district court rejected MSI’s argument that CCS “used” or “offered to sell” the allegedly infringed product because it found that CCS made no sale, took no order, and provided no price information. The Federal Circuit affirmed the district court’s decision.

In Campbell Pet Co. v. Miale, patentee Miale accused Campbell employees of infringing her patents at a convention in Seattle and asked the convention director to remove the Campbell products and to tell customers of the infringement. Campbell filed suit against Miale and her company, seeking a declaration of noninfringement and invalidity of Miale’s patents. The district court dismissed the case, finding that Miale’s contacts were not sufficient for either general jurisdiction or specific jurisdiction. On appeal, the Federal Circuit reversed with regard to specific jurisdiction, finding that Miale engaged in additional conduct beyond informing Campbell of its patent rights. The court pointed out that Miale’s attempts at extra-judicial patent enforcement were targeted at Campbell’s business activities in Washington, and could be characterized as attempts to limit competition. By enlisting a third party to take action against Campbell, these efforts went beyond merely informing others of her patent rights and intention to enforce those rights through litigation. The court thus held that Miale lost the protection afforded
by Red Wing Shoe Co. v. Hockerson-Halberstadt, Inc., and found that a sufficient basis existed for the district court to exercise specific jurisdiction.
IPHONE JAILBREAKING UNDER THE DMCA:
TOWARDS A FUNCTIONALIST APPROACH IN ANTI-
CIRCUMVENTION

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I. INTRODUCTION

Over the last ten years, the Smartphone has quickly emerged from
technological obscurity to industry standard-bearer.\(^1\) With close to twenty
percent of all mobile phone sales expected to be Smartphones by 2013, the
growth of the Smartphone market has considerably altered the global
telecommunications landscape.\(^2\) In particular, the popularity of Smartphones
has created a new type of vendor-consumer lock-in.

A lock-in is a type of relationship where consumers “are dependent on a
single manufacturer or supplier for some product (i.e., a good or service) and
cannot move to another vendor without substantial costs.”\(^3\) In the United
States, most mobile phone users are subject to contractual and technological
carrier lock-ins that prevent or discourage usage with unauthorized wireless
providers.\(^4\) Buying a mobile phone from a major U.S. carrier will typically
require the user to enter into a one or two-year contract with the carrier. The
carrier also restricts usage of the device itself through technical measures and

\(^1\) While there is no industry definition of what a Smartphone is, the term generally
refers to a mobile phone with advanced features typical of those found in personal
computers. See Jake Swearingen, Smartphones gobbling up ever more market share, VENTUREBEAT,
See generally DELLOITE.COM, TELECOMMUNICATIONS PREDICTIONS: TMT TRENDS (2009),

Editorial/article.asp?article=articles/2006/t0402/12t02/12t02.asp&guid=%3E.

\(^3\) Linux Information Project, Vendor Lock-in Definition, http://www.linfo.org/
vendor_lockin.html (last visited Jan. 29, 2010). See generally Alan Beggs and Paul Klemperer,
Multi-Period Competition with Switching Costs, 60 ECONOMETRICA 651 (1992) (discussing the
interplay between market duopolies, new entrants and switching costs).

\(^4\) See Hearing on the Consumer Wireless Experience Before the S. Comm. on Commerce, Sci., and
Transportation, 111th Cong. (2009) (testimony of Rob Frieden, Professor of
Telecommunications and Law, Penn State University) [hereinafter Frieden].
end-user license agreements. In recent years, due to the increasing sophistication of Smartphone capabilities and the rapidly maturing market for mobile applications, the industry has witnessed the rise of a new type of lock-in that ties users into the application store (app store) of the handheld manufacturer.\(^5\)

Carrier and application store lock-ins permit wireless providers and mobile phone manufacturers to sell Smartphones at a substantial up-front discount and recoup the difference through wireless service fees and app store sales.\(^6\) Carrier lock-ins bind users to the carrier’s wireless service unless users are willing to pay for the service costs and early termination fees incurred upon breach of the wireless agreement.\(^7\) Regardless of whether consumers actually subscribe for the full term of service, wireless providers receive compensation for providing the initial discount of the handset. Unlike carrier lock-ins, which affirmatively binds users to a specific wireless service, application lock-ins seek to prevent or restrict a user’s ability to install new applications on the device. In contrast, handset manufacturers have no comparable remedy for breach of its lock-in regimes and may not be able to even detect it.\(^8\) As a result, manufacturers must rely on technological protection measures (TPMs) to prevent alterations to their hardware and software devices in order to preserve their app store market downstream.\(^9\)

To further protect their app store lock-in regimes, manufacturers have argued that disabling or altering handset TPMs are prohibited as acts of illegal circumvention under the Digital Millennium Copyright Act (DMCA).\(^10\) Specifically, §1201 of the DMCA prohibits the circumvention of any technological measure that “effectively controls access” to a copyrighted work.\(^11\) Section 1201 also provides for the creation of exemptions to the ban on circumvention through a rulemaking process administered by the

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6. See Frieden, supra note 4, at 4.

7. Id. See also Michael L. Katz and Carl Shapiro, Network Externalities, Competition, and Compatibility, 75 THE AMERICAN ECONOMIC REVIEW 424 (1985).


9. See id.


In February of 2009, the Electronic Frontier Foundation filed a request with the Library of Congress to exempt the circumvention of TPMs for purposes of installing applications from sources not designated by the manufacturer, also known as “jailbreaking.” At present, it is unclear whether such an exemption is necessary because the case law is not settled. Courts have only applied § 1201 to TPMs that restrict usage of hardware platforms in a limited number of instances. The two primary cases that address the topic do so in the context of garage door openers and printer toner cartridges, which may have narrow applicability to the Smartphone context.

This Note will apply the limited case law on § 1201 to a particular Smartphone lock-in, the Apple iPhone’s App Store lock-in, and conclude that iPhone jailbreaking is illegal without a specific exemption from the Library of Congress. The case law provides for both a formal approach and a functional approach to analyzing § 1201 liability. The Note argues that under the formal approach, jailbreaking liability turns on arbitrary idiosyncrasies of software design and circumvention method, obscuring the central intent behind the DMCA’s drafting—the protection of copyrighted works in the digital age. These idiosyncrasies are formed mostly at the discretion of software manufacturers, who can shape their products or tools in ways that may extend § 1201 protections to unintended applications, leaving § 1201 vulnerable to a myriad of anti-competitive practices and abuses. This Note proposes a functionalist approach to remedying the problem that would narrow the application of § 1201 through judicial interpretation in a manner consistent with the DMCA and the intent of its drafters.

Part I will introduce the topic by exploring the rationale behind iPhone modification. Part II will explicate the technical aspects of iPhone jailbreaking. Part III will assess jailbreaking liability under § 1201, focusing on the question of whether the iPhone Software “effectively controls access” to a copyrighted work. In particular, the Note will analyze iPhone Jailbreaking liability under the formalist framework set out in *Lexmark International, Inc. v. Static Control Components, Inc.* and *Chamberlain Group, Inc. v. Skylink*. 

12. *Id.* at § 1201(a)(1)(D).
15. 387 F.3d 522.
Technologies, Inc.\textsuperscript{16} Part IV will discuss the problems associated with anti-circumvention abuse and propose a two-step analysis for courts to use when analyzing § 1201 liability in cases involving aftermarket goods or services.

II. THE RATIONALE BEHIND IPHONE MODIFICATION

The iPhone locks its users into many different services, but two lock-ins have been and continue to be of particularly controversy: AT&T as the iPhone user’s exclusive wireless provider, and the Apple App Store as the iPhone user’s exclusive source of software applications. Apple maintains these lock-ins by building protective measures into the software operating system (iPhone Software) installed on every new iPhone.

Soon after the iPhone’s initial release, users who were not content with Apple’s lock-in regimes discovered methods to enable the phone’s usage with other wireless providers (unlocking), and the installation of unauthorized programs (jailbreaking).\textsuperscript{17} The iPhone Software must be modified in both processes. Although exact figures are unknown, varying estimates have placed the number of jailbroken phones at somewhere between ten to twenty-five percent of all iPhones in operation.\textsuperscript{18}

Apple’s iPhone Software is the focal point of any jailbreaking analysis. The iPhone Software has protection under copyright law and the DMCA. However, unlike recent debates surrounding digital copyright and content piracy, iPhone jailbreaking centers not on the copyrighted work but on the restrictions placed on a hardware device through a copyrighted software operating system. In the case of the iPhone, many functions such as weather reports and stock quotes are only available through sources designated by Apple.\textsuperscript{19} By purchasing an iPhone, a user automatically enters into several

\textsuperscript{16} 292 F. Supp. 2d 1023.

\textsuperscript{17} Jenna Wortham, Unofficial Software Incurs Apple’s Wrath, N.Y. TIMES, May 13, 2009, at B1.


lock-in arrangements, most notably with AT&T Wireless and the Apple App Store.20

These lock-ins are consummated by the user’s acceptance of Apple’s end-user license agreement (EULA) shortly after purchase. In the normal course of use, most iPhone purchasers will accept Apple’s EULA at least two times. The user first agrees to the shrinkwrap contract on the iPhone’s physical packaging and then again in the form of a clickwrap contract during the initial synchronization event between the iPhone and Apple’s iTunes software.21 The iPhone EULA dictates that a user “may not copy, decompile, reverse engineer, disassemble, attempt to derive the source code of, modify, or create derivative works of the iPhone Software,” and that Apple “retain[s] ownership of the iPhone Software itself.”22 A user must click “Agree” in order to finish the setup. The acceptance of these terms provides a contractual basis on which Apple reinforces its lock-ins. However, even explicit notice is not effective for people who do not read it or fully integrate it into their decisions (before and at the point of sale).23 As a result, despite their acquiescence to Apple’s contractual terms, some users will still look to unlocking and jailbreaking to avoid being subject to iPhone lock-ins.

A. UNLOCKING: THE AT&T LOCK-IN

In most circumstances, the purchase and use of an Apple iPhone requires signing a two-year wireless service contract with AT&T.24 Vendor lock-ins of this type are not unusual in the U.S. mobile phone market. Wireless carriers subsidize the price of handsets in exchange for committing to a term of service.25

Unlocking provides users with significant benefits. For instance, it allows users to purchase local phone plans while abroad, saving money. Also, if

21. See id.
22. iPhone End-User License Agreement, supra note 20, at §§ 1, 3(c).
24. Apple, Inc., Buy iPhone 3G, http://www.apple.com/iphone/buy (last visited Jan. 29 2010) (disclaiming that discounted pricing is contingent upon a two year service contract). Users can purchase iPhones without a contract if they are willing to pay four hundred dollars more for an unsubsidized iPhone. Although this option is not widely publicized, it is probably safe to assume that since full priced iPhones are locked-in to the AT&T network, most normal customers will opt for the discounted pricing with the service contract. Prior to the release of the iPhone 3G, consumers could purchase the handset at the discounted price without signing a service contract with AT&T. See AT&T to sell iPhone without contract for $599, ASSOCIATED PRESS, Mar. 19, 2009, available at http://www.msnbc.msn.com/id/29779285/.
25. Frieden, supra note 4, at 4.
users’ needs become incompatible with a carrier’s wireless coverage, unlocking allows the user to switch to another carrier without buying a new handset. In recent years, the industry has sanctioned the practice of unlocking or removing the restrictions that bind a handset to a specific carrier for a certain amount of time. However, AT&T refuses to unlock iPhones at any point in time, even after the contract expires, a potentially serious and costly inconvenience to many users.

B. JAILBREAKING: APPLE APP STORE LOCK-IN

The iPhone is preloaded with software preventing the installation of new programs except those expressly authorized by Apple through its App Store. Critics such as the Electronic Frontier Foundation (EFF) claim that Apple, by technologically excluding competitors, forces both developers and consumers of iPhone applications to use the App Store. iPhone App Store developers must submit all new applications or programs to Apple for approval. If an application is approved, only then can it be downloaded and installed through the App Store.

As the gatekeeper to new programs and functionalities on the iPhone, Apple possesses a powerful mechanism to reinforce its App Store lock-in. As a matter of policy, the Apple App Store denies submissions or removes accepted applications that duplicate existing or planned iPhone capabilities. For example, in June of 2009, Apple drew significant criticism over its reported rejection of the Google Voice application, prompting an investigation by the Federal Communications Commission.

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27. See Rob Pegoraro, It’s Not The Money, Can You Hear Me?, THE WASHINGTON POST, May 29, 2008, http://www.washingtonpost.com/wp-dyn/content/article/2008/05/28/AR2008052803089.html. Users can either unlock their phones after 90 days of service or at the end of one or two year contract with AT&T, T-Mobile, and Nextel, among others.


claimed that the app had not been rejected and was still under study, but stated that the application appears “to alter the iPhone’s distinctive user experience by replacing the iPhone’s core mobile telephone functionality and Apple user interface with its own user interface for telephone calls, text messaging and voicemail.” Additional reports of stalled and indefinitely delayed applications have also prompted accusations of anticompetitive behavior. Some iPhone application developers have complained about delayed payouts, inconsistent or stringent decency requirements, and arbitrary submissions denials. While Apple has worked to increase the transparency of its approval system, many developers are still very unhappy with the process. Facing rejection, some developers turn to publishing their applications on unofficial app stores that require jailbroken phones.

Underpinning the grievances of some end-users and developers is the expectation of rights associated with traditional property ownership, whereby owners of a product (particularly related to hardware) are entitled to change and modify it as they see fit. Operating under this assumption, some iPhone users have turned to jailbreaking and unlocking to remedy what they perceive as an unreasonably restrictive set of lock-in regimes.

35. See, e.g., Bill Ray, Apple Joins Campaign for Real Breasts, THE REGISTER, Jan. 16, 2009, http://www.theregister.co.uk/2009/01/16/apple_boobs_again/ (reporting the acceptance of an application that allows users to animate nude body parts, while a cartoon version with similar functionality was rejected); Tom Krazit, Apple nixes 'potentially offensive' South Park app, CNET, Feb. 17, 2009, http://news.cnet.com/8301-13579_3-10165736-37.html (reporting the rejection of an application based on a cartoon for profanity, while the uncensored movie version of the cartoon was sold in the iTunes Store); Rik Myslewski, Apple snips Nine Inch Nails app, THE REGISTER, May 9, 2009, http://www.theregister.co.uk/2009/05/04/nine_inch_nails_censorship/ (discussing the rejection of an application that plays songs from a well-known band due to the use of one profane word in its lyrics); see also Posting of Jim Dalrymple to Macworld, http://www.macworld.com/article/134698/2008/07/app_store_developers.html (Jul. 25, 2008 00:00 PST).
III. A TECHNICAL INTRODUCTION TO JAILBREAKING

The first jailbreaking method was introduced in July of 2007, approximately one month after the iPhone’s initial release date. Since then, a handful of internet communities have coalesced around the goal of defeating the iPhone’s lock-in protections. As the popularity of the iPhone grew, a technical “arms race” emerged between Apple and the iPhone jailbreaking/unlocking community, resulting in an “elaborate game of whack-a-mole as rogue programmers quickly countered Apple’s efforts with their own software updates.”

During the iPhone’s first three years on the market, Apple released more than twenty versions of the iPhone Software. Many of these were jailbroken by tools widely available on the Internet. In addition to providing new features and bug fixes, new iterations of the iPhone Software closed security loopholes exploited by iPhone jailbreakers and unlockers. As a result, the process of jailbreaking an iPhone varies depending on the version of iPhone Software in operation.

When the iPhone is first turned on, the iPhone Software executes a series of authenticity checks called the “chain of trust” before loading the operating system and other iPhone components. This initial set of authenticity checks uses encryption keys to ensure that all iPhone firmware components are

40. Wortham, supra at note 17. While most of the focus (particularly in the press) has been centered on breaking the AT&T-Apple and Apple App Store lock-ins, unlocking or adding new features to the iPhone has been an equally important motivator of iPhone modification. Features are often unlocked or added through jailbreaking, followed quickly by an iPhone Software update from Apple that incorporates some features lacking in the previous iPhone Software release. The first jailbreaking method was initially designed to allow the installation of custom wallpapers and ringtones, a function that was later unlocked in version 1.1.3. An App Store for jailbroken phones had started to be used starting in version 1.1.2. Six months later, the Apple App Store was released as part of version 2.0. This process continues to this day. See id.
42. See infra note 45.
43. Id.
44. Id.
45. Maria Colenso, Jailbreaking your iPhone, HOWSTUFFWORKS.COM, Apr. 14, 2009, http://electronics.howstuffworks.com/how-to-tech/how-to-jailbreak-iphone1.htm/. A chain of trust involves the validation of key hardware and software components in a device. It is intended to ensure that only trusted software and hardware is being used.
legitimate and unadulterated. Despite differences in method, all jailbreaking solutions aim to disable this initial set of authenticity checks by exploiting a vulnerability that allows the jailbreaker to load a custom set of computer code, or payload, onto the iPhone.

In its default state, the iPhone Software only allows the user to access the file system’s “/private/var/mobile/Media” directory. Jailbreaking allows the user to break out of this “jail” and reset access to “/” or top-level access to the entire file system (also known as privilege escalation), allowing for the custom payload to be copied onto the iPhone. Once copied and then executed, the custom payload can exploit the iPhone’s other vulnerabilities, allowing a jailbreaker to disable or modify the iPhone’s chain of trust. The payload disables several components in the iPhone operating system that prevent the execution of programs lacking Apple’s encrypted digital signature. Without jailbreaking, unsigned applications cannot be loaded onto the iPhone, and even if loaded, would not run.

iPhone jailbreaks generally fall into two categories depending on where the act of circumvention takes place. The most prevalent method of jailbreaking currently in use, “firmware restore,” circumvents the iPhone Software’s protective measures on the user’s personal computer. It involves downloading Apple’s authorized iPhone Software onto a computer, then decrypting, unpacking, modifying, and repackaging it into a new file. This is generally done using a software package custom-written by a party who also reverse-engineers and supplies the necessary cryptographic keys. The modified iPhone Software is then “restored” onto the iPhone using iTunes.

46. See id.
50. Id.
51. Id.
53. Id. This process involves making an unauthorized copy of the iPhone Software.
through a process originally designed to return the device to its factory default settings.\(^5\)

Another type of jailbreaking involves circumvention of protective measures on the iPhone itself. These methods are still in use today but were more widely used during the first year of the iPhone’s initial release. Two of the most popular methods exploited flaws in the iPhone’s Universal Serial Bus (USB) connection and the iPhone Software’s Safari browser.\(^5\) These jailbreaks involved exploiting loopholes to enable some form of unrestricted communication with the iPhone. Once established, the iPhone Software’s security measures are compromised externally (with the help of a custom designed website or a special jailbreaking program on the user’s personal computer). Jailbreaking that takes place on the iPhone itself can be analogized to an attack that tunnels underneath a castle’s walls, while firmware restore is equivalent to the planting of a Trojan horse. It is also

5. See ZDZIARSKI, supra note 51; Pwnage, supra note 52.
6. These are also known as the Apple File Connection (AFC) and Library Tiff (LibTiff) Jailbreaks. AFC is a program that facilitates limited access to the iPhone file system for interoperability with desktop computers. The AFC program allows the iPhone to share photos, music, and address book contacts over a USB connection by permitting open access to the iPhone’s “/private/var/mobile/Media” directory, but prohibiting access to the rest of the file system. Jailbreakers exploited vulnerabilities in the iPhone’s AFC to modify a critical chain of trust component called iBoot. When the iPhone was restarted, iBoot then granted privilege escalation, allowing for access to the entire file system and the loading of custom payload that disables the operating system’s digital signature verification components. Id.; see iPhone Hacking, First Steps, http://www.wrightthisway.com/Articles/000428.html (Aug. 16, 2007, 21:53 PST).

Probably the most infamous of these jailbreaks involved taking advantage of the LibTiff vulnerability in version 1.1.1 of the iPhone firmware. LibTiff is a software component that enables the viewing of a certain Tag Image File Format (Tiff) image files. In iPhone versions 1.1.1 and earlier, LibTiff was prone to buffer-underflow and overflow vulnerabilities that involved the program receiving data at a faster or slower rate than was acceptable. This problem is typically prevented by built-in “boundary checks” that regulate the flow of data, but the iPhone’s LibTiff component was not programmed to conduct enough of these checks. Although in most cases this flaw would result in crashed applications and other system errors, this vulnerability could be exploited in a way where a maliciously crafted Tiff image file could be used to execute unauthorized programs on the iPhone. Although several different jailbreaking solutions were developed based on this flaw, the most popular method involved visiting the Jailbreakme.com website using the iPhone’s Safari web browser. The site contained a custom Tiff image that exploited the flaw and uploaded a custom payload onto the iPhone’s file system, which then jailbroke the iPhone and patched LibTiff vulnerability, creating an arguably more secure device. Ryan Block, iPhone and iPod touch v1.1.1 full jailbreak tested, confirmed!, ENGADGET, available at http://www.engadget.com/2007/10/10/iphone-and-ipod-touch-v1-1-1-full-jailbreak-tested-confirmed/. See also Juniper Networks, LibTiff ‘tif_lzw.c’ Remote Buffer Underflow Vulnerability, http://www.juniper.net/security/auto/vulnerabilities/vuln30832.html (last visited Apr. 17, 2010).
important to note that firmware restore has been the dominant method of jailbreaking since the release of firmware 2.0 in mid 2008.\textsuperscript{57}

\section*{IV. LIABILITY FOR JAILBREAKING UNDER SECTION 1201 OF THE DMCA}

The act of jailbreaking an iPhone may create liability in three ways: breach of contract, copyright infringement, and as an act of illegal circumvention. Apple is unlikely to pursue breach of contract claims against its users for acts of personal use due to the difficulty of proving a significant amount of actual damages and the public relations fallout likely to result from suing its own customers. Apple is in a better position to protect iPhone technology by enforcing its software copyrights. 17 U.S.C. § 106 provides copyright owners with exclusive rights to authorize reproduction, creation of derivative works, and distribution.\textsuperscript{58} Apple has claimed that depending on the method used, jailbreaking violates at least one of these exclusive rights.\textsuperscript{59} Although jailbreaking could qualify as copyright infringement of Apple’s two federally registered copyrights for the iPhone software,\textsuperscript{60} this Note will discuss these issues only to the extent that they impact liability for illegal circumvention.

In 1998 Congress enacted § 1201 as part of Title I of the DMCA to address the growing piracy concerns of content owners and promote the electronic availability of digital works on the Internet.\textsuperscript{61} The DMCA punishes

\begin{itemize}
\item the digital environment poses a unique threat to the rights of copyright owners, and as such, necessitates protection against devices that undermine copyright interests. In contrast to the analog experience, digital technology enables pirates to reproduce and distribute perfect copies of
\end{itemize}

\begin{footnotes}
\item[57.] See Jailbreak, supra note 47.
\item[58.] 17 U.S.C § 106(1)(3) (2006).
\item[59.] Response of Apple, supra note 10 at 2.
\item[60.] See Copyright Registration No. TX0006457868 (registered Sept. 13, 2007), available at http://cocatalog.loc.gov; Copyright Registration No. TX0006871140 (registered Oct. 10, 2008), available at http://cocatalog.loc.gov.
\item[61.] Section 1201 of the DMCA was initially introduced as the “WIPO Copyright Treaties Implementation Act.” It brought U.S. law in compliance with the WIPO Performances and Phonograms Treaty entered into by the Clinton Administration during the Geneva conference. See H.R. REP. NO. 105-551, pt. 1 (1998). Congress posited that the dissemination of copyrighted works on the Internet is contingent upon the adequate digital protection for copyright owners. Id. Likening HR 2815 to the prohibitions on the circumvention of satellite and cable television technologies, Congress saw the need to secure these digital protections. Id. Recognizing that the Internet and the digitization of copyrighted works represent a unique threat to the rights of copyright owners, the Commerce committee concluded that:
\end{footnotes}
those who would “try to profit from the works of others by decoding the encrypted codes protecting copyrighted works, or engaging in the business of providing devices or services to enable others to do so.”

Unlike most cases involving the DMCA, where unauthorized access is being used to copy unauthorized copyrighted content, the act of jailbreaking an iPhone does not circumvent access to copyrighted content offered on Apple’s iTunes or App Store. Apple provides three types of copyrighted works through its content delivery platforms: video, audio, and applications. These works are subject to varying degrees of access control mechanisms in the form of Digital Rights Management (DRM) schemes.

The process of jailbreaking involves the execution of custom software designed to disable authenticity checks on critical iPhone software components, without modifying any of Apple’s built-in DRM encryption systems for its copyrighted works.

However, jailbreaking does indirectly modify access control mechanisms that safeguard copyrighted content. Jailbreaking enables user access to the iPhone’s file system, which is disabled by default. Although not specifically altering a DRM protection, jailbreaking does make it easier for users to access DRM-protected files on the Apple iPhone. The usefulness of this feature is somewhat limited, as users are readily able to access the same works-at virtually no cost at all to the pirate. As technology advances, so must our laws.

Report of the U.S. House Comm. on Commerce, H.R. REP. NO. 105-551, pt. 2, at 25 (1998). Pamela Samuelson, however, has criticized this view and claims that “the DMCA went far beyond treaty requirements in broadly outlawing acts of circumvention of access controls and technologies that have circumvention-enabling uses.” Pamela Samuelson, Intellectual Property and the Digital Economy: Why the Anti-Circumvention Regulations Need To Be Revised, 14 BERKELEY TECH. L.J. 519, 521 (1999). Professor Samuelson goes on to state that “Hollywood and its allies sought the strongest possible ban both on the act of circumventing a technical protection system used by copyright owners to protect their works and on technologies having circumvention-enabling uses.” Id. at 522–23.


64. Audio works are essentially free of DRM protections as of early 2009. All applications and almost all video works distributed by Apple are protected by the Fairplay DRM scheme. iTunes Store and DRM-free music: What you need to know, MACWORLD, http://www.macworld.com/article/138000/2009/01/drm_faq.html (last visited Jan. 29, 2010).


66. See Zdziarski, supra note 52.
DRM-protected content on their home computer in iTunes without any file system protections. Nevertheless, there is some credence to the claim that jailbreaking detracts from iPhone security and the integrity of Apple’s DRM architecture. 67 Third-party applications designed to work with jailbroken iPhones have broken Apple’s Fairplay copy protections and pirated versions of App Store games and applications are widely available on the Internet. 68

A. SECTION 1201 OF THE DMCA

Section 1201(a)(1) of the DMCA provides that no persons shall circumvent “a technological measure that effectively controls access to a [copyrighted work].” 69 The House of Representatives likened violations of § 1201(a)(1) to the act of breaking into a locked room to obtain a copy of a book, rather than the use of the book itself. 70

Section 1201(a)(2), the anti-trafficking prohibition, outlaws trafficking in certain products and services that “aid and abet” those circumventing access control measures referred to in § 1201(a)(1). 71 Both §§ 1201(a)(1) and 1201(a)(2) seek to prevent circumvention, as § 1201(a)(1) prohibits the act itself and § 1201(a)(2) punishes accomplices.

Also, § 1201(b)(1) prohibits trafficking in devices that circumvent rights protection measures (“rights circumvention trafficking”). 72 As two closely related yet distinct prohibitions, § 1201(a)(2) penalizes trafficking in devices that circumvent measures safeguarding initial access, while (b)(1) implicates those who provide the tools that circumvent measures that secure the

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67. FairPlay is Apple’s proprietary digital rights management system; it secures all content sold through the Apple iTunes and App Stores. Apple has argued that jailbreaking removes file system protections on the iPhone, thus easing access to Fairplay DRM schemes on the iPhone. See Response of Apple, supra note 9 at 14. This access, however, is widely available on personal computers where the file system is not locked, so the practical utility of an unlocked file system for breaking DRM schemes is questionable. Nevertheless, jailbreaking does remove a layer of protection on the iPhone and jailbroken apps that break Apple’s Fairplay DRM have appeared. See, e.g., Charlie Sorrel, Crackulous Strips Copy Protection from iPhone Apps, WIRED, http://www.wired.com/gadgetlab/2009/02/crackulous-str/. See also How FairPlay Works: Apple’s iTunes DRM Dilemma, http://www.roughlydrafted.com/RD/RDM.Tech.Q1.07/2A351C60-A4E5-4764-A083-FF8610E66A46.html (last visited Jan. 29, 2010).
68. See id. See, e.g., IsoHunt.com, http://isohunt.com/torrents/?ihq=iphone+apps (a listing of pirated iPhone apps for download using the BitTorrent protocol) (last visited Jan. 29, 2010).
72. Id. at § 1201(b)(1).
copyright protections during lawful usage. 73 Copy controls, for example, would be a basis for § 1201(b)(1) liability but not under § 1201(a)(2), while initial access controls would be a basis for the reverse. 74 Unlike § 1201(a)(2), there is no violation for conduct in § 1201(b)(1):

Prior to [enactment of the DMCA], the conduct of circumvention was never before made unlawful. The device limitation in [§ 1201(a)(2)] enforces this new prohibition on conduct. The copyright law has long forbidden copyright infringements, so no new prohibition was necessary. The device limitation in [§ 1201(b)(1)] enforces the longstanding prohibitions on infringements.75

The statute defines circumvention as an act “to descramble a scrambled work, to decrypt an encrypted work, or otherwise to avoid, bypass, remove, deactivate, or impair a technological measure, without the authority of the copyright owner.”76 As described, supra,77 the process of jailbreaking involves numerous acts of bypassing, removing, and deactivating the iPhone Software restrictions meeting the statute’s definition of circumvention.78 The iPhone Software itself is also very likely a “technological measure,” which according to Congress could be “based on encryption, scrambling, authentication, or some other measure which requires the use of a ‘key’ provided by a copyright owner to gain access to a work.”79 The iPhone’s chain of trust, authenticity checks, digital signature checks, and restricted file system access are all examples of the iPhone’s technological measures, an interpretation supported by case law.80

Jailbreaking will always involve many separate acts of decryption aimed directly at circumventing the technical measures in a manner that is directly prohibited by the statute.81 While the act of jailbreaking is likely to fall within the scope of “circumvention” under § 1201(a), in establishing a cause of action, a plaintiff must also prove that the circumvention is directed at a technical measure that “effectively controls access” to a copyrighted work.

73. See id; see also Melville B. Nimmer & David Nimmer, 3 Nimmer on Copyright § 12A.03 (2003).
74. See id.
77. See supra Part II.
78. Id.
81. See supra Part II.
Congress did not expressly address whether §1201 applied to the circumvention of software technological protection measures (TPMs) that control access not only to the software itself, but also to aftermarket hardware or services. In cases where the copyrighted work is a piece of software that is in itself the technical measure and the gatekeeper to some hardware functionality (like the iPhone), the question of whether the technical measure actually “effectively controls access” becomes an issue of judicial interpretation.

B. **Lexmark International v. Static Control**

1. **The “Effectively Controls Access” Standard for Section 1201 Liability**

In interpreting §1201 to resolve a matter not anticipated by Congress, the Sixth Circuit Court of Appeals in *Lexmark Int’l, Inc. v. Static Control Components* employed a formalistic analysis of the statute’s “effectively controls access” language to carve out certain exemptions from §1201 liability.82

In *Lexmark*, a toner cartridge manufacturer was enjoined from further distribution of a toner cartridge microchip that circumvented a copyrighted program that prevented the use of unauthorized toner cartridges with Lexmark printers.83 The copyrighted work was Lexmark’s Printer Engine Program (PEP), which also controlled many of the printer’s essential functions.84 The defendants created SMARTEK chips containing an exact copy of Lexmark’s PEP that allowed for unofficial toner cartridges to be used with Lexmark printers.85 The PEP on SMARTEK chips permitted consumers to satisfy an authentication procedure that occurred each time the printer door was opened and closed.86

The district court found that: (1) Lexmark’s authentication sequence constituted a “technological measure that controls access” to two different copyrighted works within the printer itself, and (2) circumvention of these measures was within the scope of §1201 liability.87 The Sixth Circuit overturned this decision, holding that it was not Lexmark’s authentication sequence that “controls access” to the PEP, but rather the purchase of the printer itself—since anyone who owned a Lexmark Printer was free to read the code.88 As a result, the Court of Appeals held that there was no effective

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82. *Lexmark*, 387 F.3d 522.
83. *Id.* at 529, 532.
84. *Id.*
85. *Id.* at 530.
86. *Id.*
87. *Id.* at 532.
88. *Id.*
access control to the PEP code and therefore the defendant was not liable under § 1201.89

In its discussion of the computer code of the PEP, the Court of Appeals identified two different types of access: functional and literal.90 Functional access refers to the use of what results from the execution of computer code, while literal access allows the user to view the code in its programming language format.91 In *Lexmark*, the plaintiff’s authentication sequence blocked functional access to the printer preventing its operation, but did not restrict access to the literal programming code of the PEP.92

Thus, the Court of Appeals held that because the authentication process controlled only functional access to the PEP, it did not fall within the purview of the DMCA because § 1201 does not cover authentication measures controlling access to “otherwise-readily-accessible copyrighted works.”93 The court opined that a lock on the back door of a house cannot possibly be said to “control access” to that house if there is no lock on the front door.94

2. *Are the iPhone’s Technological Protection Measures Protected under *Lexmark*?*

In *Lexmark*, the plaintiffs used § 1201 to secure a hardware device (the printer). The actual copyrighted software involved was of relatively minor concern, a drastic departure from the issue in traditional DMCA cases.95 The key is to determine where iPhone jailbreaking fits along this spectrum, and if it falls within the *Lexmark* exemption. The first step in this determination is an analysis of the iPhone’s TPMs under *Lexmark*.

Two relevant TPMs exist: the encryption protecting the iPhone Software (while on a user’s personal computer) and the iPhone Software itself (after its installation on the iPhone).96 In its packed and encrypted state on the hard drive of the user’s computer, the iPhone Software lacks functionality and its encryption is a TPM that prevents the user from literal access to the iPhone’s code.97 On the iPhone device, the iPhone Software itself is a TPM which

89. *Id.* at 551.
90. *Id.* at 548.
91. *Id.*
92. *Id.* at 549.
93. *Id.*
94. *Id.* at 547.
96. See supra notes 45, 47, 52.
97. *Id.*
prohibits access to the literal code and restricts access to functional software components.98

Both iPhone TPMs are highly distinguishable from those that control access to the PEP in *Lexmark*. The PEP authentication process restricts functional access, and does so in a binary fashion that either grants or denies the user access to the basic functionality of the printer.99 The TPMs in the iPhone Software similarly restricts access to the functionality of the iPhone, but in a far more nuanced and complicated manner. These TPMs restrict access to certain subsets of the iPhone Software.100 For example, if the iPhone were to be used with a carrier other than AT&T, the device’s phone application will not function.101 The file system is also sealed off from user access and the installation of applications not authorized by Apple is not allowed.102 iPhone TPMs also entirely prohibit literal access to the iPhone Software code, both on the user’s computer and on the iPhone handset.103

Under *Lexmark*’s exemption of “otherwise readily available” works from § 1201 liability, iPhone TPMs likely qualify for DMCA protection. Unlike the TPMs in *Lexmark* that merely controlled access to an “otherwise readily available work,” iPhone TPMs restrict both functional and literal access to the iPhone Software—always protecting the literal code of the iPhone Software and heavily restricting the functional elements of user access. Out of the box, the current model of the iPhone is essentially nonfunctional. Aside from an option that allows the user to make emergency calls, access to the functionality of the iPhone software is entirely prohibited. Apple or AT&T must “activate” the iPhone in-store to allow for basic functional access. Even after such access is granted, iPhone TPMs continue to restrict access to the iPhone software’s functional components.

Moreover, the court in *Lexmark* held that because:

> Lexmark has not directed any of its security efforts, through its authentication sequence or otherwise, to ensuring that its copyrighted work (the Printer Engine Program) cannot be read and copied, it cannot lay claim to having put in place a “technological measure that effectively controls access to a work protected under [the copyright statute].”104

98. *Id.*
99. *See* *Lexmark*, 387 F.3d at 529–30.
100. *See supra* Part II.
101. *Id.*
102. *Id.*
103. *Id.*
104. *Lexmark*, 387 F.3d at 549.
As discussed, the iPhone TPMs, unlike those used in the PEP, do in fact protect the iPhone Software.

The court in *Lexmark* also distinguished the PEP from copyrighted works that had previously been the subject of § 1201 cases, theorizing that copyright protection under the DMCA “operates on two planes: in the literal code governing the work and in the visual or audio manifestation generated by the code’s execution.” 105 For example, “the encoded data on CDs translates into music and on DVDs into motion pictures, while the program commands in software for video games or computers translate into some other visual and audio manifestation.” 106 In these cases, restricting “use” of the work means restricting consumers from viewing or accessing the copyrightable expression that is the output of the literal software elements. The court found the output of the PEP program to be “purely functional,” operating on only one “plane of expression,” 107 and as a result, not subject to § 1201. 107 In the court’s opinion, a literal program that merely controlled paper feed, movement, and motor control was not a form of copyrightable expression. Moreover, it is because the PEP “is not a conduit to protectable expression” that Lexmark chose not to protect the literal elements of the code. 108 As Lexmark’s authentication sequence did not restrict access to this literal code, the DMCA did not protect it from circumvention. 109

In contrast, the audio and video manifestations outputted by the iPhone Software constitute the “front-end” or user interface for an entire mobile phone operating system. They far exceed the “purely functional” output of the PEP and likely qualify for § 1201 protection.

3. *Jailbreaking Liability under Lexmark*

The act of iPhone jailbreaking is likely a violation under § 1201(a)(1) and in certain cases §§ 1201(a)(2) and 1201(b)(1) as well. As discussed, *supra,* 110 iPhone jailbreaks generally belong in two categories based on where the circumvention takes place.

Regardless of the method, all jailbreaking solutions aim to achieve three goals: (1) to disable the authenticity checks during the many transitional steps of booting the device, (2) to disable the digital signature checks present in the core of the operating system, permitting program code not signed by Apple

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105. *Id* at 548.
106. *Id.*
107. *Id.* at 547.
108. *Id.* at 549.
109. *Id.*
110. *See supra* notes 52–57 and accompanying text.
to run, and (3) to modify read/write permissions to gain access to the entire iPhone file system.\(^{111}\)

Jailbreaking that takes place on the computer through firmware restore accomplishes all three goals by modifying the iPhone Software.\(^{112}\) This method relies on decrypting and unpacking the software package downloaded from Apple.\(^{113}\) The access control mechanism that firmware restore jailbreaking circumvents is the encryption that prevents access to the iPhone Software’s literal code.\(^{114}\) After modification, the user loads the modified iPhone Software onto the device granting unrestricted functional access.\(^{115}\)

In contrast, modifying iPhone TPMs on the device itself involve one or more acts of decryption, exploitation and circumvention directed at hardware and software TPMs to accomplish each of the three goals of iPhone jailbreaking.\(^{116}\) In this case, the TPMs being circumvented directly control the iPhone Software’s functional access, and involve literal access only to the extent of breaking controls on iPhone operation.\(^{117}\) Once the jailbreaking process has finished the custom payload grants literal access to the iPhone Software as part of the last step of the jailbreak.\(^{118}\)

In comparing these two classes of jailbreaking methods, firmware restore is more likely to be prohibited under the DMCA as a direct circumvention of TPMs that control access to a copyrighted work. iPhone-based jailbreaks, on the other hand, occur after the user establishes essential functional access to the device and only grants access to the literal code to the extent necessary to free the iPhone from Apple’s restrictions. This latter type of jailbreaking comes closer to the type of circumvention that bypasses access controls to “otherwise readily accessible works” and is therefore more likely to escape liability under the Lexmark rule.

Firmware restore is likely a violation of § 1201(a)(1) or 1201(a)(2) as either an act of illegal circumvention or illegal trafficking in circumvention technologies, respectively. These prohibitions punish acts that circumvent initial access. The iPhone Software in its unpacked and encrypted state, grants the user no access be it functional or literal.

111. Id.
112. Id.
113. Id.
114. Id.
115. Id.
116. Id.
117. Id.
118. Id.
On the other hand, iPhone-based jailbreaks do not always circumvent access control measures that safeguard initial access prohibited by §§ 1201(a)(1) and 1201(a)(2). These jailbreaks can be used either before or after the user has essential functional access, and may qualify as a basis for all three § 1201 violations depending on whether or not the device has basic functionality at the time of the jailbreak.

The dominant form of jailbreaking in use today, firmware restore, also happens to form the strongest basis for § 1201 liability. As a result, jailbreaking is very likely to be actionable under § 1201. Jailbreaking liability, in comparison to *Lexmark* where the court withheld § 1201 protections for the PEP, turns on a very mechanical distinction that may not be fully applicable to computer software.

4. *Lexmark*’s Inapplicability to Computer Software Circumvention

Under *Lexmark*, § 1201 liability is based on the formalist principle that one cannot break into something that is already accessible by other means. By holding that literal access cannot be protected when functional access is “otherwise readily available,” the *Lexmark* court has essentially equalized the treatment of literal and functional access in the context of computer software circumvention.

In the case of most computer software, functional and literal access has radically different implications. Literal access to the computer code grants inside knowledge of the structure and methodologies used to construct a computer program, but has no usefulness to the average user, and vice-versa for functional access. By holding that they are the same, the Court of Appeals in *Lexmark* essentially created a de facto exemption for circumvention of access controls that secure otherwise readily-accessible copyrighted works in the computer software context. All computer software is designed for the purposes of execution and operation. This operation will almost always have a functional component whereby the program actually accomplishes some task. Access to the functional component is typically not restricted to allow use of such a program by the consumer. *Lexmark* legitimizes the circumvention of access controls to the literal code whenever such software restrictions are absent. Applying *Lexmark* to iPhone jailbreaking, § 1201 liability appears to turn on a formalistic distinction that is more affected by software design than wrongfulness of conduct.
5. The Interoperability Issue

The DMCA exempts acts of circumvention necessary to achieve software interoperability. The court in *Lexmark* addressed this issue and held that because the defendant copied Lexmark’s works and did not use an independently created device in the act of circumvention, the defendant was not entitled to this defense. Because the firmware restore method of jailbreaking does in fact copy and modify the iPhone software, it would likely not fall under this exception.

C. Chamberlain v. Skylink

Another key case in interpreting the application of § 1201 to aftermarket hardware goods is *Chamberlain Group, Inc. v. Skylink Technologies*, where a garage door opener (GDO) manufacturer brought a cause of action against the manufacturer of a universal remote for circumvention of wireless radio frequency code. Skylink Technologies manufactured a universal GDO remote that replicated the functionality of a GDO remote made by the Chamberlain Group. Skylink’s universal GDO remote could “learn” the unique software code used to control Chamberlain GDOs and retransmit it. Chamberlain filed suit under the § 1201(a)(2) of the DMCA, claiming that Skylink Technologies trafficked in universal remotes primarily designed “for the purpose of circumventing [Chamberlain’s code] that effectively controls access to [their copyrighted computer programs].” At trial, Chamberlain argued that Skylink violated § 1201(a)(2) for trafficking of circumvention technologies. Skylink countered with the assertion that § 1201 can only be violated when the act of circumvention takes place without the authorization of the copyright owner. Since it is Chamberlain’s own customers who are committing the act of circumvention, Skylink posited that its manufacturing of universal GDO remotes is not actionable under § 1201(a)(2), because the underlying act of circumvention is not illegal. The district court agreed and held that Chamberlain did not explicitly restrict

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121. *See supra note 53.*
122. 381 F.3d 1178 (Fed. Cir. 2004).
123. *Id* at 1183–84.
124. *Id.*
125. *Id.*
126. *Id.* at 1187.
128. *Id.* at 1033.
the consumer’s use of alternate GDO remotes and that this was deemed an unconditional sale that implicitly authorized customers to use other remotes. The court also noted that Chamberlain’s construction of the DMCA would force its own customers to violate § 1201.

1. Six-element Test for Jailbreaking under Chamberlain

On appeal, the Federal Circuit set out a new six-element test that a plaintiff must prove to prevail in a § 1201(a)(2) trafficking action:

(1) ownership of a valid copyright on a work, (2) effectively controlled by a technological measure, which has been circumvented, (3) that third parties can now access (4) without authorization, in a manner that (5) infringes or facilitates infringing a right protected by the Copyright Act, because of a product that (6) the defendant either (i) designed or produced primarily for circumvention; (ii) made available despite only limited commercial significance other than circumvention; or (iii) marketed for use in circumvention of the controlling technological measure.

The TPM in Chamberlain, much like that in Lexmark, secured access to a copyrighted work used primarily to control a mechanical device. In Lexmark, it was the basic functions of a printer, and in Chamberlain it was the opening of a garage door. Also similar to Lexmark, the Chamberlain TPM was itself a copyrighted work: the “rolling code” was both a TPM and a piece of copyrighted code for GDO communication. The court found that a homeowner’s access to this code had “no reasonable relationship” with Chamberlain’s rights under the Copyright Act. Key to this analysis was the court’s interpretation of the legislative history behind § 1201. The court found that Congress did not intend for the DMCA to rescind the basic bargain of granting the public noninfringing and fair uses of copyrighted materials, and that therefore § 1201 “prohibits only forms of access that bear a reasonable relationship to the protections that the Copyright Act otherwise affords its owners.” As a result, the court held that for a circumvention to be prohibited by the DMCA, it must facilitate infringement of a right protected under the Copyright Act.

129. Id.
130. Id.
131. Id. at 1203.
132. Id. at 1186.
133. Id. at 1204.
134. Id. at 1202.
135. Id. at 1204.
The court also found that the plaintiff’s claim lacked the “critical nexus between access and protection,” the fifth element in the court’s § 1201(a)(2) framework,136 and found no reasonable relationship “between the access that homeowners gain to Chamberlain’s copyrighted software when using Skylink’s Model 39 transmitter and the protections that the Copyright Act grants to Chamberlain.”137 The court also reasoned that the Copyright Act authorized Chamberlain’s customers to use the copy of Chamberlain’s software embedded in the GDOs that they purchased and were therefore immune from § 1201(a)(1) circumvention liability.138 The court held that without a violation of § 1201(a)(1), there cannot be 1201(a)(2) liability.139

2. Application of Chamberlain to the iPhone

Under Chamberlain’s central nexus test, we must first assess if the access gained from jailbreaking violates any of Apple’s rights under the Copyright Act. 17 U.S.C. § 501 states that anyone who violates a copyright owner’s exclusive rights is an infringer.140 Jailbreaking the iPhone Software using the firmware restore method comprises of four potential infringements of Apple’s exclusive right of reproduction per § 106(1).

The user first downloads the iPhone Software onto the user’s computer as authorized by Apple’s EULA.141 Next, the user executes a custom-written jailbreaking application that copies the iPhone Software onto the computer’s volatile RAM, the first unauthorized reproduction.142 In MAI Systems Corporation v. Peak Computer, the unauthorized loading of copyrighted material from a hard disk into RAM for manipulation by a computer’s central processing unit was found to be an infringement.143

The copy of the iPhone Software on the computer’s RAM is then decrypted, unpacked, modified, and repacked.144 The user is then prompted to specify a location on the computer’s hard drive to save the modified file.145 As the second act of infringement, the jailbreaking tool then copies the modified iPhone Software from the computer’s RAM to its hard drive.146 Next, the user launches Apple iTunes, which copies the modified iPhone

136. Id.
137. Id.
138. Id.
139. Id.
141. See supra note 20.
142. Id.
143. MAI Sys. Corp. v. Peak Computer, 991 F.2d 511, 518 (9th Cir. 1993).
144. See supra notes 52–55 and accompanying text.
145. Id.
146. Id.
Software to the computer’s RAM and unpacks it and loads it onto the iPhone.147 These are the third and fourth unauthorized copies. Given the unauthorized copying used in the firmware restore method, iPhone jailbreaking likely meets Chamberlain’s “central nexus” test for liability due to the direct link between the act of circumvention and violations of the copyright owner’s exclusive rights under 17 U.S.C. § 106.

Insofar as the issue of authorization, the iPhone Software is also distinguishable from Chamberlain in that Apple expressly prohibits jailbreaking through its clickwrap EULA,148 and goes to retain ownership of the iPhone Software through a limited license, foreclosing any defense based on implied authorization. Under Chamberlain, jailbreaking is likely to be illegal under the DMCA.

Chamberlain’s central nexus test does improve on the Lexmark approach for circumvention liability by linking § 1201 violations to essential rights of the copyright owner under § 106. It is, however, still subject to the constraints of a formalist distinction that turns on the technicality of whether a plaintiff can obtain rights under the Copyright Act. This formalistic analysis leaves § 1201 vulnerable to misuse by manufacturers who would employ copyright protections as a sword to reinforce their lock-in regimes, rather than a shield for the protection digital rights as envisioned by Congress.

D. LIBRARY OF CONGRESS EXEMPTION

Even under the current Library of Congress exemption for unlocking, jailbreaking’s legality is highly suspect. In 2006, the Library of Congress created an exemption from § 1201 liability for “[c]omputer programs in the form of firmware that enable wireless telephone handsets to connect to a wireless telephone communication network, when circumvention is accomplished for the sole purpose of lawfully connecting to a wireless telephone communication network.”149 This is essentially a de facto exemption to § 1201 liability for unlocking mobile phones. Under the theory that jailbreaking is required for unlocking, the EFF and iPhone modification enthusiasts have claimed that jailbreaking is legal.150

However, the exemption does not expressly address the act of jailbreaking. More importantly, current unlocking methods are not designed for the “sole purpose” of wireless provider interoperability. In many iPhone

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147. Id.
148. See iPhone End-User License Agreement, supra note 20.
149. Exemptions from Prohibition on Circumvention of Technological Measures that Control Access to Copyrighted Works, 71 FED. REG. 64639 (Nov. 3, 2006).
150. Comment of the Electronic Frontier Foundation, supra note 29.
modification tools, unlocking is one of many features of a program designed chiefly for jailbreaking. In configuring how you jailbreak your phone, you can even choose not to unlock it. Some jailbreaking tools do not have unlocking features. While it is technically possible for firmware restore to be used in a manner that strictly complies with the exemption, this is simply not the way the tools have been designed. Even assuming that unlocking necessitated jailbreaking, current unlocking solutions are not implemented in a way that fits within the language of the exemption. As a result, the 2006 unlocking exemption likely does not cover jailbreaking, and until it gets its own exemption, jailbreaking is likely illegal under the DMCA.

V. A FUNCTIONALIST SOLUTION: THE LEXMARK CONCURRENCE

In *Lexmark* and *Chamberlain*, the courts employed a formalist analysis of the text and legislative intent of the DMCA. The central problem in both cases, and in any potential action involving iPhone jailbreaking, is that § 1201’s applicability to TPMs that restrict access to hardware is an issue with wide-ranging implications that Congress did not address. Lacking legislative direction, courts face the difficult task of applying and enforcing § 1201 as written without extending the reach of the DMCA further than Congress intended.

In *Lexmark*, Judge Merritt concurred with the majority opinion but offered a different perspective on the problem of determining whether the DMCA should help reinforce software-based hardware lock-ins. Judge Merritt opined that the DMCA cannot be used “in conjunction with copyright law to create monopolies of manufactured goods for themselves just by tweaking the facts of this case.” The concurring opinion emphasized looking to the purpose of the circumvention technology to decide whether or not its aim is to gain access to copyrighted works.

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151. See iSmashPhone.com, http://www.ismashphone.com/2008/07/pwnage-tool-20.html (Jul. 20, 2008 00:40 PST) (demonstrating how to jailbreak your iPhone without unlocking it by not checking the Pwnage tool’s “unlock baseband” box).
152. See, e.g., HackThatiPhone.com, http://www.hackthatiphone.com/3x/p_3_1_2_3gs.html (showcasing the “unlock” feature as one of many available for use with the Pwnage tool, the most widely used firmware restore jailbreak).
154. Id. at 551.
155. See id.
1. Problems with the Formalist Approach in the Case of the Apple iPhone

Although iPhone jailbreaking is likely illegal under *Lexmark* and *Chamberlain*’s formalist approach, the clear intent of the iPhone Software’s TPMs is to protect the iPhone itself from tampering. The iPhone Software conducts authenticity checks at every stage of the handset’s operation to ensure that the hardware is not used in any way not authorized by Apple. 156 Aftermarket iPhone accessory manufacturers also have to obtain authorization from Apple or run the risk that the next firmware update will render the unauthorized devices incompatible. 157

Apple has claimed that TPMs are present to ensure the safety of users and wireless networks from viruses and other security problems. 158 While the extent to which iPhone TPMs are necessary is a subject of great debate, it is clear from the design of the iPhone Software’s TPMs that Apple made a conscious decision to restrict the hardware in a way that monopolizes its control of the device’s aftermarket usage. 159 Under Judge Merritt’s functionalist analysis, iPhone jailbreaking is likely not actionable under § 1201.

If courts are to avoid aiding manufacturers in reinforcing aftermarket control of hardware devices and extending the reach of the DMCA, the formalist approach used in *Lexmark* and *Chamberlain* may prove untenable. Both the literal/functional distinction and the “central nexus” tests used in *Lexmark* and *Chamberlain* turn on idiosyncrasies of software design and jailbreaking approach while obscuring the TPM’s actual purpose or effects. This is problematic because the literal design of computer code cannot always be strictly correlated with the functional intent of its designer. In fact, the extent to which it can be correlated is often entirely up to the programmer. Ultimately, software designers can decide to code their programs in whatever way they choose. Thus, they may use any programming rationale to justify constructing a TPM that qualifies for protection under a formalist reading of § 1201 protections.

2. Anti-circumvention Abuse

Commentators have opined that an uninhibited anti-circumvention right has the potential to lead to anticompetitive economic behavior. 160 Apple’s

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156. *See supra* notes 39–50 and accompanying text.
159. *See supra* Part II.
160. *See* Burk, supra note 8, at 1133.
usage of the DMCA to protect its lock-in regimes has drawn similar criticisms. 161 Some commentators have also argued that the DMCA’s anti-circumvention right legitimizes a form of technological vigilantism that uses copyright law as a self-help measure to defend its TPMs from reverse engineering. 162 Congress focused on the threat of massive piracy when it composed § 1201 under the DMCA, and therefore this consideration should inform the availability of § 1201 protection. The formalist approach overlooks the protection of digital works as the central rationale behind the DMCA, leaving room for a myriad of unintended applications. In fact, some have argued that many § 1201 cases to date have not been motivated by a fear of piracy but rather a desire to suppress competitive products. 163 Lexmark, Chamberlain and other aftermarket hardware § 1201 cases support this contention. 164

As Congress acknowledged during its DMCA discussions, the digital age has given rise to a new generation of progressively more sophisticated and effective copyright pirates. While some applications of § 1201 have indeed targeted piracy or the threat of piracy through trafficking, there are many other instances where § 1201 is used to forcibly modify consumer behavior and practices. To meet the growing threat of piracy, copyright owners and content owners developed increasingly sophisticated TPMs. 165 Not all of these TPMs, however, are directly aimed at preventing piracy. For example, the manifest intent behind DVD region coding, which prevents DVDs purchased in one market from being used in another market, is not piracy prevention but controlling prices and coordinating release dates. 166 Facilitating price discrimination and localization optimizes market control for the global release of DVD content. 167 These mechanisms, while serving to maximize the efficiency and profits for major movie studios, impose a cost on consumers who are prevented from using the content across borders. 168

163. See Burk, supra note 9, at 1135–36.
165. See Burk, supra note 9 at 1101–02.
168. Id.
Region coding is in effect a vendor-imposed restriction on consumer behavior; artificially creating a form of market regionalism through technology that cannot be enforced through law.  

Technological constraints programmed into an operating system (such as the iPhone Software) provide a self-enforcing substitute for legal ones. For content owners, the choice between legal and technological protections is increasingly evident. Legal protections through contract or licensing may initially be inexpensive, but are ultimately ineffective due to the high cost of bringing suit, both in terms of legal fees and the public relations fallout. Technological protections, on the other hand, may initially be expensive to incorporate and often met with consumer resistance, but are ultimately more effective as consumers become accustomed to them and acquiesce. The introduction of DVD region coding in the early 1990s illustrates this principle. After the DMCA’s enactment in 1998, copyright owners and content providers promptly brought suits to reinforce their TPM-backed consumer restrictions.

When a vendor’s artificially created restrictions are paired with an anti-circumvention right, content providers gain the ability to legally enforce any technologically supported restriction on consumer behavior—an unwarranted expansion of the DMCA far outside the scope of its drafters’ intent. More importantly, this use of the anti-circumvention right erodes consumer choice and is acutely anticompetitive.

Similarly, in the case of the iPhone, Apple depends primarily on the iPhone Software TPMs to maintain and protect its App Store lock-in regime, which would be impractical and ineffective if enforced by law. Unlike the AT&T-Apple contractual lock-in, the Apple App Store lock-in binds the consumer to purchasing apps from Apple by technologically blocking the consumer’s ability to use the handset with any other app store platform. By itself, this characteristic could be considered the vendor’s prerogative, but
when combined with the threats of § 1201 legal action, it is an unjustified abuse of the DMCA’s anti-circumvention provisions.173

3. Anticompetitive Effects of the iPhone’s Built-In Applications

iPhone TPMs also lock users into the iPhone’s built-in applications (BIA), including streaming video, weather, maps and finance.174 With one exception, users not content with Apple’s BIAs can get the same information supplied by BIAs through Safari, the iPhone’s Internet browser, albeit at a significant time cost.175 Users who want to look up the weather or stock quotes on Safari may sometimes have to wait up to a few minutes or more for information that can be obtained in a fraction of the time through the BIAs.176 This effectively acts as a “soft” lock-in, imposing a high cost on users who choose not to use Apple’s BIAs. Moreover, the iPhone Safari web browser cannot play most streaming videos due to its lack of support for the Adobe Flash protocol.177 In terms of streaming video playback, users have no alternative but to use Apple’s YouTube BIA, restricting them to both the BIA and a service provider designated by Apple.178

iPhone TPMs and the App Store’s own submission process naturally protect iPhone BIAs against competition.179 iPhone TPMs prevent users from loading custom applications and Apple automatically rejects application submissions it finds duplicative of current and planned features of its BIAs or of the iPhone Software.180 By monopolizing control of these functionalities on the iPhone, Apple has effectively foreclosed all legitimate opportunities for market competition of these services. Perhaps more troubling is that manufacturers are using this incumbent advantage to shape the users’ interactions with the Internet, potentially creating antitrust concerns similar to those raised by the merger of the Windows operating system and Internet Explorer.181

Given this potential for abuse, courts should narrow the applicability of § 1201 protections in cases involving aftermarket products and services. This

173. See Burk, supra note 9, at 1132–1136.
174. See supra, note 19.
178. Id.
179. See supra note 31 and accompanying text.
180. Id.
would reflect the intent of the DMCA’s drafters, who were chiefly concerned with the impact of digital piracy on the market for original works.

4. The Scope of Section 1201 Anti-Circumvention Should be Narrowed

To date, numerous commentators have written about § 1201’s overreach and many have suggested limiting its scope through legislative reform and judicial discretion. 182 Professor Pamela Samuelson has opined that § 1201 prohibitions “are not predictable, minimalist, consistent, or simple . . . [and] unless the anti-device provisions of the DMCA are modified, either by narrow judicial interpretation or by legislative amendments, they are likely to have harmful effects on competition and innovation in the high technology sector.” 183

To address this problem, this Note proposes a two-part test that requires § 1201 claims to meet the Chamberlain central nexus standard and establish a clear causal chain from infringement to market harm. Additionally, courts should focus on the practical effect of the technological measure on consumer choice and competition.

Central to this analysis is a close examination of the original works at issue and the potential for market harm. Per Chamberlain, courts should look for a critical nexus between access and protection to determine if the act of circumvention is being used to access actual copyrighted works rather than some auxiliary service or good. Next, courts should examine the exact nature of market harm. In the case of aftermarket goods and services, it is important to assess whether the act of circumvention does in fact violate the copyright owner’s rights, creating market harm for the copyrighted work. In order to receive § 1201 protection, plaintiffs must prove that the circumvention of access controls is at least the proximate cause of the market harm to their copyrighted works. This causal chain from circumvention to market harm is necessary to prevent § 1201 protections from being used to reinforce the lock-ins of services or goods that are not protectable under copyright law.

183. Samuelson, supra note 61, at 557.
Additionally, in close cases, courts should also look at another factor: the degree to which the original work constrains consumer choice and competition. This will serve as a general-purpose exemption to allow judges to weigh external and market factors in choosing to apply § 1201 protections. In instances where the copyright owners can demonstrate little or no market harm, but are not attempting to control consumer or market behavior, judges may use this additional factor to grant § 1201 protection. Similarly, in cases where the copyright owner can prove market harm, but is using the copyrighted work as gatekeeper to a product or service lock-in regime, judges can choose to withhold § 1201 protection.

This two-step approach prevents vendors and manufacturers from hijacking the DMCA to reinforce their platform lock-ins and limits § 1201 protection to scenarios originally envisioned by Congress. Most importantly, it levels the legal playing field for consumers and new market entrants. Consumer choice is maximized, allowing the end-user to decide whether to incur the cost of breaching contractual lock-ins without the fear of DMCA liability. Taking away legal protection for vendor lock-in regimes also lowers the barrier to entry for new entrants.

All of this comes at a cost to incumbent manufacturer and vendors, who would have to contend with market challengers and competitors on a strictly technological basis. In the event that a vendor chooses to maintain its lock-in regimes, a narrowed application of § 1201 protections may force them to incur additional costs in securing their systems. In the event that market or platform incumbents choose to cooperate with challengers, they must incur the cost of facilitating interoperability to protect the integrity of their existing architecture.

In its current functionality, iPhone jailbreaking is not aimed at replacing or diminishing demand for the iPhone Software in any way. In fact, by opening up its functionality, jailbreaking may potentially make the iPhone more popular and stimulate demand for the iPhone and the iPhone Software. There is also a limited or nonexistent market for the actual copyrighted work being accessed, the iPhone Software, which also happens to be the keystone in Apple’s App Store lock-in regime. Under a narrowed application of § 1201, jailbreaking would not be illegal.

VI. CONCLUSION

For the majority of users, the legality of iPhone jailbreaking will make little or no difference in the purchase and use of iPhone handsets. Apple, by leveraging the power of its incumbency, has attempted to keep widespread
jailbreaking and unlocking at bay by threatening to void the warranties of modified phones. 184 For the most part, Apple’s feature-rich App Store and iPhone Software updates have discouraged iPhone modification. Jailbreaking and unlocking both require a basic level of technical expertise and daring. These are obstacles that average users, who are content with the features on their devices, are not incentivized to take on.

However, the Apple iPhone does represent a new class of personal electronics in which the device manufacturer retains control of the only legitimate conduit for new content. Never before has a hardware manufacturer been able to exert so much control over the aftermarket usage of its products. On the iPhone, the iPod and upcoming iPad devices, this control extends to nearly every aspect of the device’s features, allowing for little deviation from Apple’s prescribed uses. When paired with threats of § 1201 liability, this results in a highly controlled and anticompetitive environment.

Congress never conceived of such a scenario while formulating the DMCA’s anti-circumvention provisions, which it crafted to encourage the expansion of freely available digital content on the Internet. Until the legislature addresses the issue, § 1201 protections should be narrowed to ensure they are applied to cases similar to those originally envisioned by Congress and not exploited to the detriment of consumer choice and competition.

In March of 2007, Congress published updated compulsory royalty rates for webcasters\(^1\) wishing to license rights in sound recordings under the Digital Performance Right in Sound Recordings Act of 1995 (DPRA) and the Digital Millennium Copyright Act (DMCA).\(^2\) Working under its authority as created by the DPRA, the Copyright Royalty Board established per-performance rates through 2010 that radio industry commentators claimed would “wipe out an entire class of business,” that of small independent internet radio stations.\(^3\) Early analysis indicated that larger commercial webcasters, such as industry-darling Pandora, would also be unable to sustain profitability.\(^4\)

Two July 2009 announcements drastically altered what had been a bleak landscape for internet radio since March of 2007. In the same month that the D.C. Circuit affirmed the Copyright Royalty Board’s ratesetting decision, the Copyright Office announced that SoundExchange, its selected clearinghouse for administering digital sound recording rights, had reached a negotiated agreement with a collection of large and small commercial webcasters on an

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\(^1\)Webcasting consists of digital delivery of real-time content using “streams” of audio data, which are buffered on the listener’s computer and deleted following playback. In its most common form, webcasting is analogous to AM/FM radio broadcasts—the user selects a channel and content is streamed continuously.


\(^4\)See id.
alternative set of royalty rates and payment structures through 2015. Some feel that these two developments saved internet radio. To better evaluate the successes and challenges met by the DPRA/DMCA thus far, it can be helpful to look to entitlement theory. Entitlement theorists, relying on a law and economics theory pioneered by Professor Guido Calabresi and A. Douglas Melamed, classify entitlements as being protected under one of two rules: property rules or liability rules. If an entitlement is protected under a property rule it is an “absolute permission rule” and cannot be used by others without the permission of the owner. Liability rules, in contrast, allow the user of the entitlement to compensate the owner at a later date, often at a value determined by courts. The compulsory license used to protect many intellectual property rights, including the digital performance right for webcasters, exemplifies the liability rule—courts or legislatures determine an amount owed to an entitlement owner ex-post.

Entitlement theorists have, over the past few decades, endeavored to describe the consequences of creating property-rule and liability-rule entitlements in the context of efficient exchange of resources between holders and users of such entitlements. Focusing on various forms of transaction costs associated with these exchanges, debate continues over whether one entitlement form or another is superior or, more subtly, in what situations policymakers may do better to prescribe one rule over another. Two points of view in this debate are particularly useful to understanding the DPRA’s compulsory license in these terms. In Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade, Professors Ian Ayres and Eric Talley (hereinafter Ayres & Talley) explore the value of liability rule


8. The government’s eminent domain power to take property so long as it pays just compensation is an example of a liability rule. See id. at 1092.

9. See generally R.H. Coase, The Problem of Social Cost, 3 J.L. & ECON. 1(1960). Coase argued that, when transaction costs equal zero, initial property grants do not matter, because parties will bargain with each other to achieve a distribution of property that maximizes value to all parties. As transaction costs come into play, however, initial entitlements become important to allocative efficiency.
entitlements, such as the compulsory license, in facilitating bargaining by forcing parties to the entitlement to exchange information about their relative valuation. In *Contracting into Liability Rules: Intellectual Property Rights and Collective Rights Organizations*, Professor Robert Merges outlines several issues associated with the use of liability rules in intellectual property entitlements and analyzes the birth of collective rights organizations (CROs) such as ASCAP out of the creation of property rule entitlements.

This Note evaluates the structure and history of the digital performance right in the context of non-interactive webcasting—a liability rule entitlement with some property rule-like features—and tests it against the theories of both articles, exploring the information-forcing attributes described by each through the empirical lens of fifteen years of webcasting regulation. Ultimately, it appears from this brief history that the theories each set forth have been borne out to some extent: certain features of the DPRA structure have served to increase information exchange between rights holders and rights users, while other features have limited that exchange and stifled Coasean bargaining, demonstrating that there are some significant issues for policymakers to consider when prescribing liability rules for intellectual property rights (IPRs).

Part I summarizes the theories of Ayres & Talley and Merges, with a focus on implications for IPRs. Part II provides a history of the creation of the digital performance right as it relates to webcasters, from the Digital Performance Right in Sound Recordings Act of 1995 to the Digital Millennium Copyright Act of 1998, recent royalty rate determinations for webcasters under the DPRA and DMCA, and the challenges of arbitration under the willing buyer/willing seller standard of review. Part III evaluates the history of the webcasting proceedings in the context of the theories described in Part I and discusses the specific impact of the webcasting compulsory license on information exchange and efficient bargaining between interested parties.

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12. To be classified as a non-interactive webcaster, a webcaster must meet several criteria outlined in the DPRA/DMCA, the most important of which is that users must not be able to select upcoming songs to stream. See *infra* Section II.A.1.
I. ENTITLEMENT THEORIES AND THE DIGITAL PERFORMANCE RIGHT IN SOUND RECORDINGS

Ayres & Talley present a number of ways in which divided entitlements, such as those created by liability rules, reduce transaction costs towards Coasean bargaining, and also describe several types of transaction costs that may be exacerbated by liability rules. Merges extends this thread, further analyzing efficiency gains and losses for liability and property rules in the IPR context. These articles indicate that neither liability rules nor property rules have a categorically superior effect on efficiency, and proper ex ante allocation critically relies on a refined sense of the specific entitlement and relevant parties to an exchange.

A. AYRES AND TALLEY: SOLOMONIC BARGAINING AND INFORMATION COSTS

Ayres & Talley’s 1995 article is a response to the conventional wisdom at the time that property rules produced more efficient allocative results than liability rules by promoting bargaining. It was argued that property rules were “market-encouraging” and liability rules were “market-mimicking.” Their view of liability rule entitlements focuses on the fact that such entitlements create a form of divided ownership: the property owner is free to use the property, but other interested parties have a form of call option, allowing them to use the property and pay compensation. “Endowing each bargainer with a share of the underlying entitlement creates the possibility of two different types of Coasean trade: A bargainer might buy the other party’s claim, or, alternatively, she might sell her own.”

The type of offer the parties make to each other in this circumstance—an owner’s offer to pay a potential user not to exercise her call option and pay compensation, for example—serves as an indicator of value not present in a property rule structure, and can induce more bargaining and thus more efficient allocation versus property rule entitlements. Additionally, in the shadow of a liability rule, representations of value by parties are more credible, improving the efficiency of bargaining when compared to property rule allocations. However, Ayres & Talley do point out circumstances in

14. See Merges, supra note 11.
15. See Ayres & Talley, supra note 10, at 1032.
16. Id. at 1030.
17. Id. at 1041–43.
18. Id. at 1039.
which non-information-based transaction costs can be exacerbated by liability rules, and note the potential negative effect “tailoring” liability rule valuations can have on bargaining in this context.19

1. Liability Rules’ Information-Inducing Effects on Bargaining

Ayres & Talley describe a three-stage game that makes up bargaining under a liability rule, and the results of this game exemplify the information effects absent in a typical two-stage property rule bargain.20 A typical property rule bargain involves two steps: (1) the interested party makes an offer, and (2) the owner accepts or rejects the offer. Other discussions may surround those two points, but they suffer from the classic challenge of adverse possession as the owner is incentivized to represent its valuation as high as possible, and the buyer to represent its valuation as low as possible.21

A divided, liability rule allocation adds an initial step to this game. In the three-stage game, the owner first offers to sell her claim to the property or offers to buy the interested user’s call option under the liability rule.22 The effect of this initial step is to separate the owners into two categories: high valuing and low valuing entitlement holders and to set boundaries on the resulting offers via the liability rule damages amount.23 “This self-selection ... can increase the likelihood of an efficient transaction, because it effectively gives the parties less ‘room’ to misrepresent their private valuations in bargaining.”24 Ayres & Talley demonstrate via a rigorous game theoretical model that the constraints created by this three-stage game will induce more parties to trade than under a property rule game and increase the joint payoffs to buyers and sellers.25 By credibly representing their preferences to potential users, owners deal in the second stage with users who are open to trade at relative valuations closer to Coasean equilibrium.26

2. Tailoring, Impediments to Efficient Information Exchange, and Potential Consequences

Ayres & Talley make an important qualification regarding the effects of bargaining in the shadow of liability rules, noting that the act of tailoring

19. Id. at 1035–36.
20. Id. at 1049.
21. Id. at 1042.
22. Id. at 1049–50.
23. Id. at 1055.
24. Id.
25. Id. at 1058–61.
26. Id. at 1044.
liability rule damages to closely reflect the owner’s valuation, though initially appealing, can actually damage the information-inducing effects of the liability rule structure. If the damages amount of a liability rule perfectly compensates the owner (“plaintiff” in a potential suit), she is no longer incentivized to represent an interest in bribing the option-holder not to take the property. The game returns to two stages and nonconsensual takings (exercise of options by “defendant”) increase, eliminating the information efficiencies and resultant bargaining. This result is particularly significant in the context of compulsory licenses such as the digital performance right, where Congress has put in place proceedings to determine accurately the adequate royalty rate to compensate copyright holders—a perfect example of tailoring damages that makes up the bulk of the discussion below.

Additionally, Ayres & Talley note that “structural impediments to pre-taking negotiations might be so great that the facilitating effects of liability rules . . . are not sufficient to induce any bargaining.” Large, amorphous bodies of potential buyers or sellers can make such divided bargaining impossible. Furthermore, if lawmakers misidentify the most efficient owners and users of a given entitlement, a divided entitlement can induce collective-action inefficiency. Inefficient owners may be incentivized only to sell their property and will therefore not credibly represent their interests, as exemplified by the hold-out problems inherent in purchasing adjoining plots of land to build a large development. Furthermore, the model created by Ayres & Talley assumes valuations are uncorrelated. Where one party’s representation of valuation can affect that of another party, liability rules may further disincentivize a potential buyer to state credibly her interest, and “thus reduce the potential benefit of Solomonic bargaining.”

One of the major consequences of divided entitlements is the potential to induce underinvestment. If an initial owner of a divided entitlement is unsure whether she will achieve full value for her investment, or will instead

27. Id. at 1066.
28. Id. at 1067.
29. Id. at 1068.
30. Digital Performance Right in Sound Recordings and Ephemeral Recordings, 72 Fed. Reg. 24,084 (May 1, 2007) (codified at 37 C.F.R. pt. 380) at 24084; see also infra Section III.A.
31. Ayers & Talley, supra note 10, at 1083.
32. Id.
33. Id. at 1086. In this example, a single property owner’s land is not relatively more valuable than another’s, but she is incentivized to wait until she is the last owner to sell, at which point the value of the entire development rests on her sale.
34. Id. at 1089.
have the item taken nonconsensually, there may not be sufficient incentive to develop the property.\(^{35}\) This is a significant concern for lawmakers in the context of intellectual property entitlements, where the goal is balancing incentive to create with public access to technological and creative advances.\(^{36}\)

**B. Merges: Superiority of Property Rules When Allocating Intellectual Property Rights**

In his article, Merges argues for the superiority of property rule entitlements in situations where rights holders encounter each other frequently, such as in IPRs.\(^ {37}\) In so doing, he addresses Ayres & Talley and points to a number of efficiency issues endemic to using liability rule entitlements to protect rights holders in new media.\(^ {38}\) In Merges’s IPR-specific theory, liability rule entitlements such as compulsory licenses authorize “rights holders” to receive compensation from “infringers” who wish to use the IPR.\(^ {39}\) Merges discusses two historical examples of property rule IPRs that resulted in the formation of private CROs—ASCAP for musical works and patent pools for related patents—and concludes that strong property rule protection of IPRs, coupled with encouragement of fledgling CROs, can yield a form of collective liability rule protection that offers the same free access for potential infringers as congressional liability rules but better approximates the proper valuation for these rights.\(^ {40}\)

1. Efficiency Concerns with Liability Rules and IPRs

Merges identifies several issues with liability rules that seem to produce suboptimal results in the context of IPRs when compared to property rules. He cites historical evidence based on IPRs such as the long-standing mechanical royalty and song “covers”.\(^ {41}\) First, the positive information effect proposed by Ayres & Talley falls apart in the IPR context due to the potential for “phantom infringers” to discredit claims by entitlement holders.\(^ {42}\) Also, although liability rules may limit transaction costs in the

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35. *Id.* at 1083.
37. See Merges, *supra* note 11, at 1297.
38. *Id.* at 1300 (“I argue that the conclusion of some scholars that liability rules best facilitate transactions and bargains is inapplicable in the IPR context . . . .”).
39. See generally *id*.
40. *Id.* at 1391.
41. *Id.* at 1308–09.
42. *Id.* at 1305–06.
traditional entitlement context, valuation problems with IPRs require internalization of significantly higher litigation risk as well as the volume of expert analysis required to effectively educate courts in rapidly changing markets.43

Merges’s argument regarding the potential for “phantom infringers” to disrupt the information-producing results of liability rules is an echo of Ayres & Talley’s concern that a high-valuing seller will not wish to bribe all parties with a call option to infringe. Because taking can occur infinitely in the IPR context, liability rule entitlements can spawn phantom infringers. Phantom infringers are parties who will, upon discovering that a rights holder is willing to buy call options from potential infringers under the Ayres & Talley model, represent a false high valuation in order to receive a payout without a credible interest in using the property.44 Phantom infringers prevent the rights holder from credibly signaling an intent to bribe the potential infringer not to infringe.45 The positive effects of liability rules to provide a valuation signal in pre-taking bargaining is therefore defeated in the IPR context.

Because a proliferation of phantom infringers prevents a rights holder from representing a valuation higher than the liability rule damage award (or compulsory royalty), it creates a ceiling on valuation, from which parties can only negotiate downward, and this presents significant incentive issues for creators.46 The valuation ceiling created by this bargaining inefficiency ties into two other concerns expressed by Ayres & Talley: the potential of liability rules to encourage underinvestment and the problems created by tailoring. The valuation ceiling is particularly challenging in the world of copyright and music, where overlapping rights and responses to new technologies (such as webcasting) make it difficult to determine the effects of valuation on creators’ incentives. Pricing an IPR liability too low defeats a key copyright goal (encouraging creation47), but pricing too high may have the practical impact of destroying distribution models before their benefit to creators and the public can be fully realized. Additionally, phantom infringers have a similar impact as tailoring damage awards on Coasean bargaining, eliminating the incentive of a rights holder to represent higher valuation. The phantom infringer problem is even more significant, though, because it occurs independent of whether the damage award accurately reflects the rights

43. Id. at 1317–18.
44. Id. at 1305–06.
45. Id.
46. Id.
47. Keller & Cunard, supra note 36, at § 1:2.1.
holder’s ideal valuation. As nonconsensual taking increases under a liability rule entitlement that suffers from the problem of phantom infringers, the accuracy of Congress’s or the court’s damage award becomes increasingly critical to compensate properly creators or rights holders for their creations.

Compulsory licenses in the context of IPRs and developing technologies suffer from at least two transaction costs not typically associated with property rule entitlements of the same rights. First, high administrative costs are associated with arbitration to determine future compulsory royalty rates. 48 “[O]ne component of this cost,” Merges states, “would be the expenditures made to influence the judge’s valuation decision.” 49 Beyond rate-setting administrative decisions, there is a high potential for litigation because IPRs are notoriously difficult to value. 50 As will be discussed below, the administrative costs of compulsory licensing in webcasting have substantially borne out these concerns.

2. Private Collective Rights Organizations and Market-tuned Liability Rules

In response to these IPR-endemic transaction costs, Merges argues that property rule entitlements can outperform liability rule entitlements when parties engage in a high volume of repeat transactions, doing so through the creation of private CROs. 51 He examines two such institutions—ASCAP for copyrighted musical works and patent pools for related patents—that formed organically out of property rule protections. 52 In Merges’s view, CROs create a form of liability rule by contracting with potential infringers. By pooling content and negotiating various “one-size-fits-all” agreements with potential infringers, CROs form a compulsory license of sorts: terms will not necessarily mirror individual negotiation by rights holders and are available to all who wish to deal with the CRO, but they will more closely approximate equilibrium value than legislative or judicial liability rules through repeated negotiation and contracting. 53

48. Merges, supra note 11, at 1317.
49. Id.
50. Id. The intangible nature of the rights, combined with uncertainty around the media in which they will be exploited in the future, leads to difficulty in assigning consistent value. For example, a copyright in a musical composition can vary widely in value depending on the popularity of the original artist, current uses of the song, and potential future revenue streams from music sales or performances.
51. Id. at 1325–1327.
52. Id. at 1328.
53. Id.
Private CROs reduce enforcement and administrative transaction costs for individual rights holders, and therefore address many of the concerns with liability rules presented by both articles.\textsuperscript{54} To this end, Merges concludes that policymakers should consider strong property rule protections for IPRs in conjunction with efforts to encourage the formation of CROs.\textsuperscript{55} These “intermediate forms of collective valuation” are critical to new markets and multimedia, as overlapping licenses become increasingly necessary and the rate of repeat interactions increases.\textsuperscript{56}

II. BACKGROUND AND HISTORY OF THE DIGITAL PERFORMANCE RIGHT IN SOUND RECORDINGS

Since its creation under the Digital Performance Right in Sound Recordings Act (DPRA), the digital performance right in sound recordings has been embroiled in confusion and controversy as the recording industry, broadcasting industry, and digital community struggle for ground amid the tremors of rapidly changing technologies and markets.

A. THE DPRA/DMCA AND THE DIGITAL PERFORMANCE RIGHT

A response to the emergence of new music consumption technologies and concerns by artists and other copyright holders regarding monetization of these technologies, the DPRA created categories of digital copyright users and established a range of rules under which licenses to digital performance rights would be granted.\textsuperscript{57} These categories were immediately challenged as failing specifically to include traditional webcasting, and were ultimately clarified by the DMCA.\textsuperscript{58}

1. Categories of Copyright User Under the DPRA and DMCA

Four subcategories of digital audio broadcaster arose out of the DPRA and DMCA. An “interactive service” such as Rhapsody, to which users subscribe and through which they are able to select individual songs for immediate streaming, is subject to the rights created by the DPRA in the form of a typical property rule and requires permission from the copyright holder for use. “Non-subscription broadcast transmissions,” which occur when terrestrial radio broadcasters stream their broadcasts over the Internet,

\textsuperscript{54} See id. at 1325–27.
\textsuperscript{55} Id. at 1391.
\textsuperscript{56} Id. at 1392.
\textsuperscript{57} H.R. REP. NO. 104-274, 10 (1995).
\textsuperscript{58} 17 U.S.C. § 114(d) (2006).
were initially exempt from the DPRA, but were eventually determined by the Copyright Office to fall within it. 59 “Non-interactive online-only transmissions,” which encompass traditional webcasting, are subject to a compulsory royalty as determined by the Copyright Office, and is protected by the hybrid property/liability rule that is the subject of the bulk of this Note. 60 In order to qualify for this license, broadcasters must meet strict requirements, including restrictions on the number of songs by one artist that can be played in a three-hour period and that no advance notice be given as to what song will be played. 61 Finally, online-only transmissions that do not meet the strict requirements above, such as those that only play the music of a single artist, are required to obtain licenses directly from copyright owners. 62

2. The Compulsory Royalty for Webcasters

The DPRA authorized the Librarian of Congress to convene a Copyright Arbitration Royalty Panel (CARP) composed of three professional arbitrators to recommend royalty rates and terms for the imposition of the compulsory royalty in digital performance rights for webcasters. 63 This task was taken over by the Copyright Royalty Board (CRB), a set of three full-time judges that sit on issues of compulsory royalties in copyright, under the Copyright Royalty and Distribution Act of 2004. 64 Statutory royalty rates are to be set by the conduct of adversarial proceedings, with participants to include broadcasters, copyright holders, or the copyright holders’ designated common agent for the administration of the statutory royalty (in this case, SoundExchange, described below). 65 The Copyright Office publishes notice of intent to commence proceedings to determine the statutory royalty rate for a given period of \( x \) years, and parties have six months to submit negotiated terms of their own before the panel convenes. 66

60. See Digital Millennium Copyright Act, 17 U.S.C. § 114. It was not clear to industry participants whether the DPRA intended to include webcasters in this category. As such, Congress specifically included webcasters under the DMCA.
61. Keesan, supra note 59, at 360.
62. Id.
65. 17 U.S.C. § 114(e)–(f).
In making its decisions in these proceedings, the CRB is expected to consider several criteria under 17 U.S.C. § 114(f)(2)(B), the most important of these being the willing buyer/willing seller standard. Under that standard, the Copyright Royalty Judges “shall establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.”

The Copyright Office convened one CARP in 2001–2002 (Webcasting I) and the first CRB in 2006–2007 (Webcasting II). Both went through extensive appeals and were ultimately superseded by the Small Webcaster Settlement Act of 2002, and the Webcaster Settlement Acts of 2008 and 2009. They are discussed further below.

3. SoundExchange as Royalty Clearinghouse

SoundExchange was established in 2000 by the Recording Industry Association of America (RIAA) to administer and distribute the royalties under the compulsory license of the DPRA and DMCA. The RIAA is an industry group comprised of music labels owning approximately 90 percent of the relevant sound recordings covered by the digital performance right. The Copyright Office acknowledged this agency function in Webcasting I. Following Webcasting I, in 2003, SoundExchange was spun off from the RIAA into an independent, non-profit organization, with a board comprised

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68. Id.
71. See infra Section II.B.
of RIAA members and performer or creator representatives.\textsuperscript{74} \textit{Webcasting II} upheld the Copyright Royalty Board’s decision to appoint SoundExchange as the sole agent for administering the compulsory royalty, against challenges by Royalty Logic, a competing, for-profit organization.\textsuperscript{75}

B. \textit{WEBCASTING I AND THE SMALL WEBCASTER SETTLEMENT ACT OF 2002}

The first proceedings under the DPRA and DMCA began on November 27, 1998, with the initiation of voluntary negotiations for the first royalty period from 1998–2000.\textsuperscript{76} When this schedule proved unworkable for the parties, the Copyright Office consolidated the 1998–2000 rate determination with the 2001–02 determination and hearings began July 30, 2001.\textsuperscript{77} Parties included companies and organizations representing both webcasters and copyright holders, although small webcasters were noticeably absent from the proceedings.\textsuperscript{78}

1. \textit{CARP and Library of Congress Determinations}

One of the primary points of contention between webcasters and copyright holders, represented by the RIAA, dealt with the collection of royalties on a percentage of revenue versus a per-performance rate. The RIAA argued for per-performance rates as the closest proxy for actual usage and value in the right, while the Digital Media Association (DiMA) proposed an option between a per-performance royalty and a per aggregate tuning hour (ATH) royalty.\textsuperscript{79} What small webcasters remained insisted on a percentage of gross revenue model for calculating royalties.\textsuperscript{80}

\textsuperscript{74} \emph{Id.} One may speculate that this was in response to concerns of anti-competitive conduct by the RIAA via SoundExchange, as alleged in \textit{Webcaster Alliance, Inc. v. RIAA}, No. C 03-3948 WHA, 2004 WL 1465722, *2 (N.D. Cal. Apr. 1, 2004).

\textsuperscript{75} \emph{See} \textit{Intercollegiate Broad. Sys. Inc. v. Copyright Royalty Bd.}, 571 F.3d 69, 91 (D.C. Cir. 2009).


\textsuperscript{77} \emph{Id.}

\textsuperscript{78} \emph{See id.} Commentators point out that, in order to participate in a CARP proceeding, a party had to pay a share of the arbitrators’ fees, and this excluded many small webcasters from participating. \emph{See}, e.g., Karen Fessler, Note, \textit{Webcasting Royalty Rates}, 18 BERKELEY TECH. L.J. 399, 415 (2003).

Relying on a prior agreement reached between the RIAA and Yahoo! before the initiation of proceedings, CARP found that a per-performance rate was appropriate, and the Library of Congress in its review affirmed this determination. However, the Library rejected royalty rates determined by CARP as being arbitrarily high, instead setting rates for commercial webcasting at $0.0007 under §114 and a fee for ephemeral recordings under §112 of nine percent of per-performance royalties. CARP also designated SoundExchange as agent for unaffiliated copyright holders, allowing it to collect and distribute royalties for parties to the compulsory license that did not designate other agents.

2. **Small Webcaster Settlement Act of 2002 and Copyright Royalty Distribution Reform Act of 2004**

The absence of many small webcasters as participants in the proceeding, coupled with complaints that establishment of a per-performance royalty fee by CARP disadvantaged those webcasters, prompted the Small Webcasters Settlement Act of 2002. Fees under the 2002 CARP decision were suspended for small webcasters and noncommercial webcasters, and Congress provided approximately eighteen months for parties to negotiate an agreement based on a percentage of revenue structure for small webcasters. Furthermore, Congress established that any agreement under this act would not have precedential value under the willing buyer/willing seller standard. Responding to this mandate, parties reached such an agreement on December 24, 2002.

In an effort to renovate the dysfunctional CARP process and its inconsistent results, Congress passed the Copyright Royalty Distribution Reform Act of 2004. The act substituted ad hoc CARP panels for a permanent three-member Copyright Royalty Board; added three months of

80. *Id.*
81. *Id.* at 45,250.
82. *Id.* at 45,255 and 45,272.
83. *Id.* at 45,267.
85. *Id.* at 2781.
86. *Id.*
board-supervised negotiations prior to initiation of hearings and a twenty-one-day settlement period following discovery; and greatly reduced costs associated with participation. Although many experts argued that substantive reform would benefit the ratesetting process (revision of the willing buyer/willing seller standard, for example), the legislation achieved only procedural reform.

C. WEBCASTING II AND THE WEBCAST SETTLEMENT ACTS OF 2008 AND 2009

The Copyright Royalty Board initiated the second rate-setting process on February 16, 2005, and, following three months of failed negotiations, heard testimony and proposals by experts representing large commercial webcasters and the DiMA, small commercial webcasters, radio broadcasters, and SoundExchange. These proposals once again varied significantly in value and structure.

1. CRB Decision in Webcasting II

SoundExchange set forth a proposal with a dual payment structure that demanded the greater of a fixed percentage of broadcast revenue or a per-performance rate multiplied by the number of performances. By contrast, DiMA and several small commercial webcasters were seeking a royalty structure based on a percentage of revenue or on an ATH basis. The CRB refused to apply the percentage of revenue approach, citing a number of issues and stating that such a proxy for per-performance metrics was unnecessary in light of the ability to collect per-performance royalties directly.

Both sides of Webcasting II provided their views on which benchmarks were appropriate for determining per-performance royalty rates. The CRB ultimately agreed with SoundExchange’s expert that agreements in the market for interactive webcasting covering the digital performance of sound recordings most closely resembled the target market for their ratesetting decision. SoundExchange’s expert discounted the rates for interactive

89. Id. at 2341.
92. Id. at 24,091–94.
93. Id.
94. Id.
webcasting by an “interactivity value” to achieve proposed rates, which the CRB found persuasive. The court rejected benchmarks offered by webcasters, as well as a host of evidence provided by commercial webcasters that buyers and sellers in the market faced a less-competitive market than non-interactive services. Based on this testimony, the CRB decided to adopt SoundExchange’s proposed royalty rates for commercial webcasters, as well as an ATH-based royalty for 2006–2008.


In July 2009, nearly all holdings by the CRB were affirmed in Intercollegiate Broadcast System, over objections that this would destroy the businesses of small commercial webcasters. The Circuit Court stated, “[t]he Judges are not required to preserve the business of every participant in a market. . . . If small commercial webcasters cannot pay the same rate as other willing buyers and still earn a profit, then the Judges are not required to accommodate them.” If Webcasting II caused critics to “say goodbye to webcasting,” then this statement in Intercollegiate Broadcast System was an indicator that they should not expect to see it again.

At the same time as the webcasters’ appeal moved through the D.C. Circuit, Congress intervened, much as they had in Webcasting I, and passed the Webcaster Settlement Act of 2008, which provided a temporary suspension of fees and permitted a privately negotiated settlement to supplant the arbitrated terms if such an agreement could be made by February 15, 2009. When an agreement had not been reached by the end of Spring 2009, Congress extended the deadline to July 30 through the Webcaster Settlement Act of 2009.

95. Id. at 24,092.

96. Id. at 24,093.

97. Id. at 24,096.


99. Id. at 81.


3. SoundExchange’s Negotiated Agreement with Commercial Webcasters

The Librarian of Congress published the results of those government-supported negotiations on July 17, 2009. Independent negotiations uncovered a higher level of detail in analysis, based on the fact that the private settlement includes additional market subcategories within the commercial webcaster category.

The negotiated agreement contemplates three types of commercial webcaster, distinguishing between large commercial webcasters providing bundled services, large pureplay commercial webcasters, and small commercial webcasters. The royalty rates negotiated under the July agreement are markedly different than those determined by *Webcasting II*. SoundExchange justified these terms by stating:

> We believe the rates the CRB set were appropriate and fair. However, by incorporating an experimental approach whereby artists and copyright holders share in the growth of pureplay services, it gives certain pureplay webcasters the opportunity to flesh out various business models and the creators of music the opportunity to share in the success their recordings generate.

Despite these statements, the rates agreed upon by the parties cast some doubt on the usefulness of the willing buyer/willing seller standard as a means to determine statutory rates. In 2010, for example, the rates to be paid under the negotiated agreement are only fifty-one percent of the CRB-determined royalty. Efforts to reach a mutual accord that maximizes market potential for all parties involved reached a drastically different result than the adversarial proceedings. This is further exemplified by the creation of alternative term structures for pureplay commercial webcasters. However, there is a clear intent on the part of SoundExchange to focus its collaborative efforts on the broadcasters that can do the most to promote its constituents’

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104. *Id.* at 34,797–98. (defining Affiliates/Bundled Services, Commercial Webcasters, and Small Pureplay Webcasters). Pureplay commercial webcasters are distinct from bundled service providers because bundled service providers broadcast DPRA eligible transmissions as well as non-eligible transmissions as part of a bundled subscription.


interest, as evidenced by the addition of a $25,000 minimum fee per broadcaster that elects to be bound by the private agreement. 107 This fee offsets the first $25,000 in royalty payments made, and the practical effect is to eliminate from this agreement those small webcasters than can have little to no effect on developing the market.

III. DISCUSSION

The fifteen-year history of the DPRA provides a rich background against which to test the theories of Ayres & Talley and of Merges. As a liability rule-protected IPR, subject to possible tailoring and phantom infringer issues, the digital performance right in webcasting addresses head-on both articles’ concerns with valuation ceilings and their impact on the information efficiencies of divided entitlements. Furthermore, the record of the CRB and Webcasting I and II demonstrates the impacts on efficient bargaining of other, non information-related transaction costs associated with liability rule entitlements.

As discussed above, the key to realizing the private bargaining efficiencies predicted by Ayres & Talley’s liability rule analytics is the exchange of credible information regarding the relative valuations of each party to the divided entitlement. 108 This is captured in the first stage of the three-stage game—the offer by the owner to sell her entitlement or to buy the potential infringer’s “call” option to infringe. 109 Both articles, however, note the possibility that certain aspects of a particular liability rule entitlement could destroy the credibility of this information. Either through structural impediments, such as tailored damages, or through the nature of liability rule-protected IPRs and the potential for phantom infringers, an inability to exchange credible information on relative valuation creates a valuation ceiling by eliminating entitlement holders’ incentives to offer to bribe potential infringers not to infringe. 110 Absent this indicator of whether a holder is high-valuing or low-valuing, the benefits Ayres & Talley calculate for liability rule bargaining versus property rule bargaining are lost. 111

107. See id. at 34,799.
108. See Ayres & Talley, supra note 10, at 1100.
109. Id. at 1049.
110. See infra Sections I.A.1 and I.B.
111. See Ayres & Talley, supra note 10, at 1068.
A. **Tailored Royalties and DPRA**

For webcasters, the DPRA represents a liability rule entitlement that seeks to proactively tailor royalties to compensate effectively copyright holders, while simultaneously encouraging pre- and post-hearing private negotiations. Ayres & Talley would argue that efforts to encourage bargaining in the shadow of a liability rule would be ineffective where the entitlement also includes tailored damages.\(^\text{112}\) Though this argument is in many ways borne out by the recent history of ratesetting under the DPRA, the proceedings have the potential to force information exchange not currently contemplated by the Ayres & Talley model.

Although some pre-ratesetting bargaining did occur prior to *Webcasting I*, Ayres & Talley’s concerns regarding tailoring are particularly well-supported by events following the Small Webcaster Settlement Act of 2002. Though the Act suspended the high rates set by CARP in *Webcasting I*, the signal sent by CARP’s decision to rights holders such as SoundExchange was that their arguments for valuation were far more persuasive than those of the webcasters, and therefore they could expect royalty rates approximating that valuation. Armed with this information, SoundExchange had limited incentive to engage in credible exchange of information with webcasters in the negotiating period that followed. If any nonconsensual taking on the part of webcasters would result in payment of a compulsory royalty approximating the value sought by SoundExchange in its proceedings, there is little chance that the organization would bribe webcasters not to infringe, as this would imply it valued the entitlement at significantly more than it argued for in court. Consequently, in the period leading up to *Webcasting II*, the bargaining window opened and closed without an agreement.\(^\text{113}\)

Private negotiation induced by the settlement acts of 2002 and 2008–2009 provides another perspective on tailoring in the context of the DPRA. Though the fact that some bargaining did exist in the shadow of these ratesetting decisions is perhaps encouraging, there is little evidence that this bargaining reflects the efficiencies of information exchange contemplated by Ayres & Talley. In this case, the effects of tailoring royalties to match the rates argued for by SoundExchange created a valuation ceiling from which webcasters could only hope to bargain downward. Outcry in the press by webcasters that the rates determined by CARP would succeed only in

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\(^{112}\) *Id.* at 1066–68.

destroying the webcasting business model in its entirety further reduced the credibility of SoundExchange to represent that it valued its entitlement at higher than the royalty amount. Tailoring, in this case, may not have led to an increase in nonconsensual takings, but the bargaining that did occur did not reflect any information-exchange efficiencies over those likely to take place in a property rule context.

Despite the issues with tailoring evident in the DPRA ratesetting structure, the process of adversarial hearings on royalty rates does have the effect of introducing some new, credible information on valuation that would be absent from property rule bargaining. The willing buyer/willing seller analytical framework under which the CRB operates allows parties for both sides, copyright holders and webcasters, to submit proposed benchmarks and economic justification for their recommended royalty structure. Based on those proposals, the CRB selects a structure that best represents what a willing buyer and willing seller would agree to in a hypothetical market without a compulsory license. Because parties must make persuasive arguments for a reasonable royalty rate, they are ultimately providing some information regarding valuation. They are stating what they believe to be a reasonable valuation.

The penalty for providing a structure/rate recommendation that is not credible is evident from the results of Webcasting I and II. Where webcasters failed to provide a reasonable economic analysis in the eyes of CARP and CRB, that analysis was rejected and the panel adopted the analysis set forth by SoundExchange. The Webcasting I and II opinions speak very unfavorably of the webcasters’ recommendations, and it would seem likely that future proceedings would see a tighter valuation gap between SoundExchange and webcasters as webcasters seek to persuade the CRB. This information regarding a reasonable valuation should serve to narrow the


band of negotiation to within those values. In this, credible information about the relative valuations of both rights holder and infringer might be ascertained, representing greater information exchange than even that predicted by Ayres & Talley.119

This information exchange may have been a significant contributor to the enhanced bargaining codified by the settlement acts of 2002 and 2008/2009, but it is unclear whether this factor was outweighed by the significance of Congressional intervention. Although Ayres & Talley’s game would imply that, following ratesetting, parties would privately negotiate individual agreements around use of the digital performance right, the Acts encouraged all interested parties to reach a broad agreement that contemplated multiple user types, rates, and payment structures.120 SoundExchange (and through it the RIAA and primary rights holders) provided some information about its valuation of the webcasting performance right during ratesetting, and agreements were reached in both cases with many categories of webcaster.121 In this way, Congress’s efforts to force private negotiation through the settlement Acts once additional information had been injected into the system both promotes and discredits the significance of this additional information on the bargaining process.

Because Congress required broad private agreement to be reached following the ratesetting decisions, one cannot be certain whether Coasean bargaining would have truly occurred without that mandate. The fact that an agreement could not be reached prior to Webcasting II may be evidence that Congressional involvement was more significant than information exchange in encouraging bargaining post-ratesetting, as one would have predicted that the information shared in Webcasting I would have improved bargaining in the following proceeding. This fact is not dispositive, however, and speaks to one of the great challenges of this field: with technology advancing so quickly and digital media markets undergoing incredible transformation on a month-to-month basis, the value of information about valuation, particularly where multiple IPRs cover a single work, may be useful only within a narrow band

119. See Ayres & Talley, supra note 10, at 1043–44. While Ayres & Talley’s model predicts increased information exchange on the part of liability rule plaintiffs (rights holders), defendants under the generic liability rule structure do not credibly provide any information beyond that in a property rule. Id.


of time and within a narrow subsector of the broader market. Nevertheless, the history of the webcasting compulsory license does provide examples of information exchange not found in property rule entitlement structures, and this may be sufficient to induce additional bargaining, where the tailoring aspects of the DPRA diminish the exchange effects theorized by Ayres & Talley in traditional liability rule entitlements. To the extent that more information can have a positive effect on bargaining, there is some evidence that the DPRA produces more information than a property rule structure.

B. PHANTOM INFRINGERS AND THE DPRA

Similar to Ayres & Talley, Merges expresses concerns about the ability of liability rule entitlements to produce credible information exchange in the face of a valuation ceiling created by structural elements.\textsuperscript{122} His article focuses its critique of liability rule entitlements specifically on issues specific to IPRs, and the existence of phantom infringers is one such issue.\textsuperscript{123} As discussed above, the ability of an IPR to be used (infringed) an infinite number of times reduces the credibility of any offer by a holder to bribe a potential infringer not to infringe on a liability-rule protected IPR.\textsuperscript{124} A phantom infringer may falsely represent a high valuation in order to induce the holder to bribe them not to take, and no holder has the ability to effectively bribe an infinite number of users.\textsuperscript{125} Furthermore, the presence of so many potential infringers points to another issue Ayres & Talley note in their article: amorphous bodies of entitlement holders and users can make credible exchange of information difficult.\textsuperscript{126} As with tailoring, the inability to indicate credibly valuation on the part of the entitlement holder above that of the damage award eliminates the information exchange benefits Ayres & Talley predict for a liability rule entitlement.

Despite the problems the webcasting compulsory license, as an IPR, has on its face with phantom infringers, there are two ways in which parties in the webcasting space may root out phantom infringers and make indications of high valuation. First, the costs of participating in ratesetting proceedings, coupled with the connection between the proceedings and the pre- and post-proceeding private negotiations serves to separate the honest infringers by forcing interested parties to invest resources in the process. Second, recent efforts by record labels to acquire equity stakes in digital broadcasters, such

\textsuperscript{122} Merges, supra note 11, at 1305–06.
\textsuperscript{123} Id.
\textsuperscript{124} Id.
\textsuperscript{125} See id.
\textsuperscript{126} Ayres & Talley, supra note 10, at 1082–83.
as YouTube, MySpace Music, and Spotify, serves as a model for labels to indicate credibly a valuation above the compulsory royalty rate.\textsuperscript{127}

The key aspect of the DPRA royalty proceedings that serves to reduce the theoretical impact of phantom infringers and nebulous infringer pools is the way that Congress has bundled private bargaining with the ratesetting proceedings, creating a window before and after (through the settlement Acts) the proceedings for parties to negotiate a mutual agreement.\textsuperscript{128} It is in these proceedings that parties on either side are able to interact with those counterparties representing a credible interest in using the entitlement. Prior to the Copyright Royalty and Distribution Reform Act of 2004, costs associated with ratesetting decisions by CARP were borne by parties to the negotiation.\textsuperscript{129} Arbitrators’ fees for the 2002 CARP hearing exceeded $1.2 million, and many small webcasters were excluded from the proceedings because of their inability to bear a share of the costs.\textsuperscript{130}

Although this fee structure may have overexcluded a number of legitimately interested parties, the general exclusionary effect is clear: it is likely that only parties with such a legitimate interest will invest their own resources into the proceedings.\textsuperscript{131} By then, coupling the private negotiations with those proceedings, the parties can easily identify serious users for information exchange, where those who have signed up for arbitration are likely open to negotiation. Even the current CRB ratesetting structure, in which royalty judges are paid federal employees, still requires that parties bear their own costs of the proceedings.\textsuperscript{132} Such costs are likely to be high, where, in addition to written statements from the twenty-eight participants and their witnesses, the 2007 CRB judges “heard 48 days of testimony, which filled

\begin{footnotesize}
\begin{enumerate}
\item[129.] 17 U.S.C. § 802(c) (2006).
\item[130.] Fessler, \textit{supra} note 78, at 415.
\item[132.] See 17 U.S.C. §802(c), (e) (2006).
\end{enumerate}
\end{footnotesize}
13,288 pages of transcript, and 192 exhibits were admitted. The docket contains 475 entries of pleadings, motions and orders.\textsuperscript{133}

No amount of reducing the population of potential infringers at the bargaining stage will be sufficient to eliminate the valuation ceiling created by a lack of credible information exchange unless rights holders have a means to effectively bribe them not to infringe. In the context of IPRs, the concept of a monetary payment to a potential infringer not to infringe is practically meaningless, for reasons described above. As soon as SoundExchange pays one webcaster not to broadcast, a thousand webcasters would no doubt be at their door, prior interest in ratesetting be damned. However, an interesting model has arisen in several digital media contexts (and in one ex-U.S. webcaster) to address this, and may be useful to U.S. webcasters going forward. In the licensing arrangements negotiated by YouTube, MySpace Music, and Spotify, the major record labels have acquired equity interests in those companies, indicating a desire to obtain some of the economic benefit of their licenses beyond royalty rates.\textsuperscript{134}

In acquiring these equity interests, the record labels are attempting to capture a portion of the potential profits the companies seek to earn on distribution of licensed content. It follows that they are relying on the assumption that the rights they have licensed to these companies are more valuable than the licenses themselves. Were the rights not, the companies would fail to generate profit, and any equity interest would yield no return.

The licensing agreements for the three companies mentioned above do not appear on their face to include DPRA webcasting royalties.\textsuperscript{135} Nevertheless, the agreements stand as an interesting model for “bribing” potential infringers. Under this model, SoundExchange would, upon determination by the CRB of a compulsory royalty rate, offer to purchase from chosen infringers an equity interest in their operations. This upfront payment would not be for infringers not to infringe per se, but rather for SoundExchange to recover some of the economics it sees itself (and through it, rights holders) as giving up through compulsory use by webcasters. The amount paid for an equity interest would be a function of the expected profits foreseen by the operation, itself a function of the value of the content


\textsuperscript{134} See supra, note 127.

\textsuperscript{135} While Spotify is a pureplay webcaster, it does not offer services to U.S. users and therefore does not pay a compulsory royalty under the DPRA/DMCA.
over the royalty rate paid. The greater SoundExchange’s relative valuation, the higher the offer for a given equity interest.

Encapsulating the Ayres & Talley “bribe” in an equity interest adds practical significance to an otherwise purely theoretical payment when dealing with IPRs. Potential phantom infringers, those parties with low valuations representing a high valuation in hopes of a payout, are more likely to be seen for their true colors when their books are opened in the context of a potential equity investment. As with the burden of persuasion in ratesetting, this model has the potential to encourage greater information exchange than Ayres & Talley assume in their theory. Both the rights holder and the potential infringer must exchange information on relative valuation: the rights holder through its offer for an equity interest, and the potential infringer through the opening of the books in anticipation of such an investment. Practical issues abound in such a hypothetical, such as liquidity concerns and mechanisms for SoundExchange to distribute proceeds from these investments in light of its legal independence from record labels and artists. The fact that the labels have already attempted to bring the model to bear on distributed digital media, however, provides some hope it might succeed in the context of the DPRA webcasting license.

C. CORRELATED VALUATION AND THE DPRA

Ayres & Talley briefly discuss the potential challenges to their theory brought about by the potential for correlated valuation between two parties to a liability rule negotiation.136 In situations where one party’s valuation (or their representation of that valuation) impacts that of the other, both may be disincentivized to exchange credible information.137 While Ayres & Talley note this one type of correlated valuation, two others deserve exploration in the context of the DPRA, where they may have an impact on information exchange. First, the benchmark approach to royalty rate determinations under the CRB creates the possibility of correlation between prior valuation and future compulsory rates. Second, the multi-class structure of the DPRA creates a series of correlated valuations between different types of users. In all three cases, there is the potential for parties to be disincentivized to exchange information or to exchange false information, defeating the potential efficiency advantages of the Ayres & Talley liability rule theory.

136. Ayres & Talley, supra note 10, at 1088–89.
137. Id. (“When their valuations are correlated, however, a buyer’s revelation may also raise the minimum price that the seller is willing to accept. With correlated valuations, then, a buyer may be even more reluctant to reveal her valuation.”).
1. Inter-party Correlation

The potential for inter-party correlation of valuation is evident in the structure of the DPRA ratesetting proceedings in both the pre-arbitration and post-arbitration negotiation windows. In the pre-arbitration window, parties are likely to be reluctant to share credible information about their relative valuations for fear that it will affect the arguments made by their counterparty during the arbitration itself. An indication by webcasters of a high valuation may serve to encourage SoundExchange to push the CRB for a high royalty rate, and vice versa. Post-ratesetting behavior under the DPRA may also lack credibility, where a low-valuing SoundExchange might attempt to induce webcasters into infringing by representing a high valuation.

The argument for correlated valuation between two parties to a liability rule entitlement in the context of digital media is hampered somewhat by the youth of the digital media market. Ayres & Talley suggest that liability rule entitlements, coupled with Coasean bargaining, are best at unlocking idiosyncratic value, or value specific to a particular user.138 Because participants in the digital media market have a vast array of opinions on its future growth and size, the absence of consensus works against any idea of inter-party correlated valuation.139 With different approaches to distributing content rising and failing almost daily, the idiosyncrasies of particular methods appear crucial to capturing the value of that content.140 One party’s valuation is therefore unlikely to affect that of another.

2. Temporal Correlation within Webcasting

The structure of the webcasting royalty rate proceedings is more likely to produce correlated valuation from five-year period to five-year period than between parties, due to the benchmark analytical framework employed by the CRB. In Webcasting I and II, parties presented their recommended royalty structures in terms of existing benchmarks, from which CARP and CRB

138. Id. at 1084.
determined the proper solution. It bargaining in the shadow of upcoming
rate-setting proceedings, this format encourages a party to negotiate as harshly
as possible, in hopes of solidifying one favorable agreement that it can hold
up as its benchmark in arbitration. It minimizes, for example, SoundExchange’s incentives to represent anything but a high valuation prior
to CRB proceedings. Should it come across a high-valuing webcaster, it can
secure a deal that proves a high royalty rate is reasonable for all parties, later
on negotiating downward during the post-arbitration period, but from an
elevated level.

This behavior surfaced in Webcasting I, where CARP threw out twenty-
five of the twenty-six agreements the RIAA reached with webcasters prior to
arbitration, noting that none of the webcasters in those agreements had
anywhere near the resources or expertise of SoundExchange and that it was
apparent that SoundExchange had sought out a “sweet spot” and closed only
deals that conformed to those rates. Nevertheless, CARP selected the
agreement between the RIAA and Yahoo! to serve as the benchmark, despite
outrage that even those rates were exorbitant and potentially destructive to the
industry. The fear of the benchmark was struck in the hearts of all parties
to the webcasting proceedings, and future negotiations under the Small
Webcaster Settlement Act of 2002 were statutorily exempted from having
precedential value as such. Further, negotiation prior to Webcasting II
resulted in no additional agreements, and the Webcaster Settlement Acts of
2008 and 2009 exempted any private agreements reached from use as
benchmarks once again.

Information exchange to induce bargaining in the shadow of a liability
rule suffers when correlation may exist between current and future
valuations. The parties to Webcasting II were forced to rely on benchmarks
outside the commercial webcasting field, shifting the debate to which

141. See, e.g., Determination of Reasonable Rates and Terms for the Digital Performance
142. See Fessler, supra note 78, at 420.
143. Id.
144. Id.
145. See Hinckley, supra note 114.
    2782. (“[N]o provisions of any agreement entered into pursuant to subparagraph (A) . . .
    shall be admissible as evidence or otherwise taken into account in any administrative,
    judicial, or other government proceeding . . .”)
submarket of digital music distribution could best be modified to approximate that of webcasting. The benchmark analytical framework thus contributes to information-exchange inefficiencies produced by two types of correlation: the temporal valuation correlation discussed here, and the valuation correlation between multiple classes of DPRA users.

3. Valuation Correlation Between Multiple User Classes of a Single Right

In *Webcasting II*, without a voluntary agreement in non-interactive webcasting to rely on as a benchmark, SoundExchange turned instead to another category of user under the DPRA, the interactive webcaster. The CRB agreed with SoundExchange’s recommendation to apply a discount to previous voluntary interactive webcasting licensing agreements in order to determine applicable rates for the compulsory license in non-interactive webcasting. This result is an example of a third type of correlation that can have the effect of reducing credible information exchange, valuation correlation between categories of DPRA/DMCA user.

To summarize briefly an offshoot of entitlement theory, Abraham Bell and Gideon Parchomovsky describe the existence of “pliability rules,” entitlements that take on more than one form, not simply one protected by a liability rule or a property rule. One form of these pliability rules is the simultaneous pliability rule, in which entitlement holders hold different types of rights with respect to different users. Bell and Parchomovsky give the example of fair use in copyright, where commercial users are subject to a property rule exclusion but fair users are free to use the right as a liability rule with a payment of zero to the entitlement holder. The digital performance right in sound recordings is such a simultaneous pliability rule, contemplating several types of users and protecting the copyright holder with a number of property rule and liability rule protections against particular types.

Bell and Parchomovsky argue that understanding whether an entitlement is protected by a pliability rule provides entitlement holders with “certainty concerning future changes in the rules protecting their entitlements, and,

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149. Id. at 24,091–92.
150. See id. at 24,092.
152. Id. at 49–50.
153. Id. at 50–51.
154. See supra Section II.A.
therefore, a truer appreciation of the nature of protection they enjoy at present.\footnote{155} However, the history of the DPRA and webcasting raises concerns about the potential negative impacts of pliability rules on efficient bargaining and investment in IPRs. Where rights protected from multiple user classes under a pliability rule have correlated values, the potential for uncertainty can both reduce information exchange and induce underinvestment in IPRs.

The argument for reduced information exchange created by correlated valuation among user classes parallels those for the temporal correlation discussed above: where a single agreement can serve as a relevant benchmark for future negotiations or arbitration, rights holders become incentivized to represent their valuation regarding a particular rights use higher, in an effort to close a deal with a high-valuing user. Similarly, if both property rule- and liability rule-protected uses are likely to result in a non-zero license, information made public in a compulsory license ratesetting proceeding such as the CRB, where recommendations by the rights holder are constrained by the burden of persuasion, may be harmful to the holder’s property rule-protected interests. This type of correlation, therefore, has the additionally negative impact of calling into question the credibility of the recommendations made by a rights holder such as SoundExchange, despite the burden of persuasion discussed above. This is because the cost of losing a few tenths of a cent in compulsory royalties may not outweigh the benefit of keeping real information regarding valuation private for future property rule negotiations.

The potential for valuation-correlated pliability rules to impact investment in IPRs stems from the possibility that information exchanged in the context of determining a liability rule damage award, or the determination itself, may serve as a benchmark for future property rule negotiations.\footnote{156} Bell and Parchomovsky state that “[p]roperty rules are generally thought to encourage greater investment than liability rules, since the entitlement holder may prevent involuntary loss of the object.”\footnote{157} To the extent that the liability rule aspects of a simultaneous pliability rule drag down the actual value for

\footnote{155. Bell & Parchomovsky, supra note 151, at 27.}

\footnote{156. It has been mentioned above that the converse has already occurred, where a voluntarily negotiated property rule license for interactive webcasters was used as a benchmark for determining the compulsory royalty rate for non-interactive webcasters. See Digital Performance Right in Sound Recordings and Ephemeral Recordings, 72 Fed. Reg. 24,084 (May 1, 2007) (codified at 37 C.F.R. pt. 380) at 24,090.}

\footnote{157. Bell & Parchomovsky, supra note 151, at 27; see also Ayres & Talley, supra note 10, at 1032–33.}
which a rights holder can negotiate in a property rule license, investment in the IPR will be doubly affected, both by the uncertainty of the liability rule protection and the decreased value received for the property rule protection. To use the digital performance right in sound recordings as an example: if an unfavorably low compulsory royalty rate were ascribed to non-interactive webcasting in the next ratesetting proceeding, an interactive webcaster may expect the next property rule license he negotiates to drop as well. If it does not, and his business becomes less competitive as a result, he may exit or change models, eliminating revenues for rights holders. As such revenues fall, artists are will consequently have less incentive to create new works versus engaging in other revenue-generating activities. Where incentivizing artists to create works is a central goal of copyright, the risks of correlated, simultaneous pliability rules can have an even more damaging effect than independent liability rules.158

D. **SOUNDEXCHANGE AND THE DPRA**

One aspect of the development of the webcasting compulsory license under the DPRA/DMCA that Ayres & Talley and Merges would both likely applaud is the ascension of SoundExchange as the congressionally mandated sole agent of digital performance rights holders for the administration of the compulsory license. Responding to challenges by other parties seeking to achieve a share of the digital royalty administrator business (namely Royalty Logic in Webcasting II), Congress has taken steps to establish SoundExchange as the default agent for rights holders under the DPRA/DMCA.159 In so doing, they have improved the potential for information exchange and private negotiation by creating a single point of contact for potential infringers. Furthermore, fostering the growth of a CRO with connections to RIAA, Congress has enabled the record labels to better internalize the valuation externalities predicted by the correlated valuation issues.

The main thrust of Merges’s article is that CROs, typically born out of property rules, are better able to negotiate market-tuned royalty rates than government bodies.160 Similarly, Ayres & Talley note that information exchange under liability rules is most likely to produce benefits when entitlements are made to the most efficient holder and negotiating parties are small in number and easily identifiable.161 By supporting SoundExchange,

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158. See Keller & Cunard, *supra* note 36.
160. See Merges, *supra* note 11, at 1328.
itself controlled by a board of both artist and record label representatives,\textsuperscript{162} it would appear Congress has properly empowered an agent of the most efficient holders and created essentially a single party on one side of the negotiation. Much as organic CROs such as ASCAP are, in Merges’s eyes, able to achieve a more accurate royalty rate through private bargaining than would be possible under a compulsory license, SoundExchange (and through it the RIAA) is able to couple its public arbitration experience with almost fifteen years of private negotiations and deliver similar value to rights holders, where ratesetting by the CRB can only draw on one of those two datasets.\textsuperscript{163}

By supporting an RIAA-directed agent in SoundExchange over an independent agent in Royalty Logic, Congress has also maximized the potential for rights holders to internalize some of the externalities outlined above regarding correlated valuation, particularly the simultaneous pliability rule of the broader digital performance right.\textsuperscript{164} Were Royalty Logic the default agent authorized to negotiate on behalf of compulsory license rights holders, it would lack visibility into discussions being held by the RIAA with potential users of other digital performance rights. Conversely, the RIAA would be unable to proactively account for any information exchange or actions by Royalty Logic with potential infringers of the compulsory license. In this scenario, it is much more likely that Royalty Logic could do harm to the incentives underlying the simultaneous pliability rule of the DPRA/DMCA than SoundExchange, with its Board connections to the RIAA. Once again, information exchange—even between parties representing the same rights holders—can maximize efficiency.

\section*{IV. CONCLUSION}

The history of the digital performance right in webcasting has provided a great deal of data about the practical implications of liability rule entitlements in new media. Testing this record against the theories of Ayres & Talley and Merges, we learn that policymakers must consider the qualifications of Ayres & Talley and the challenges of Merges to the efficiency of liability rules as

\begin{itemize}
  \item \textsuperscript{162} SoundExchange, Board, \url{http://soundexchange.com/about/people/board/} (last visited Jan. 31, 2010).
  \item \textsuperscript{163} Further analysis of the discovery documents uncovered during the ratesetting proceeding may establish that this is when a great deal of the private negotiation between proceedings is made public. That being said, SoundExchange will always have more information than the CRB at the commencement of the proceedings, based on private information exchange in the interim period.
  \item \textsuperscript{164} See supra Section III.C.3.
\end{itemize}
they consider using compulsory licenses and other liability rules to protect new media entitlements. Although liability rules in the IPR context can be shown to promote some Coasean bargaining, the impact of this bargaining on other, correlated rights is unclear and efficiency versus organically grown CROs is untested. However, this context and those described by Merges, show that reducing the number of bargaining parties through CROs can produce some degree of exchange, and such organizations should be supported in both liability rule and property rule entitlement schemes.
MARKET ACCESS IN CHINA—PUBLICATIONS AND AUDIOVISUAL MATERIALS: A MORAL VICTORY WITH A SILVER LINING

Elanor A. Mangin

“International arrangement [for protecting intellectual property] becomes the character of a great country: first, because it is justice; secondly; because without it you never can have, and keep, a literature of your own.” —Charles Dickens.¹

From the earliest days of the People's Republic of China's interest in international markets and membership in the World Trade Organization (WTO), U.S. reaction ranged from cautiously supportive to openly enthusiastic.² Many saw an opportunity not only to engage a billion potential consumers, but also to re-shape the polity in the image of a Western democracy. Given China's status as the world's most populous country, global enterprises based in WTO member nations immediately recognized the enormous potential of expansion into Chinese markets.³ Western foreign policy makers hoped that China's accession and the expansion of markets would bolster concurrent liberal democratic ideals and force Chinese domestic reforms.⁴ Free markets, it was assumed, would naturally yield free society. But China has not been a passive participant in its international economic expansion. Indeed, when U.S. industries have sought economic

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1. WILLIAM GLYDE WILKINS, CHARLES DICKENS IN AMERICAN 33 (1911).
3. KONG, supra note 2, at 13.
expansion into China, they have frequently met with market-prohibitive
government regulation and cultural inertia.\textsuperscript{5}

The recent WTO dispute between the United States and China illustrates
a fundamental tension between the two countries: the United States’ desire
for market access and China’s fear of the liberalizing effect access to those
goods might engender.\textsuperscript{6} In April of 2007, the United States formally
challenged several of China’s official policies, practices, and enforcement
measures related to protection of Intellectual Property Rights (IPR) in two
WTO disputes.\textsuperscript{7} Together, these cases contain the most complex challenge to
a WTO member nation’s policies in U.S. history, and represent the
culmination of decades of contention.\textsuperscript{8} The second of these cases did not
address any substantive challenges to IPR enforcement in China, but rather
focused on the related issue of Chinese market access for U.S. content
industries. While this decision represents a decided victory for the United
States, most agree that the battle for a place in China’s market is far from
over.\textsuperscript{9} Nonetheless, some elements of the dispute indicate that China is
indeed progressing towards a culture and polity that values intellectual
property. It is here that many may find the real victory.

China is an undeniably significant, if enigmatic, market force in
international trade.\textsuperscript{10} China has a robust national economy, ranked second in
world trade of goods.\textsuperscript{11} And perhaps more importantly, China represents one
of the fastest growing economies in the world, with an average growth in

\textsuperscript{5} See, e.g., THOMAS LUM & DICK K. NANTO, CONG. RESEARCH SERV., CRS REPORT
FOR CONGRESS: CHINA’S TRADE WITH THE UNITED STATES AND THE WORLD 1 (2007)
(“The trade is highly unbalanced in China’s favor . . . . Some policymakers as well as leaders
of industry and labor blame China for unfair trade practices, including deliberately
undervaluing its currency . . . U.S.-China trade issues are often driven by larger policy
objectives.”).

\textsuperscript{6} Panel Report, China—Measures Affecting Trading Rights and Distribution Services for
Certain Publications and Audiovisual Entertainment Products, ¶ 1.1, WT/DS363/R (Aug. 12, 2009)
[hereinafter China—Publications & Audiovisual Materials].

\textsuperscript{7} Id.; Panel Report, China—Measures Affecting Protection & Enforcement of Intellectual

\textsuperscript{8} WILLIAM M. MORRISON, CONG. RESEARCH SERV., CRS REPORT FOR CONGRESS:

\textsuperscript{9} See Sue Zeidler, Hollywood Sees Win in China WTO Case as First Step, REUTERS.COM,

\textsuperscript{10} See, e.g., MICHAEL J. TREBILCOCK & ROBERT HOWSE, REGULATION OF
INTERNATIONAL TRADE 641 (3d ed. 2005).

\textsuperscript{11} WTO, China Trade Profile, http://stat.wto.org/CountryProfile/WSDBCountry
GDP above 10 percent. One-fifth of the world’s population lives within its borders, representing a large region of potential consumers. This population is also becoming an increasingly sophisticated group of consumers, as Chinese economic expansion continues and Chinese citizens enjoy increased purchasing power.

The U.S. content industry is similarly ambitious in its growth. Copyrightable products rank among the most important exports of the United States, both economically and politically; with one scholar even contending that the entertainment industries are the single most important driving force in the world market, outstripping any other commodity. The Motion Picture Association of America (MPAA) reports that “[t]he American motion picture industry carries a positive balance of trade around the world and a $13.6 billion trade surplus. For decades, the motion picture and television production industry has been a cornerstone in America’s creative economy.” Beyond its economic impact, America’s content industry is also a key player in defining, presenting, and exporting “American culture.” Again, the MPAA lauds the industry, stating “Hollywood produces another form of wealth: the pictures in our head by which both we, and the world at large, define the phenomenon of American culture.”

Despite the U.S. content industry’s continued efforts to engage the huge potential market in China, such efforts have often been frustrated, most consistently by piracy. According to the MPAA, “China is the most difficult

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14. MORRISON, supra note 8, at 5–6 (noting increases in personal computer ownership, cell phone and automobile purchases, and travel amongst the Chinese).
15. See STEPHEN E. SIWEK, COPYRIGHT INDUSTRIES IN THE U.S. ECONOMY 8 (2009) (“This latest report confirms once again that the U.S. copyright industries have outpaced the rest of the economy in real growth and in its contribution to the overall growth achieved by the U.S. economy as a whole.”); Tyler Cowen, French Kiss-Off: How Protectionism has Hurt French Films, REASON (July 1998) available at http://reason.com/archives/1998/07/01/french-kiss-off (“After aircraft production, the entertainment industry is America’s largest source of trade surplus.”).
16. MICHAEL J. WOLF, THE ENTERTAINMENT ECONOMY: HOW MEGA-MEDIA FORCES ARE TRANSFORMING OUR LIVES 4 (1999) (“In the United States . . . entertainment ranks ahead of clothing and health care as a percentage of household spending,” and “entertainment is in many parts of the world the fastest-growing sector of the economy.”).
18. Id. at 4.
market to crack for the U.S. motion picture industry,” with pirated DVDs flooding the market, and limits to the number of screens available to foreign films. Similarly, high piracy rates in China have plagued U.S. music producers, leading to an estimated industry loss of $451 million in 2007. Furthermore, estimates from the Chinese government suggest that there are around 500 million pirated books produced in the country each year.

This Note will attempt to situate the recent market access dispute in the broader context of U.S.-China economic and political relations. The first Part surveys the history of China’s entry into the WTO, addressing specifically the obligations relevant to the WTO Panel dispute. The second Part presents the arguments made by the United States and China, and summarizes the Panel’s findings. Finally, Part III evaluates the extent to which the dispute and the Panel’s decision addressed and advanced U.S. economic and policy goals related to the trade of copyrighted goods in China.

I. THE TREATIES

This Part describes the various treaty obligations that arise under the umbrella of China’s WTO membership. First, it examines the controversial progression of China’s membership, focusing on China’s specific obligations under its accession agreement, and the concerns raised by other WTO member nations specific to China. Next, it details China’s obligations under the General Agreement on Tariffs and Trade (GATT), and the General Agreement on Trade in Services (GATS), both with reference to China’s National Treatment obligations. The terms of these agreements form the basis of the dispute in China—Publications & Audiovisual Materials.

A. THE HISTORY OF CHINA’S WTO MEMBERSHIP, AND THE TERMS OF THE ACCESSION PROTOCOL

In 1947, the Republic of China, as an original Signatory and a participant in early negotiations, entered into the GATT, predecessor of the WTO. However, the founding of the Peoples Republic of China in 1949 led to the Republic of China’s formal withdrawal from GATT. For the next thirty

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19. MORRISON, supra note 8, at 20–21 (quoting Statement by Dan Glickman, Chairman and Chief Executive Officer, Motion Picture Association of America before the House Ways & Means Committee, Subcommittee on Trade, hearing on Trade With China, February 15, 2007).
20. Id. at 21.
21. Id.
22. KONG, supra note 2, at 4.
23. Id.
years, China’s domestic interests and ideological objections to free market systems superseded its interests in international trade with the West, and China had no participation in GATT.\footnote{See id. at 5, 20 n.6 (suggesting that among the reasons for China’s disinterest in the GATT/WTO is a perception of it as “the club for rich countries”).}

However, during the early 1980s, pursuit of an “Open Door Policy” encouraged China to modernize its markets and reconsider its role as a participant in international trade and cooperation.\footnote{Id. at 5. See Deng Xiaoping, Chairman, Chinese People’s Political Consultative Conference, Address to Press Delegation for the Federal Republic of Germany (Oct. 10, 1978).} After attending proceedings as an official observer, China formally applied to join GATT in 1986.\footnote{KONG, supra note 2, at 5. The original petition was based on a theory that the Republic of China lacked the authority to withdraw the country from the agreement in the first place. Id.} Following general accession guidelines, GATT established a Working Party to examine China’s application and make recommendations to the General Council regarding the necessary Protocols (or terms of China’s accession).\footnote{Accession to the WTO follows an identical procedure. See WTO, The WTO General Council, http://www.wto.org/english/tratop_e/gcoun_e/gcoun_e.htm (last visited Feb. 26, 2010). “The General Council is the WTO’s highest-level decision-making body in Geneva, meeting regularly to carry out the functions of the WTO. It has representatives (usually ambassadors or equivalent) from all member governments.” WTO, Understanding the WTO: The Organization, http://www.wto.org/english/tratop_e/whatis_e/tif_e/org3_e.htm (last visited Feb. 26, 2010).} After the submission of the Working Party’s report, the General Council was to vote on accession, and would grant after two-thirds approval, representative signature, and ratification by China’s legislative body.\footnote{See WTO, Understanding the WTO: The Organization, http://www.wto.org/english/tratop_e/whatis_e/tif_e/org3_e.htm (last visited Feb. 26, 2010).}

China’s application to join GATT was not without controversy. Almost immediately, the U.S. Congress expressed frustration regarding China’s socialist economic development and socialist legality.\footnote{See Peter K. Yu, From Pirates to Partners: Protecting Intellectual Property in China in the Twenty-First Century, 50 AM. U.L. REV. 131, 136–37 (2000).} The U.S. government was particularly concerned with China’s lack of IPR protection.\footnote{Id. at 136–38. China had virtually no IP rights until this era, and its first attempts at introducing IP schemes were often half-hearted and awkward. Id.} As a result of these concerns, Congress developed one of the United States’ most powerful trade weapons, requiring the United States Trade Representative (USTR) to identify, investigate, consult with, and eventually sanction nations who failed to properly protect U.S. intellectual property or otherwise denied U.S. content goods equal market access.\footnote{Id. at 140 (citing 19 U.S.C. § 2242(a)(1)(A) (2006)).}
Beyond trade issues, GATT members also questioned China’s application in light of political controversies and policy concerns. The 1989 Tiananmen Square massacre caused the Working Party to become increasingly meticulous in reviewing China’s stability, economy, and trade regime. Furthermore, China neither formally nor publically embraced the idea of domestic capitalism until its adoption of the “socialist market economy” as a policy goal in 1992.

GATT’s 1995 reorganization into the WTO forced China to renew its application. Fortunately for China, the Working Party on accession to the WTO comprised the same members who formed the Working Party on China’s accession to the GATT, so the review process moved relatively quickly thereafter. After China concluded negotiations with all thirty-seven member nations, the Working Party finalized China’s Draft Accession Protocol, the General Council approved, and China’s National People’s Congress ratified. China became a member of the WTO on December 11, 2001, fifteen years after its initial application.

1. Terms of China’s Membership in the WTO

The WTO is built largely upon three agreements: GATT, GATS, and the Trade-Related Aspects of Intellectual Property Rights (TRIPS). GATT, as the predecessor for the WTO, represents a set of long-standing trade agreements governing the trade of goods. GATS is a more recent collection of agreements comparable to GATT, only pursuant to the trade of services. Finally, TRIPS represents an agreement to apply GATT principles to WTO member nations’ widely varying intellectual property regimes with the goal of establishing a baseline of IPR protection and enforcement.

In addition to these three pillar agreements, China also must abide by the terms of its Accession Protocol and accompanying Working Party Report.

32. KONG, supra note 2, at 6.
33. See id.
34. Id.
35. Id. at 6–7.
36. Id. at 7.
37. Id. Rivaling the time Accession took for China, the Working Party on the Accession of the Russian Federation formed in 1993, at the time of this writing Russian negotiations for membership are still underway, and it remains unclear if Russia will ever attain full member status. See WTO, Accessions Russian Federation, http://www.wto.org/english/thewto_e/acc_e/acc_e/ral_russie_e.htm (last visited Feb. 26, 2010).
These two documents assign a timeframe for China to come into compliance with the WTO agreements and emphasize WTO Working Party members’ concerns specific to China. 40

The Accession Protocol contains two important provisions relating to China’s commitment to open its domestic markets. First, the Chinese government had three years from accession (until December 11, 2004) to “progressively liberalize” its markets, and to afford “all enterprises” the right to trade in all goods not specifically exempt. 41 Second, China had to treat foreign firms “no less favorably” than domestic firms with respect to the right to trade, except for trade in certain specific exempt goods. 42

The Working Party Report reinforces and emphasizes the language of the Accession Protocol provisions. China agreed to “progressively liberalize the scope and availability of trading rights . . . to all enterprises in China,” regardless of national affiliation. 43 Similarly, the Report provides that “China would permit . . . foreign enterprises and individuals, including sole proprietorships of other WTO members, to export and import all goods,” and that foreign enterprise trading rights in China must “be granted in a non-discriminatory and non-discretionary way . . . any requirements for obtaining trading rights would be for customs and fiscal purposes only and would not constitute a barrier to trade.” 44

2. China’s Accession to the WTO makes it Subject to the Organization’s Dispute Resolution Process.

In addition to the three pillar agreements, a primary function of the WTO is dispute resolution. 45 This was not always the case. The original 1947 GATT contained no provision for formal dispute resolution or adjudication, relying instead on a spirit of cooperation based on diplomatic consensus and negotiation. 46 When disputes did arise—when trade groups, associations, entrepreneurs, or foreign policy makers objected to a member nation’s trade

41. Id. ¶ 5.1.
42. Id. ¶ 5.2.
43. Working Party on the Accession of China, Report, ¶ 83(c)–(d) WT/ACC/CHN/49 (Oct. 1, 2001) [hereinafter Working Party Report] (providing in part that “Foreign-invested enterprises would not be required to establish in a particular form or as a separate entity to engage in importing and exporting”).
44. Id. ¶ 84(a), (b).
46. TREBILCOCK & HOWSE, supra note 10, at 112.
practices—the GATT leadership addressed them in an ad hoc manner that eventually led to the evolution of a third-party panel system.47

This evolution culminated in the Understanding on Dispute Settlement (DSU), to which member nations agreed under the same set of negotiations that organized the WTO.48 The DSU established a procedure for WTO dispute resolution.49 A dispute formally begins when interested parties bring trade concerns to the attention of their nation’s WTO trade representative, who in turn makes a request for consultations to the Dispute Settlement Body (DSB).50 Perhaps in deference to the diplomatic nature of the enterprise, there are no strict definitions of grounds for dispute in the WTO: any interested party can approach their representative and raise objections regarding another member nation’s official conduct, legislation, or any regulation that the objecting party perceives as a violation of the WTO agreements.51 After a series of mandated consultations, if the issues remain unresolved, the parties submit to adjudication before a Panel of three experts in the field the parties themselves select.52 The Panel then issues a Final Report, analogous to a U.S. judicial opinion, in which it reproduces the written and oral arguments of the parties, determines whether the conduct violates relevant WTO provisions, and has discretion to make recommendations on how to realign the objectionable conduct, if appropriate.53

47. The Chairman of the Contracting Parties addressed the earliest disputes in GATT by assigning “working parties” that included the parties in dispute. Id. at 112–13.
48. Id. at 112–14.
49. See generally id. at 120–53 (providing detailed analysis and critiques of the DSU articles).
50. WTO, Understanding the WTO: Settling Disputes, http://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm (last visited Feb. 26, 2010). The Dispute Settlement Body is a session of the General Council that includes ambassadors from every member nation held specifically to address a panel report. Id.
51. See General Agreement on Tariffs and Trade, art. XXIII(1), Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT] (providing the broad basis for liability). A complaint can be based on “the existence of any other situation, the contracting party may . . . make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it.” Id. art. XXIII (1)(c).
53. See id.; see also TREBILCOCK & HOWSE, supra note 10, at 137 (discussing the recent criticism of a panel’s recommendations).
After receipt of the Final Report, either party can appeal the decision.54 Either party may file a notice of appeal, provided it is within sixty days of circulation of the Final Report, and prior to the adoption of the Panel’s recommendations by the DSB.55 Following timely notice, the Appellate Body, a standing group of seven panelists, must complete its appellate review within ninety days.56 Three randomly selected members of the Appellate Body hear the appeal, issue a decision, and give any party in violation a “reasonable” period of time to bring its conduct into compliance before authorizing sanction proceedings.57 The results of the Appellate Body panel are final.58

B. **MEMBERSHIP IN THE WTO REQUIRES CHINA’S ADHERENCE TO GATT**

As the predecessor of the WTO, GATT represents “the heart of the multilateral world trading regime.”59 GATT provides for mutually reduced tariffs, reduction of trade barriers, and the elimination of unfair trade practices.60 To achieve those goals, GATT utilizes Most Favored Nation and National Treatment principles to regulate the international trade of goods.61 GATT’s National Treatment provision controls the multilateral treatment of foreign goods by mandating internally non-discriminatory practices:

> The products of the territory of any Member imported into the territory of any other Member shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their

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55. TREBILCOCK & HOWSE, supra note 10, at 138.
56. Id.
60. Id. at 27.
61. Id. at 28 (“The principle of non-discrimination - often viewed as the cornerstone of the GATT . . . is amplified in two key provisions: Article I, adoption the Most Favoured National principle; and Article III, adoption the principle of National Treatment.”).
internal sale, offering for sale, purchase, transportation, distribution or use.\footnote{62}

GATT allows for several exceptions to its mandates in \textit{Article XX}. Provided that such measures “would not constitute a means of arbitrary or unjustifiable discrimination . . . or a disguised restriction on international trade,” GATT members may adopt or enforce measures “necessary to protect public morals” under \textit{Article XX(a)} regardless of their potential violation of other GATT provisions.\footnote{63} Other exceptions include measures necessary to protect human and environmental health, and measures relating to goods produced through prison labor, goods that constitute national treasures, or goods with historic or architectural value.\footnote{64}

Somewhat surprisingly, the WTO Appellate Body has never had occasion to rule on whether a given measure meets the \textit{Article XX(a)} public morals exception,\footnote{65} although it has ruled on the scope of other \textit{Article XX} exceptions.\footnote{66} And it has ruled on disputes invoking the virtually identically worded “public morals” exception language in \textit{Article XIV} of GATS.\footnote{67} From these disputes, WTO members, scholars, and jurists have developed an understanding that the “public morals” exception is meant to be an evolving standard, liberal and broadly interpreted.\footnote{68}

\section{C. Membership in the WTO Requires China’s Adherence to GATS}

The WTO encompasses agreements relating to trade in services collectively known as GATS. The purpose of a separate agreement specific to trade in services is to provide a framework of rules, principles, and specific commitments related to, though legally distinct from, those in GATT.\footnote{69}

\footnotesize
\begin{itemize}
  \item \footnote{62}{GATT art. III:4.}
  \item \footnote{63}{Id. art. XX(a).}
  \item \footnote{64}{See id. art. XX.}
  \item \footnote{65}{TREBILCOCK & HOWSE, supra note 10, at 572.}
  \item \footnote{67}{Appellate Body Report, \textit{United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services}, WT/DS285/R (Apr. 20, 2005) [hereinafter \textit{US—Gambling (AB)}]. The General Agreement on Trade in Services’ “public morals” exception states: Provided that such measures do not “constitute a means of arbitrary or unjustifiable discrimination between countries . . . or a disguised restriction on trade in services” GATS allows the “adoption or enforcement by any Member of measures: (a) necessary to protect public morals or to maintain public order.” General Agreement on Trade in Services, art. XIV(a), April 15, 1994, WTO Agreement, Annex 1B 33 LL.M. 1168 (1994) [hereinafter GATS].}
  \item \footnote{68}{See TREBILCOCK & HOWSE, supra note 10, at 573. (summarizing the WTO stance that “the interpretation of public morals should not be frozen in time”).}
  \item \footnote{69}{Id. at 358.}
\end{itemize}
China’s accession documents demonstrate the importance of this distinction. After making clear the importance of China’s commitment to liberalize its markets and guarantee foreign enterprises the right to import and export, the Working Party Report emphasized “such right, however, did not permit importers to distribute goods within China. Providing distribution services would be done in accordance with China’s Schedule of Specific Commitments under the GATS.”

China’s commitments under GATS include a provision to ensure equal access to its service markets. GATS requires WTO members to afford service suppliers from other member nations “treatment no less favourable than that it accords to its own like services and service suppliers.” In order to ensure a level trading field, GATS allows that the manner in which treatment will be “no less favourable” can be either “formally identical treatment or formally different treatment.” The measure for determining a violation is the standard of treatment afforded domestic suppliers of similar services.

II. THE DISPUTE

Having established the context in which China—Publications & Audiovisual Materials arises, and the treaty obligations at issue, this Note will now summarize the Panel Report. First, the Note surveys the United States’ specific claims characterizing China’s treatment of importation and distribution of certain goods as violations of the Accession Protocol, GATT, and GATS. The second section discusses China’s counter arguments to the United States’ complaints, including the “public morals” exception China raised. The third section summarizes the Panels’ findings and recommendations. Finally, the fourth section discusses the Appellate Body’s review of the Panel’s decision.

A. THE COMPLAINT

The dispute before the WTO Panel officially began when the USTR requested consultations with the Chinese government regarding measures that allegedly restricted foreign companies’ trading rights and market access

70. Working Party Report ¶ 84(a) (emphasis added).
71. GATS art. XVII(1).
72. Id. art. XVII(2).
73. Specifically: “Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.” Id. art. XVII(3).
in a discriminatory manner. Once raised, the dispute went through the requisite pre-resolution negotiation process. The United States requested that the DSB compose a Panel to address issues that remained despite consultations.

The United States argued that China violated its National Treatment obligations to the WTO under the Accession Protocol, Article III:4 of GATT, and Article XIV of GATS. Specifically, the United States pointed to measures that (1) restricted imports into China by limiting importation rights to Chinese state-owned entities; (2) imposed more cumbersome burdens on distribution ventures engaged in by foreign-invested enterprises than those imposed on wholly Chinese-owned distributors; and (3) discriminated against imported entertainment media by subjecting it to a significantly more stringent content-review regime. The United States alleged that specific aspects of Chinese law and policy violated China’s trade commitments under the WTO with regards to four sets of products: (1) reading materials (including traditional print and electronic distributions); (2) audiovisual home entertainment products (AVHE) (including DVDs); (3) sound recordings (including ringtones); and (4) motion picture films intended for theatrical release.

1. Alleged Violations of the Accession Protocol & GATT: Import Restrictions

The United States argued that twelve specific Chinese measures, relating to the importation and content review of the four categories of goods, violated the Accession Protocol. For example, Article 4 of an important Chinese importation measure, the Several Opinions, barred foreign-invested enterprises from engaging in the “import [of] books, newspapers, periodicals, films for theatrical release, other audiovisual products (including sound

74. China—Publications & Audiovisual Materials, supra note 6, ¶ 1.1.
75. Id. ¶¶ 1.2–1.5. The first round of consultations, joined by the European Communities, took place in early June 2007 and failed to resolve the issues in dispute. Supplemental consultations were held in late July 2007 and also failed to find an acceptable resolution. Id.
76. Id. ¶ 1.6.
77. Id. ¶¶ 2.1–3(c).
78. Id. ¶ 4.3.
79. Id. ¶ 7.329. Those twelve measures are: the Catalogue; the Foreign Investment Regulation; the Several Opinions; the Publications Regulation; the Importation Procedure; the Electronic Publications Regulation; the 2001 Audiovisual Products Regulation; the Audiovisual Products Importation Rule; the Audiovisual (Sub)-Distribution Rule; the Film Regulation; the Film Enterprise Rule; and the Film Distribution and Exhibition Rule. Id.
Under such measures, China was able to grant exclusive rights to import finished audiovisual products to wholly state-owned enterprises, such as the China National Publications Import and Export Corporation (CNPIEC).

The United States also submitted to the Panel its complaint that, even with majority Chinese-owned distribution and exclusive CNPIEC importation rights, foreign goods were subject to yet another importation/distribution hurdle in China: they were held to a disproportionately strict content-review process. The United States pointed to the disparate treatment of foreign-content goods in virtually every market. For example, in sound recordings the United States noted that those “intended for electronic distribution must receive prior approval from MOC [the Ministry of Culture] before distribution. Domestic sound recordings, in contrast, require no such approval . . . .” The United States also identified other Chinese regulations, like the Internet Culture Rule, that affect the import of sound recordings by establishing an intense state-run content-review regime.

2. Alleged Violations of GATS: Distribution Restrictions

The United States claimed that, in addition to prohibitions on imports, specific Chinese measures prevented foreign individuals and enterprises from engaging in the distribution of reading materials, sound recordings, and AVHE. The regulation of such distribution services falls under the provisions of GATS.

Regarding reading materials, the United States argued that several measures prohibited foreign-invested enterprises from wholesale distribution via limited distribution (i.e., subscription), as well as unlimited distribution. These measures, the United States argued, worked to discriminate against foreign enterprise. For example, the Publications (Sub-) Distribution Rule required any Chinese distributors with foreign investment to demonstrate a
minimum level of invested capital (approximately US$4 million), and a minimum time commitment (approximately 30 years) in order to lawfully engage in the wholesale distribution of reading materials. No such minimum capital or time commitments were required of wholly Chinese-owned distribution operations.

The United States also alleged GATS violations pursuant to the distribution rights associated with physical AVHE Products. Similar to the restrictions on reading materials, the United States argued that the measures affecting physical AVHE distribution set unenforceable limits on the percentage of foreign investment in these ventures, thereby unfairly discriminating against foreign distribution services in China.

Finally, the United States also identified several measures it alleged violate China’s GATS commitments as to the distribution of sound recordings. These measures, issued in part by the Chinese Ministry of Culture, state blanket prohibitions against foreign investment in “setting up and operating a business dealing in internet culture.”

In sum, the United States argued that China, by establishing prohibitively high standards for foreign distributors in these three product categories, afforded more favorable treatment to domestic distributors than their foreign counterparts, thus violating their commitments under the National Treatment provision of GATS.

B. CHINA’S COUNTER ARGUMENTS

China raised one procedural and two substantive counter arguments to the United States’ charges. Procedurally, China argued that the United States was barred from bringing some of their complaints. China noted, and the Panel agreed, that several of the measures identified by the United States in its written submission to the Panel were not indicated in their earlier requests for consultations, and therefore ineligible for panel adjudication. Substantively, China first argued that motion pictures intended for theatrical

88. Id. ¶¶ 7.1103, 7.1122.
89. Id. ¶ 7.1124.
90. Id. ¶ 7.1314. These measures are: the Audiovisual (Sub-) Distribution Rule, the Catalogue, the Foreign Investment Regulation, and the Several Opinions.
91. See id. ¶¶ 7.1362–75.
92. Id. ¶ 7.1143. Specifically, the United States identified the Internet Culture Rule, the Circular on Internet Culture, the Network Music Opinions, and the Several Opinions. Id.
93. Id. ¶ 7.1308.
94. Id. ¶ 4.164.
95. See, e.g., id. ¶¶ 4.163–68. According to WTO precedent in Korea—Commercial Vessels, the scope of the Panel’s authority is limited by the content of the consultations. Id. (citing WT/DS273/R, (adopted Apr. 11, 2005)).
release do not qualify as “goods” within the meaning of the treaties. 96
Second, as an affirmative defense, China claimed its measures were an
exercise of their right under the WTO to hold cultural goods to stricter
regulatory standards by virtue of the “public morals” exception. 97

1. Films for Theatrical Release are Not “Goods”

The United States’ complaint challenged both the importation and
distribution of films intended for theatrical release as GATT violations.
China argued before the Panel that a motion picture is not a “good” under
the language of China’s WTO Accession Protocol, and therefore GATT
should not apply. 98 China presented this alternative view of a theatrical
release film by characterizing it as “a sequence of pictures that is projected on
to a screen . . . per se intangible and cannot be possessed . . . . Likewise,
movie-goers do not buy the motion picture as such, but only the right to
attend the projection.” 99

China argued that a motion picture was more akin to a service than a
good by illustrating the process of a film’s theatrical release. The transaction
begins when the producer and distributor execute a copyright licensing
agreement. 100 The distributor then receives all associated materials, including
prints, scores, and soundtracks, in order to facilitate distribution. 101 After the
film’s release and run, those materials are either returned or destroyed,
leaving no trace of a tangible good. 102

China maintained that a motion picture’s intangibility means that it is not
a good. 103 They advanced the definition used by the Appellate Body that
“goods” are “items that are tangible and capable of being possessed.” 104
China noted that although the delivered film canisters often “carry” the
motion picture, films are increasingly delivered digitally, further bolstering
the argument that they are entirely intangible. 105

Finally, China argued that the presence of “importation of motion
tables for theatrical release” on its GATS Schedule clearly marks this

96. Id. ¶¶ 4.92–94.
98. Id. ¶ 4.99.
99. Id.
100. Id. ¶ 4.97.
101. Id. ¶ 4.98.
102. Id.
103. Id. ¶¶ 4.99–100.
104. Id. ¶ 4.100.
105. Id.
product as a service rather than a good. As discussed, supra, the entire purpose of GATS is to cover services legally distinct from GATT. China’s argument was that measures relating to a product covered under GATS cannot also be challenged under GATT, or the Accession Protocol, which defer to GATS authority over services.

2. Cultural Goods & the “Public Morals” Exception

China most notably defended its regulations under Article XX(a): the “public morals” exception. As discussed, supra, this provision allows for the “adoption or enforcement by any Member of measures: ... (a) necessary to protect public morals” regardless of their potential violation of other GATT provisions.

China laid the foundation for this argument by emphasizing the nature of the products. Reading materials, AVHE, and sound recordings are cultural goods. Cultural goods, China noted, have an influence over social and public morals. In order to protect its polity from damaging influences, especially those that depict or vindicate violence or pornography,” China argued that strict regulation of trade in these goods is necessary.

The importation measures at issue, China maintained, are its best means of addressing that necessity. China said that its importation structure for these products is “designed to guarantee an effective and efficient application of content review decided by China and is in full compliance with China’s WTO rights and obligations.” It characterized the content review process as unavoidably part of importation, too cumbersome to conduct elsewhere, and because of the high volume of foreign materials and the vital interest China has in protecting public morals, it presented that the process must be undertaken by a number of administrative authorities with a set of different tasks.

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106. Id. ¶ 4.103.
107. See supra Section I.
108. GATT art. XX(a). See supra Section I.B.
109. China—Publications & Audiovisual Materials, supra note 6, ¶4.107. China did not include motion pictures intended for theatrical release in the category of goods protected by the “public morals” exception perhaps because it had just made the argument that theatrical films were a service, and thus not subject to Article XX(a) of GATT.
110. Id. ¶ 4.108.
111. Id. ¶ 4.114.
112. Id. ¶¶ 4.107–114.
113. Id. ¶ 4.107.
114. Id. ¶4.110. China lists the different tasks assigned to the authorities: One group administers and reviews the entire process. Another, “selected, based on their capacity relating to content review” screens out anything “having a negative impact on public
China argued that Article XX(a) allowed for the differential treatment of the goods at issue. While acknowledging obligations to liberalize their markets under GATT and the Accession Protocol, the Chinese reasoned that these measures are allowed so long as they are administered “in a manner consistent with the WTO Agreement,” which includes Article XX(a).\footnote{115}

C. PANEL’S FINDINGS

The United States prevailed on nearly every argument raised.\footnote{116} The Panel found that films intended for theatrical release are goods, the importation and distribution of which is governed by China’s GATT commitments.\footnote{117} Furthermore, the Panel determined that all but one of the contested measures failed to meet the preliminary test of “necessary” to qualify for the “public morals” exception.\footnote{118} The one measure that the Panel found necessary on preliminary inquiry still failed to qualify for the exception due to the presentation of reasonably available alternatives.\footnote{119} Accordingly, the Panel found all of the contested measures violated China’s WTO obligations.\footnote{120}

1. Films Intended for Theatrical Release are Goods

The Panel first addressed China’s argument that films meant for theatrical release are services and not goods.\footnote{121} The Panel considered whether film is tangible, the effect transition through a series of services may have on a good, and the classification structures associated with films meant for theatrical release.\footnote{122}

The Panel looked to presentations by the United States, arguing against China’s interpretation of a film as a service based on intangibility.\footnote{123} While the United States conceded that some aspects of all the goods in question are intangible, the Panel noted the U.S. argument that intangible content does not transform the physical good into a service.\footnote{124} The series of images flashed...
on a screen to make a motion picture may well be what holds value for the consumer; however, the United States maintained, there remains a tangible good in the film itself as the content of the canister.125 Furthermore, the United States argued that most goods go through a series of services and yet that process does not transform the goods into services.126

The Panel directed the majority of its analysis on the United States’ final argument that China itself treats films as goods in its customs regulations.127 In the schedule of goods China attached to its Accession Protocol documents, China lists “cinematographic film.”128 Furthermore, the language of GATT carves out certain exceptions to the national treatment of film; such exceptions, the United States argued, would be moot if films were not goods and GATT did not apply.129

The Panel relied heavily on this final argument in determining that hard-copy cinematographic films intended for theatrical release are indeed goods relevant to China’s trade commitments.130 In addition to China’s customs regulations, the schedule China attached to the Accession Protocol, and the relevant language in GATT specific to films, the Panel also noted that China collects customs duties when cinematographic films are imported, consistent with the treatment of goods, not services.131

2. The “Public Morals” Exception

The Panel found that the Chinese measures do not qualify for the “public morals” exception of Article XX(a).132 According to GATT, China has a “right to regulate trade” so long as “[1] the regulation of importers has a reasonable link to the regulation of the goods at issue . . . and [2] the regulation of importers is WTO-consistent.”133 Both parties conceded, and the Panel concluded, that China’s measures had a reasonable link to the goods.134 Consequently, the Panel’s main inquiry was whether China’s

125. Id.
126. Id. ¶ 7.504. The United States, used the analogy of a stethoscope, and argued that a stethoscope is most frequently, if not exclusively, utilized in providing healthcare services, yet retains its character as an individual good. Id.
127. Id. ¶ 7.505.
128. Id.
129. Id. ¶ 7.506 (citing GATT art. III:10, IV).
130. Id. ¶ 7.526.
131. Id. ¶ 7.524.
132. Id. ¶¶ 7.907–13.
133. Id. ¶ 7.722.
134. Id. ¶ 7.723.
regulations were WTO-consistent and in particular whether they qualified under Article XX(a).\textsuperscript{135}

There was no preexisting WTO jurisprudence on the GATT “public morals” exception;\textsuperscript{136} however, the Panel was able to draw from previous analysis of other Article XX exceptions and other treaty language to aid its inquiry. For instance, the Appellate Body had established a two-tiered approach to examining any measure under Article XX.\textsuperscript{137} First, does the measure arise under one of the listed exceptions, such as public morals? Second, is the measure “necessary”?\textsuperscript{138}

\begin{itemize}
\item[a)] Do the relevant measures address public morals?
\end{itemize}

The question of whether the measure falls under an Article XX exception led the Panel to examine whether the challenged measures touched upon “public morals” and the meaning of that phrase in the WTO context.\textsuperscript{139} Again, with no Article XX(a) jurisprudence to guide them, the Panel looked towards a closely related Appellate Body decision regarding the “public morals” exception of GATS in \textit{US—Gambling}.\textsuperscript{140} In \textit{US—Gambling}, the Appellate Body examined U.S. measures prohibiting certain online gambling services brought before the WTO by Antigua and Barbuda.\textsuperscript{141} As an affirmative defense, the United States raised the “public morals” exception of GATS, and argued that the measures were necessary to protect against the U.S. concerns of “money laundering, organized crime, fraud, underage gambling and pathological gambling.”\textsuperscript{142} In that case, the Appellate Body took a very broad view of “public morals,” noting that member nations “should be given some scope to define and apply for themselves the concepts of ‘public morals’ . . . in their respective territories, according to their own systems and scales of values.”\textsuperscript{143} Despite this broad definition, the

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\textsuperscript{135} Id. ¶ 7.722–23.
\textsuperscript{136} TReBilcock & Howse, supra note 10, at 572.
\textsuperscript{137} \textit{China—Publications \\& Audiovisual Material}, supra note 6, at ¶ 7.746 (citing Appellate Body Report, \textit{Brazil—Measures Affecting Imports of Retreaded Tyres}, ¶ 139, WT/DS332/AB/R (Dec. 17, 2007)).
\textsuperscript{138} Id. ¶¶ 7.746, 7.781
\textsuperscript{139} Id. ¶ 7.750.
\textsuperscript{140} \textit{US—Gambling (AB)}, supra note 67.
\textsuperscript{141} Id.
\textsuperscript{142} Id. ¶ 301 (quoting Panel Report ¶ 6.494).
measures in *US—Gambling* failed to qualify for the “public morals” exception of GATS.\(^{144}\)

Recognizing that “the content and scope of ‘public morals’ can vary . . . as they are influenced by each Members’ prevailing social, cultural, ethical and religious values,” the Panel assumed *arguendo* that the materials and measures were relevant to the protection of public morals, that if imported they “could have a negative impact on ‘public morals’ in China,” and moved to the more determinative “necessary” question.\(^{145}\)

b) Are the measures “necessary”?

In determining “necessary,” the Panel again relied upon a balancing test detailed in *US—Gambling*.\(^{146}\) This test directs the Panel to determine “necessary” by balancing the (1) “contribution of the measure to the realization of the ends pursued by it” against (2) “the restrictive impact of the measure on international commerce.”\(^{147}\) Even if that balance suggests a preliminary finding of “necessary,” however, the Panel must further examine whether a WTO-consistent alternative to the measures exists before finding a legitimate “public morals” exception.\(^{148}\)

The Panel identified only one measure as preliminarily “necessary”: *Article 42 of the Publications Regulation* is a “criteria provision” that sets forth guidelines and requirements on who can import publication materials.\(^{149}\) The Panel first decided that the conditions of this measure represent a “material contribution to the protection of public morals.”\(^{150}\) As for the second prong of the “necessary” analysis, the Panel determined that some conditions of the measure do not “a priori exclude particular types of enterprise in China from the right to engage in importing,” while others are “unclear” in their restrictive impact.\(^{151}\) Given these findings, the Panel ruled “absent reasonably

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\(^{144}\) *US—Gambling (AB)*, supra note 67, ¶ 372.

\(^{145}\) *China—Publications and Audioworld Products*, supra note 6, at ¶ 7.763.


\(^{147}\) *US—Gambling (AB)*, supra note 67, ¶ 306.

\(^{148}\) *Id.* ¶¶ 309–10. However, the Appellate Body noted that the responding party bears no burden “to identify the universe of less trade-restrictive alternatives.” *Id.*

\(^{149}\) *See China—Publications and Audioworld Products*, supra note 6, ¶¶ 7.821–26. The Panel found that China failed to demonstrate that any of the other measures were “necessary” at the preliminary stage because they were all too trade restrictive. *Id.* ¶¶ 7.837–868.

\(^{150}\) *Id.* ¶ 7.828.

\(^{151}\) *Id.* ¶¶ 7.822, 7.836.
available alternatives,” Article 42 of the Publications Regulation, and only Article 42, was “necessary” to protect public morals.152

But the “absence of reasonably available alternatives” element prompted the Panel to consider the possible alternatives the United States presented.153 For one, the United States pointed to China’s use of “in-house” content-review procedures for domestic producers as an alternative to the current implementation of the Publications Regulation, which in effect gives China’s state-owned enterprises a monopoly on importing.154

The Panel evaluated this and other alternatives to determine whether they were “reasonably available.”155 While the Panel noted, “implementing the US proposal might make it necessary for China to allocate additional human and financial resources to the authorities tasked with performing content review,” it also determined that, “it is not apparent to us that the cost to the Chinese Government would be any higher if the US proposal were implemented.”156 China failed to raise any arguments that the U.S.-proposed alternative was unreasonable.157 Therefore, given the existence of potentially equally effective and less restrictive alternatives to China’s practices, the Panel found that the Article 42 was ultimately not “necessary” within the meaning of the “public morals” exception.158

The Panel applied the balancing test to all other measures in question, and found that the results were inconsistent with a preliminary finding of “necessary.”159 The Panel agreed that all measures were consistent with China’s particularly “high level of protection of public morals.”160 However, because the measures so completely barred international commerce and only tangentially contributed to the protection of public morals, they failed to strike a reasonable balance, and could not be considered “necessary.”161

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152. Id. ¶ 7.869.
153. See id. ¶¶ 7.873–75.
154. Id. ¶ 7.873.
155. Id. ¶¶ 7.901–06.
156. Id. ¶¶ 7.903–04. “To recall, the main difference would be that content review would be conducted, not by incorporated wholly state-owned enterprises, but by non-incorporated offices comprising the Government of China.” Id. ¶ 7.904.
157. Id. ¶ 7.905.
158. Id. ¶¶ 7.886–7.909.
159. Id. ¶ 7.911.
160. Id. ¶ 7.819.
161. Id. ¶ 7.868.
3. Recommendations

After finding China in violation of the Accession Protocol, GATS, and GATT, the Panel recommended simply that the DSB “request China to bring the relevant measures into conformity with its [WTO] obligations.”

D. Appeals

China filed its notice to appeal on September 23, 2009. China appealed the Panel’s legal findings, arguing that the “public morals” test was misapplied, and that the measures found to be in violation are indeed necessary within the meaning of Article XX(a). In addition, China appealed the Panel’s findings relating to the importation of films meant for theatrical release, stating that the Panel “erred in concluding that China’s trading rights commitments are applicable to the Chinese measures at issue, despite the fact that these measures do not regulate hard-copy cinematographic film, which is the subject of the US claim.”

The United States also filed an appeal on October 6, 2009. In its appeal, the United States argued that the Panel erred when finding any element of the Publications Regulation “can be characterized as ‘necessary’ [under Article XX(a)] to protect public morals in China.”

The Appellate Body issued its report on December 21, 2009. Of primary concern to the Appellate Body was the extent to which the “public morals” exception, or any of the Article XX exceptions, is available as an affirmative defense for violations outside the GATT. In addition to GATT violations, China had argued before the panel the appropriate applicability of the exception to alleged violations of its Accession Protocol. In conducting its substantive analysis, the Panel had assumed arguendo the exception’s applicability. The Appellate Body warned about the use of arguendo assumptions, stating “it may not always provide a solid foundation upon

162. Id. ¶ 8.4.
165. Id. at 3 (citing China—Publications & Audiovisual, supra note 6, ¶¶ 7.528–60, 7.584).
166. Notification of an Other Appeal by the United States, WT/DS363/11 (Oct. 6, 2009).
167. Id. (citing China—Publications & Audiovisual, supra note 6, ¶¶ 7.829–36).
169. Id. ¶¶ 205-233.
170. Id.
171. Id. ¶ 213.
which to rest legal conclusions,”172 and “risks creating uncertainty.”173 Despite these admonishments, the Appellate Body affirmed the applicability of the Article XX exception in this instance, suggesting a trend towards broadening their applicability in general.174

The Appellate Body also affirmed the Panel’s conclusion regarding the characterization of films intended for theatrical release as goods.175 In doing so, it addressed China’s arguments regarding procedural flaws in the U.S. complaint, possible translation issues of a contested term, and the characterization of the regulated activity as a service rather than a good.176

The Appellate Body clarified the Panel’s analysis and conclusion by reaffirming the principle that trade in goods and services are not always mutually exclusive, and that such trade may be subject to both WTO categories of obligations.177

The Appellate Body agreed with the United States, and found that the Panel erred when making a preliminary finding of “necessary” for the Publications Regulation.178 The Panel based its finding partially on a determination that the measure made a material contribution to the goal of protecting public morals.179 The Appellate Body rejected this finding as based on the Panel’s false assumptions regarding the extent to which the measure’s limitation on the number of importation entities actually affected the ease with which government officials could then conduct content review.180 The Panel made these assumptions, the Appellate Body noted, without any reference to supporting evidence. 181 The Appellate Body, however, affirmed all other findings within the Panel Report, and upheld the Panel’s conclusion that the contested measures were not “necessary” to protect public morals.182

172. Id.
173. Id. ¶ 215.
175. China—Publications (AB) ¶¶ 159–204.
176. Id.
177. Id. ¶¶ 194–95.
178. Id. ¶¶ 279–97.
179. See supra note 150, and accompanying text.
181. Id. ¶ 294. The Appellate Body admonished that “the Panel neither addressed quantitative projections nor provided qualitative reasoning.” Id.
182. Id. ¶ 415(e).
III. THE IMPLICATIONS

As articulated by the Panel, and upheld by the Appellate Body, the two prongs of the “public morals” test of Article XX(a) encapsulate the dual interests of parties involved: public policy and economic goals related to the trade of content goods. The Panel evaluates the question of whether a measure touches upon public morals with an understanding that a member has the right, as a matter of public policy and national sovereignty, to regulate the cultural content its population consumes. The “necessary” analysis—and particularly the question of how effective versus how trade prohibitive a given measure is and whether viable alternatives exist—is an economic argument. When setting the first bar low, the WTO acts in deference to cultural specificity. The “public morals” exception test compensates for that concession by making the second economic bar high.

Just as the United States has economic and policy goals concerning China’s trade practices, China has two opposing motivations for its measures restricting import, distribution, and screening of U.S. content goods. The first, and the one China was most explicit about in its arguments, is its desire to control the population’s exposure to socially and morally challenging content. The second, and somewhat natural corollary, is that China’s behavior is meant to carve out and protect market space for its own domestic content goods.

This Part will examine the policy and economic implications of the China—Publications & Audiovisual Materials dispute, analysis, and decision. First, while the United States has consistently maintained objections to the type of social and political control exhibited in China’s public policy towards foreign content, challenging such conduct in the WTO might not be wise for the United States or its content industries due to international tensions regarding perceived U.S. cultural colonialism. Second, while certainly frustrating to U.S. content industries’ desire for expansion into China’s markets, to the extent that China’s actions reflect protectionist sentiments, these measures might actually represent a significant milestone in the development of China’s IPR regime. Finally, the structure of the WTO, its dispute resolution procedures, and China’s history of adhering to recommendations made therein, present unique challenges to timely resolution.

183. See supra Introduction.
A. GAINING MARKET ACCESS WITHOUT RAISING FEARS OF CULTURAL COLONIALISM

As discussed, supra, U.S. content industries represent a significant player in the United States’ economic, political, and cultural standing in the world.\textsuperscript{184} China, like many other WTO member nations, has not welcomed the U.S. economic and cultural influx with open arms.\textsuperscript{185} While negotiating with WTO members on the wording of their copyright laws in the early 1990s, prior to accession, China maintained a strong resistance to opening its market to foreign cultural enterprises, almost entirely on ideological grounds.\textsuperscript{186}

Similarly, during the organization of the WTO itself, several nations—notably France and Canada—wanted to create a specifically exempt category of cultural goods and services in order to combat perceived cultural colonialism.\textsuperscript{187} Indeed, at the end of the twentieth century “keeping out American films [as well as music, and TV shows] became one of the most important French national policies.”\textsuperscript{188} Several European and Latin American countries have established quota systems and tax subsidies to protect domestic content industries from the Hollywood juggernaut.\textsuperscript{189}

\textit{Article XX} protects WTO members from compromising certain exclusionary rights through their membership in GATT. The Appellate Body has interpreted the \textit{Article XX} exceptions as setting a delicate balance between one member invoking an exception and another exercising its affirmative trading rights, “so that neither of the competing rights will cancel out the other and thereby distort and nullify or impair the balance of rights and obligations constructed by the Members themselves.”\textsuperscript{190} Widespread practice amongst members seeking to keep out foreign content goods would seem to suggest that carving out trade-agreement exceptions for exclusionary treatment of such goods is a common goal. Indeed, the Panel noted in \textit{China—Publications \& Audiovisual Materials} that the “public morals” exception,
being the first in the long list of possible Article XX categories, was clearly very important to the drafting members.191

However, the Panel administered the test in such a way as to shift the controversy entirely away from the policy question of public morals and toward the economic analysis. As discussed, supra, the Panel set the bar very low for whether a measure touches upon public morals.192 In so doing, the Panel essentially ignored the culturally specific subjective element of the “public morals” exception analysis in favor of the more easily determined “necessary” question, which turns on a more objective economic cost/benefit analysis of the measures themselves. Having established summarily that there is a “public moral” policy interest worth protecting, the Panel shifts its analysis to how well the member’s practices protect that interest and balance that performance against any less prohibitive and no-more costly alternatives the opposition presents. This is all done without any means of establishing the relative value of the right the measure serves. With much of the “public moral” exception analysis falling on the question of cost efficiency, and particularly on finding cost-neutral alternatives, it is difficult to imagine how any WTO member could pass such a high economic bar, and successfully raise the public morals defense.

The Panel’s application of the “necessary” test was entirely in keeping with Appellate Body Article XX precedent,193 but with such an unbalanced balancing test, it is not likely to remain free from controversy. Especially given the history of other WTO members intent on carving out a national space for their own domestic content industries, the ruling might be perceived as an example of the United States and major content industry players (such as the MPAA) running roughshod over the cultural preferences of another member.

B. THE CONTINUING DEVELOPMENT OF IPR IN CHINA

Conventional wisdom holds that the most significant barrier to U.S. content industries entering the Chinese market is piracy.194 While lack of

191. China—Publications & Audiovisual, supra note 6, ¶ 7.817 (“We do not consider it simply accident that the exception relating to ‘public morals’ is the first exception identified in the ten-subparagraphs of Article XX.”).
192. See supra Section II.C.2.
193. See supra Section II.C.
194. See generally MERTHA, supra note 13; Brent T. Yonehara, Enter the Dragon: China’s WTO Accession, Film Piracy and Prospects for the Enforcement of Copyright Laws, 9 UCLA ENT. L.R. 389 (2002).
protection for IPR in China is hardly a new concern, the staggering statistics, undeniable empirical analysis, and anecdotal evidence combine to present a picture of a modern intellectual property piracy epidemic. Because of piracy, one study estimated that the U.S. motion picture industry lost $6.1 billion worldwide in 2005. In China, the same study put U.S. motion picture revenue loss at $244 million, and singled out the country as the world’s piracy rate leader.

Although the parties in China—Publications & Audiovisual Materials never explicitly address piracy, it is undeniable that piracy is able to thrive, in part, because the only option for consumers is on the wrong side of the law. Generations of limited market access and censorship have increased the market for pirated goods in China. In a press release regarding the dispute, USTR Ron Kirk commented that the decision would “level the playing field for American companies working to distribute high-quality entertainment products in China, so that legitimate American products can get to market and beat out the pirates.” The United States also raised another dispute in the WTO challenging China’s lack of IPR enforcement on the same day, underscoring the interrelatedness of market access and piracy concerns.

Of course, such race-to-the-market strategies assume a great deal about the Chinese entertainment consumer. There are a number of reasons to doubt that, even given the option of a legitimate version of a content product, the average Chinese consumer would choose the official IPR-protected product over a pirated copy. Foreign influence is largely

198. Id. at 4, 7. The monetary number is artificially low because it is determined based on loss-per-screen and China severely limits the number of screens available to foreign films. Id.
202. See, e.g., Peter K. Yu, supra note 29, at 165 (noting reasons including “Confucian beliefs ingrained in the Chinese culture, the country’s socialist economic system, the leaders’
responsible for China’s IPR regime,\textsuperscript{203} which in its current form dates only from the latter quarter of the twentieth century.\textsuperscript{204} One consequence of this recent evolution is the gap between China’s black letter IPR law on one hand and the willingness and ability of Chinese officials to enforce those laws and the cultural appreciation for IPR protection on the other.\textsuperscript{205} Other factors that contribute to the alarming piracy rates in China include tight restrictions on the number of foreign movies (the Chinese government only allows twenty per year), lengthy delays in China’s content review process for foreign film screenings, and official demands on domestic theaters to screen only domestic films.\textsuperscript{206}

Local content industry protectionism appears to be growing in China and presents ongoing challenges to U.S. attempts at market entry. In a decision at the end of 2009, after the WTO Panel’s report, China announced purchasing guidelines for all government technology buyers that would “establish an accreditation system that gives Chinese intellectual property preferential treatment.”\textsuperscript{207} The same state-sponsored import companies at issue in China—Publications and Audiovisual Materials have shown a willingness to withdraw foreign films administratively in favor of providing screen time and market access for domestic product.\textsuperscript{208}

While certainly frustrating for foreign content industries, domestic content protectionism can actually be a powerful motivation for increasing the strength of both international and domestic IPR. In its history, the United States has a poor track record with recognizing copyright in foreign works.\textsuperscript{209}

skepticism toward Western institutions, the xenophobic and nationalist sentiments of the populace, the government’s censorship and information control policy, and the significantly different Chinese legal culture and judicial system.”).

\textsuperscript{203} MERTHA, supra note 13, at 3 n.6 (“The principal engine of IPR development in China... has been direct pressure brought about by other countries, chiefly the USA, ... [which has] essentially set the pace and priorities of China’s drive to establish an IPR regime.”) (quoting Economist Intelligence Unit, China Hand: The Complete Guide to Doing Business in China (Hong Kong: Economist Intelligence Unit, 1996), 5.).

\textsuperscript{204} Baum, supra note 2, at 54 (noting the first copyright principles were legally established in China in 1986).

\textsuperscript{205} See Rogoyski & Basin, supra note 4, at 252–54.

\textsuperscript{206} MORRISON, supra note 8, at 20–21.

\textsuperscript{207} Loretta Chao, China Firms Defend Tech-Purchase Rules, WALL ST. J. Dec. 14, 2009, at A4 (“[G]overnment procurement so far isn’t included in China’s [WTO] commitments.”).


It was not until the end of the nineteenth century that the United States recognized copyright for British authors. Prior to that point, publishers in the United States practiced rampant piracy against other English-speaking nations, prompting Charles Dickens to dub them “American Robbers” and tour the country lecturing on the benefits of recognizing foreign copyright. He found an audience for his lectures amongst American authors who “suffered from neglect,” unable to compete with their more popular, recognized, and accomplished compatriots on the other side of the Atlantic, whom American publishers preferred partially because they did not have to pay any licensing fees. As a result, it was actually American authors who became the major proponents for the recognition of foreign copyright, partially out of understanding that if the domestic content industry were to thrive, rampant piracy of foreign works would have to be curtailed. This evolution would seem to suggest that local content protectionism can play a significant role in effectively combating piracy and strengthening IPR as a whole.

It is important to note that, unlike China, the United States had generations of modern western philosophical thought upon which to establish the principles of international copyright protection, as well as sui generis protection for domestic works, and the relative absence of government interference in the trade and consumption of content goods. China is in the unenviable position of having to build respect for, traditions in, and enforcement of IPR virtually simultaneously. While the trade-prohibitive conduct with regards to U.S. content goods clearly violated China’s WTO obligations, it should not be ignored that China’s aggressive defense of its content industry marketplace might actually be an encouraging sign for both domestic and foreign content producers—an indication of strengthening internal justifications for protecting IPR in China.

211. Hudon, supra note 209, at 1158 (quoting Wilkens, Charles Dickens in America 237 (1911)).
212. Id.
213. Id.
C. WTO PROCEDURAL DELAYS IN GAINING MARKET ACCESS

Ultimately WTO dispute resolution is not the ideal forum for U.S. content industries seeking to gain meaningful access to Chinese markets quickly. It is a lengthy process wherein the affected parties must lobby the USTR to begin the series of consultations, which in turn begins the process of formal panel review. Several years after the initial objections, with a panel report in hand, the dispute is eligible for review by the Appellate Body. Even if the Appellate Body concludes that there was no error in the Panel’s findings, the offending party would still have the fluid “reasonable” period of time to somehow bring their conduct into compliance with WTO obligations. Although it is true that China—Publications & Audiovisual Materials is a landmark decision, and a victory for U.S. content industries, any change in how these goods reach China’s market will likely be slow in coming.\(^{216}\)

WTO dispute resolution procedures evolved from a desire to find diplomatic solutions and avoid confrontation. Lengthy consultation requirements\(^{217}\) and a general reliance “upon the willingness of members to implement decisions”\(^{218}\) demonstrate the diplomatic foundations and assumptions inherent in WTO dispute resolution. In China—Publications & Audiovisual Materials, the United States raised objections to China’s conduct several years before formal arbitration even began.\(^{219}\) Indeed, restrictions China placed on market access for certain goods were a point of contention pre-dating China’s WTO accession, and a topic the Working Party Group discussed.\(^{220}\)

Even after a dispute has gone through the lengthy formal arbitration process, and the DSB adopts the Panel’s recommendation, the dispute is often far from over. As seen in China—Publications & Audiovisual Materials, the recommendations are not very specific and simply call for the offending member to bring their conduct into compliance with WTO commitments.\(^{221}\) How China decides to bring its measures into compliance may also be a point of contention, and could reopen the dispute for another round of

\(^{216}\) Zeidler, supra note 9 (quoting Greg Frazier, executive vice president of the MPAA: “Nothing in China is right around the corner except for pirated DVDs.”).

\(^{217}\) Supra Section I.A.2.

\(^{218}\) Baum, supra note 2, at 64.

\(^{219}\) MORRISON, supra note 8, at 17–20.

\(^{220}\) Id. at 17.

\(^{221}\) See supra Section II.C.3.
lengthy arbitration in the WTO. Furthermore, China has a less-than-
encouraging record of promptly complying with international agreements.

IV. CONCLUSION

The United States won a significant victory in *China—Publications &
Audiovisual Materials*. There is a market in China for these content goods, and
the decision makes clear that cumbersome restrictions on the right to import,
distribute, and conduct content review for those goods is in violation of
China’s WTO obligations. Being able to circumvent some of these
government restrictions will undoubtedly aid foreign content industry
providers in entering the Chinese market in a timely manner, and thereby
combat piracy.

However, the victory is not without controversy. While the WTO
process runs its course, China has a “reasonable period of time” to bring its
conduct into WTO compliance. Even now that the Appellate Body has
affirmed the decision, it is certainly possible that something as benign as
institutional inertia may cause the violating conduct to continue, despite
China’s earnest attempts to bring its measures into compliance. A victory in
the WTO, even a resounding one, does not ensure immediate or even swift
market access.

Furthermore, by aggressively pursuing access to the markets through the
WTO, and defeating “public morals” exception claims, there is a danger that
the United States will appear to the rest of the world as cultural imperialists.
Content industries produce cultural goods capable of having dramatic social
and political influence. The “public morals” exception was included in
GATT to serve a vital purpose. China’s challenges to the way the Panel
applied the exception will likely resonate with several other countries who
have demonstrated a commitment to protecting their domestic national
content industries.

Beyond the legal victory and the potential practical and political
ramifications, there is nonetheless an element of this dispute that should be
encouraging for U.S. content industries. The fact that these measures are in
place in China, and being defended at least partially under the guise of
creating space for domestic content industries, gives support to the idea that

222. See, e.g., Panel Report, *US—Gambling*, supra note 143 (ruling on Antigua's claim,
after prevailing in the initial Panel Report and Appellate Body review, that the United States
failed to take steps to comply with the DSB's recommendations).

223. See Baum, supra note 2, at 64 (“China's record of adherence to such international
agreements . . . is not positive”). But see KONG, supra note 2, at 133 (“China has a generally
satisfactory history of adhering to international treaties”).
China is moving towards a polity with greater respect for cultural goods and the IPR embedded therein.
A NEW (OLD) SOLUTION FOR ONLINE COPYRIGHT ENFORCEMENT AFTER THOMAS AND TENENBAUM

Will Moseley

I. INTRODUCTION

Following ten years of rapid growth, online copyright infringement still represents a significant challenge to modern copyright owners. Over the past decade, the Recording Industry Association of America (RIAA) engaged in two major litigation campaigns to combat the spread of online music piracy: (1) against the companies that facilitated unauthorized online music sharing, and (2) against individual users who distributed copyrighted music. Towards the end of the first campaign, Professors Mark A. Lemley and R. Anthony Reese proposed an alternative system for resolving copyright disputes that would offer copyright owners a better means of enforcing their rights online.1

Prior to Lemley and Reese’s proposal, the RIAA began a challenging task: attempting to collect damages from online infringers within the framework of the 1976 Copyright Act. Given the practical challenges of gathering infringement evidence, the RIAA’s litigation strategy focused on testing new arguments for liability and damages. Although most defendants settled, those who fought the RIAA countered with their own theories of liability, defenses, and damages.

By the summer of 2009, juries returned verdicts in the only two cases to proceed through the entire trial process: Capitol Records, Inc. v. Thomas-Rasset and Sony BMG Music Entertainment v. Tenenbaum.2 Although these cases helped clear up some of the remaining uncertainty over how to apply existing copyright jurisprudence to online infringement by individuals, they had no effect on RIAA litigation strategies. The RIAA had announced the end of its campaign against individual infringers more than a year earlier, after finding that it proved costly, ineffective, and harmful to its clients’ public images.

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The RIAA’s attorneys spent years developing a strategy for establishing peer-to-peer copyright infringement liability, only to find that the drawbacks of using it outweighed its benefits.

This Note examines the RIAA’s approach in further detail, and proposes an alternative solution: the same system that Lemley and Reese described six years ago. Although they intended to solve a different set of problems, their proposal could address many of the shortcomings of the current system. Parts II and III discuss the RIAA’s first and second litigation campaigns, as well as the relevant legal precedents settled in each phase regarding direct copyright infringement online. Part IV describes Lemley and Reese’s proposal, and explains why the current state of affairs is unacceptable for copyright owners and for alleged defendants. The Note concludes with a discussion of the advantages of implementing the Lemley and Reese system.

II. PHASE ONE: THE RIAA’S LAWSUITS AGAINST FACILITATORS

The RIAA, in service of its mission to “protect intellectual property rights worldwide,” first responded to the threat of online music sharing by filing lawsuits against the companies that released file sharing software or operated peer-to-peer networks. The first Section of this Part discusses the litigation against Napster and other facilitators of online infringement. The second Section examines the aftermath of this initial campaign.

A. THE RIAA’S CLASHES WITH NAPSTER AND ITS COHORTS

On June 1, 1999, Shawn Fanning began a limited test of his project Napster, a system that would allow individual users to search for and download digital recordings of songs from the collections stored on fellow users’ hard drives. By October, Napster traffic was taking over university networks, and its users had downloaded a million songs. Although savvy Internet users had been able to download digital audio recordings before Napster, the new network’s growth rate and buzz was unprecedented. While

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3. RIAA, Who We Are (Aug. 22, 2008) (previous version of web page, on file with author). As the trade group representing the record labels responsible for 85% of American music production and sales, the RIAA strives to “foster a business and legal climate that supports and promotes [its] members’ creative and financial vitality.” Id.


5. Id.

this news excited Fanning and music fans, it deeply concerned the record industry. Mass quantities of copyrighted songs were being traded online, and business negotiations between Napster and major record labels to legitimize the service fell through in late 1999.7

After the failure of these negotiations, the RIAA’s member labels filed suit against Napster on December 7, 1999.8 The district court found that the labels’ claims of contributory and vicarious infringement of sound recording copyrights were likely to succeed, and granted a preliminary injunction against further unauthorized distribution.9 Napster appealed the order, arguing that there was no showing of likelihood of irreparable harm to the labels, and claiming several defenses including fair use.10 These arguments failed to persuade the Ninth Circuit, which upheld the preliminary injunction.11 The district court issued a modified injunction on March 5, 2001.12

Although this injunction effectively shut down Napster’s illegal trading, by that time other peer-to-peer file-sharing networks existed that allowed users to exchange music with similar ease. The RIAA’s member labels sued at least eight other companies operating peer-to-peer networks.13 The most notable of these cases, MGM Studios Inc. v. Grokster, Ltd., culminated in a U.S. Supreme Court decision addressing the standard for secondary liability for copyright infringement.14

8. Id.
11. Id. at 1027–28. Although Judge Beezer held that the district court was correct to grant the injunction, she found it to be “overbroad,” and instructed the district court on remand to require the labels to provide notice of infringement to Napster, while still requiring Napster to “polic[e] the system within the limits of the system.” Id. at 1027.
14. 545 U.S. 913 (2005). The Court clarified that the “staple article of commerce” safe harbor from Sony Corp. of Am. v. Universal City Studios, Inc., 464 U.S. 417, 442 (1984), only “limits imputing culpable intent as a matter of law from the characteristics or uses of a distributed product;” where other evidence of intent exists, the Sony rule does not apply. Id. at 933–35. The Court held that one who distributes a device (such as file-sharing software) “with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement” will be liable for secondary infringement, even where the device has substantial noninfringing uses. Id. at 936–37.
B. THE AFTERMATH OF THE LAWSUITS AGAINST FACILITATORS

Despite the RIAA’s successes in court against the operators of peer-to-peer networks, the popularity of file sharing over the Internet continued to grow. Penetration of broadband Internet access was forty-eight times higher in Q4 2003 than it was in 1998, so more people could download songs at a faster rate.\(^{15}\) Moreover, shortly after Napster began facing legal troubles, programmers started developing alternative peer-to-peer networks designed to avoid a key vulnerability of the Napster system.\(^{16}\) These “decentralized” file-sharing networks did not need a central server to operate, and thus could not be taken down by an injunction against a single operator. Whereas the original incarnation of the Napster network was shut down within two years of its creation, file sharing on the decentralized Gnutella network continued in abundance at least seven years after it first came online.\(^{17}\)

Although polling indicated that a majority of Napster users would be willing to pay a fee for music downloads,\(^{18}\) successful online stores for authorized downloads took much longer to open. By 2001, the five major record companies formed joint ventures to operate MusicNet and PressPlay, legal services that offered users new features such as streaming songs and exclusive remixes not available on CDs.\(^{19}\) However, customers were disappointed by the stores’ limited selections and upset by the technical restrictions on their purchases (such as expiration after a certain time or number of plays),\(^{20}\) and ultimately the services failed.\(^{21}\) Learning from these

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16. Two examples of such networks are Gnutella and FreeNet, both of which were released in 2000, after the filing of the first Napster suit. See Howard Weaver, New Secrecy, Anonymity Can Change Networked World, THE SACRAMENTO BEE, Apr. 3, 2000, at B5.


mistakes, Apple Computer licensed songs from all five major record companies and offered permanent copies to users for a flat rate from the successful iTunes Music Store.22

The Napster injunction eliminated the Napster network, but online music downloads continued. Illegal networks multiplied despite further lawsuits, and programmers released new systems that could not be shut down. By the time the iTunes Music Store provided a viable legal alternative, the damage was done: the RIAA labels’ record sales had been dropping since 1999, the year of Napster’s introduction.23 The RIAA needed a new legal strategy to protect its member labels’ intellectual property rights.

III. PHASE TWO: THE RIAA’S CAMPAIGN AGAINST INDIVIDUAL PEER-TO-PEER SOFTWARE USERS

On September 8, 2003, the RIAA’s member labels filed “the first wave of what could ultimately be thousands of civil lawsuits against major offenders who have been illegally distributing substantial amounts . . . of copyrighted music on peer-to-peer networks.”24 The RIAA cited two primary motivations for the campaign. First, it emphasized that these lawsuits came at the end of a multi-year campaign designed to raise public awareness of the illegality of unauthorized downloading, and were meant to “send a strong message” about the consequences of distributing copyrighted music online.25 Second, they hoped to motivate Internet users to begin choosing legal methods to acquire music online.26 Ultimately, the RIAA filed charges against approximately 35,000 individuals over the course of five years,27 which in turn forced courts to apply the Copyright Act to the realm of online digital copyright infringement.

Section III.A examines trends in the theories of liability argued by the plaintiffs and defendants in individual file sharing cases. Section III.B
discusses damage awards in these cases. Section III.C analyzes the implications of *Thomas* and *Tennebaum* on file sharing cases. Section III.D gives an overview of the results of the RIAA’s lawsuit campaign against individuals.

A. **THE PARTIES’ COMPETING THEORIES OF LIABILITY**

Although unauthorized sharing of copyrighted songs online was a serious problem for the RIAA’s member labels, the RIAA struggled to prove that particular users had actually committed any infringing acts. The RIAA could search a peer-to-peer network for a particular song and receive a list of other users offering that song for download, presumably in violation of copyright law. However, since there was no information about the source of the audio files, they also could have been purchased legally or transcoded from rightfully-owned compact discs. Although each user could have illegally distributed his copyrighted works to millions of other users, there were no records to prove or disprove such a claim. Therefore, RIAA lawyers and file sharing defendants’ counsels clashed over what type of showing would be necessary to establish online infringement, resulting in several competing theories.

1. **Statutory Sources of Liability for Infringement**

Direct copyright infringement requires two elements: “(1) the plaintiff must show ownership of the allegedly infringed material and (2) they must demonstrate that the alleged infringers violate at least one exclusive right granted to copyright holders under 17 U.S.C. §106.”

28 Since the RIAA’s member labels almost always succeeded in establishing their ownership of the allegedly infringed material, a defendant’s liability in an individual file sharing case usually turned on the court’s interpretation of the exclusive rights.

a) **The RIAA’s Successful Arguments for the “Making Available” Distribution Standard**

The RIAA had difficulty establishing that uploaders violated the traditional exclusive rights enumerated in 17 U.S.C. §106. The RIAA’s investigators, working for companies such as MediaSentry, developed a system for establishing an evidentiary record that an Internet user at a

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28 A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1013 (9th Cir. 2001). Section 106 grants the owner of a copyright (or his agent) the exclusive rights to do and to authorize reproduction of the copyrighted work, preparation of derivative works based on the copyrighted work, distribution of copies or phonorecords of the copyrighted work to the public, and several other more specific exclusive rights. 17 U.S.C. §106.
particular IP address had offered copyrighted works for download.\textsuperscript{29} However, the distribution of the work to a MediaSentry investigator would be the only instance of actual distribution that the RIAA could prove.\textsuperscript{30} RIAA attorneys countered that the uploaders’ offense was not a single distribution of copyrighted works to MediaSentry, but instead the act of making those works available for millions of other peer-to-peer network users to download.\textsuperscript{31}

RIAA attorneys initially argued that defendants violate plaintiffs’ exclusive right of distribution merely by making plaintiffs’ copyrighted works available for download by the public, even without actual direct proof of distribution. This “making available” language is not found in the statutory text of the Copyright Act,\textsuperscript{32} but appears to have been introduced as a basis for liability in \textit{Hotaling v. Church of Jesus Christ of Latter-Day Saints}.\textsuperscript{33} In that case, the defendant made unauthorized copies of plaintiff’s copyrighted work and almost certainly distributed them to the public by offering them in a library, but the statute of limitation on infringement by reproduction had passed.\textsuperscript{34}

The circuit court held,

\begin{quote}
When a public library adds a work to its collection, lists the work in its index or catalog system, and makes the work available to the borrowing or browsing public, it has completed all the steps necessary for distribution to the public. . . . Were this not to be considered distribution within the meaning of § 106(3), a copyright
\end{quote}


\textsuperscript{30} There is some disagreement over the admissibility of such evidence generally, but on the matter of infringement more specifically as well. Some defendants and commentators have alleged that, as an agent of the copyright owner, it would be impossible for MediaSentry to engage in infringement. See Robert Kasunic, \textit{Making Circumstantial Proof of Distribution Available}, 18 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 1145, 1157 (2008). But see Marc E. Mayer, \textit{Distributive Principles: The Determination of Copyright Infringement May Hinge on Whether “Actual Distribution” or Mere “Making Available” Has Occurred}, 32 L.A. LAWYER 35, 40 (2009).

\textsuperscript{31} See Plaintiffs’ Motion to Dismiss Counterclaims at 5, Sony BMG Music Ent. v. Tenenbaum, Civil Action No. 07cv11446-NG (D. Mass. Oct. 6, 2008) (arguing that the defendant “had 816 music files in the share directory on his computer and was distributing them to millions of persons who use peer-to-peer networks”); Plaintiffs’ Response to Motion to Suppress Evidence at 19, Capitol Records, Inc. v. Thomas-Rasset, Civil File No. 06-1497 (D. Minn. June 4, 2009) (concluding that “recordings in Defendant’s shared folder could have been downloaded by any one of the millions of users of the FastTrack network”).

\textsuperscript{32} See 17 U.S.C. §106.

\textsuperscript{33} 118 F.3d 199 (4th Cir. 1997).

\textsuperscript{34} \textit{Id.} at 201–03.
holder would be prejudiced by a library that does not keep records of public use, and the library would unjustly profit by its own omission.\textsuperscript{35}

The “making available” theory was applied in a scenario involving electronic distribution a few years later in \textit{New York Times Co. v. Tasini}\.\textsuperscript{36} The \textit{Tasini} plaintiffs were freelance authors who sold their work to periodicals for publication, only to have their articles sold by those periodicals to database vendors who made the articles available for end users to download.\textsuperscript{37} Despite lacking evidence that the database owners actually allowed end users to access or download the articles,\textsuperscript{38} the Court found that defendants’ system “effectively overrides the Authors’ exclusive right to control the individual reproduction and distribution of each Article.”\textsuperscript{39}

The Ninth Circuit supported a concept of liability by “making available” without direct evidence of distribution during the initial \textit{Napster} preliminary injunction appeal.\textsuperscript{40} Affirming the district court's finding that Napster users’ file sharing constituted copyright infringement, the circuit court held that “Napster users who upload file names to the search index for others to copy violate plaintiffs’ distribution rights.”\textsuperscript{41} As in \textit{Tasini}, the opinion does not explain the principle leading to this result,\textsuperscript{42} but \textit{Napster} stands as a particularly convincing precedent since the subject matter discussed is similar to that in the later individual file sharing cases.\textsuperscript{43}

In 2006 and 2007, a series of cases strengthened the “making available” theory of liability in individual file sharing cases. First, district courts in four separate opinions denied a defendant’s motion to dismiss RIAA infringement

\begin{itemize}
  \item 35. \textit{Id.} at 203.
  \item 36. 533 U.S. 483 (2001).
  \item 37. \textit{Id.} at 488–91.
  \item 39. \textit{Tasini}, 533 U.S. at 503–04.
  \item 40. See A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1014 (9th Cir. 2001).
  \item 41. \textit{Id.}
  \item 42. The court may have found it unnecessary to elucidate a principle to justify finding the users’ behavior to be infringement, as “[t]he district court also noted that ‘it is pretty much acknowledged… by Napster that this is infringement.’” \textit{Id.} (referring to the behavior of “a majority of Napster users”).
claims for a failure to prove that copyrighted works were actually distributed to the public. Though the courts denied the motions based on different analyses, each court decided that actual dissemination was not required to establish an infringement of the owner’s distribution right. Second, two courts granted motions for summary judgment to plaintiffs alleging infringement on “making available” theories. This series of decisions established a body of case law supporting liability on the basis of “making available” in peer-to-peer file sharing cases.

b) Defendants’ and Scholars’ Successful Arguments for the Actual Dissemination Standard

In opposition to the “making available” theories of liability, many defendants in individual file sharing cases and several academics fought for a standard of liability that required proof of actual distribution of copyrighted content. These opponents found support in National Car Rental System v. Computer Associates International, Inc. The district court in that case held that the plaintiff’s state breach of contract action sought to pre-empt the Copyright Act’s exclusive distribution right. The circuit court reversed, explaining that “[t]he copyright holder’s distribution right is the right to distribute copies,” and that the court could not conclude that “an allegation

45. See Horsfield-Bradbury, supra note 38 at 288–89 (discussing the rulings in these four cases).
46. Universal City Studios Prods. LLLP v. Bigwood, 441 F. Supp. 2d 185 (D. Maine July 25, 2006) (holding that “by . . . mak[ing] copies of the Motion Pictures available to thousands of people over the Internet, Defendant violated Plaintiffs’ exclusive right to distribute the Motion Pictures”); Motown Record Co., LP v. DePietro, No. 04-CV-2246, 2007 WL 576284 (E.D. Pa. Feb. 16, 2007) (mentioning that “the Court is convinced” that a plaintiff can establish infringement of the distribution right “by proof of actual infringement or by proof of offers to distribute, that is, proof that the defendant ‘made available’ the copyrighted work”).
47. See, e.g., Horsfield-Bradbury, supra note 38, at 275 (arguing that “the ‘making available’ doctrine has no basis in the text of the Copyright Act, the Act’s legislative history, or appellate jurisprudence, and thus should be abolished”).
48. 991 F.2d 426 (8th Cir. 1993).
49. Id. at 429.
that National ‘permitted the use’ necessarily amounts to an allegation of the actual distribution of a copy of the program.”

The “actual distribution” doctrine made its way into Internet copy infringement jurisprudence almost a decade later via *Arista Records, Inc. v. MP3Board, Inc.* MP3Board operated an online message board that provided links to downloads of copyrighted audio recordings that were not located on their own servers. Citing *National Car Rental*, the court denied a motion for summary judgment against MP3Board because there was no showing that the defendants had actually distributed unlawful copies. Notably, the court limited the “making available” liability from *Hotaling* to “particular instances” where “the proof is impossible to produce because the infringer has not kept records of public use.”

Surprisingly, the district court of the Northern District of California adopted an actual dissemination standard in *In re Napster, Inc. Copyright Litigation* after having allowed a “making available” standard in the *Napster* preliminary injunction appeal a few years earlier. Considering the same types of claims as in *A&M Records, Inc. v. Napster, Inc.* several years prior, Judge Patel followed Ninth Circuit authority requiring a showing of actual dissemination of copyrighted content to find direct infringement. The court also held that, “to the extent that *Hotaling* suggests that a mere offer to distribute a copyrighted work gives rise to liability under section 106(3),” it is contrary to both the weight of authority and the text and legislative history of the Copyright Act.

In 2008, after two decisions that supported “making available” theories of liability, the tide began to turn in favor of an actual dissemination

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50. *Id.* at 430 (original emphasis).
52. *Id.* at 5–6, 13–14; *see also* Perfect 10, Inc. v. Google, Inc., 416 F. Supp. 2d 828, 844 (C.D. Cal. 2006), *rev’d in part on other grounds sub nom.* Perfect 10, Inc. v. Amazon.com, Inc., 487 F.3d 701 (9th Cir. 2007) (holding that a search engine that linked to websites featuring unauthorized copies of the plaintiff’s photos did not infringe the plaintiff’s exclusive distribution right because “it is those websites, not Google, that transfer the full-size images to users’ computers”).
55. 114 F. Supp. 2d 896, 925–27 (N.D. Cal. Aug. 10, 2000); *see supra* Section II.A (discussing this case).
56. *Id.* at 802 (citing *National Car Rental* and *MP3Board*, among others).
57. *Id.* at 803.
requirement. In February 2008, in an order denying the RIAA’s motion for default judgment, a district court described the plaintiff’s “making available” claims as “problematic,” holding that “without actual distribution of copies . . . there is no violation [of] the distribution right.”

Two separate file sharing opinions released on March 31 undermined the Hotaling decision and took issue with “making available” theories in general. And on April 28, in an opinion denying plaintiffs’ motion for summary judgment, another court adopted an actual dissemination standard and dismissed all of the standard “making available” arguments. By mid-2008, this series of opinions noticeably weakened the credibility of “making available” theories.

2. Rejection of Fair Use Defense

Even if a copyright owner manages to prove that the defendant committed an act of infringement, the Copyright Act provides a defense for certain unauthorized “fair” uses. However, courts began to cast doubt on fair use as a defense to end user peer-to-peer infringement during the RIAA’s first litigation campaign. The most thorough rebuttal took place in the Circuit Court opinion on the Napster preliminary injunction. Defending against a secondary liability claim by arguing that its users had not infringed copyrighted sound recordings, Napster maintained that they were engaging in one of two fair uses: “sampling” music before deciding to purchase it legally, and “space-shifting” to listen to copies of music legally purchased elsewhere. After performing an extensive fair use analysis, the court held that “plaintiffs will likely succeed in establishing that Napster users do not have a fair use defense” and agreed with the district court’s conclusion that “Napster users are not fair users.” The Supreme Court returned to the subject of fair use in the Grokster opinion, but only in the offhand mention that “there has been no finding of fair use and little beyond anecdotal evidence of noninfringing uses.”

64. Id. at 1018–19.
65. Id. at 1019.
66. Id. at 1015.
Despite such precedents, courts occasionally seemed to validate fair use defenses in peer-to-peer end user infringement cases. In *Brennan*, the court listed fair use among the defendant’s possible meritorious defenses in an opinion denying the plaintiffs’ motion for summary judgment. In his order granting a new trial in *Capitol Records, Inc. v. Thomas*, Chief Judge Davis made the following statement of law: “A person who makes an unauthorized copy or phonorecord of a copyrighted work for the purposes of uploading it onto a peer-to-peer network, absent a defense such as fair use, violates the reproduction right.” However, in an order before the retrial, Chief Judge Davis held that the defendant had waived the fair use defense by failing to assert it during the first trial or at any point earlier than two weeks before the retrial. Thus the applicability of the fair use to file sharing defendants remained unclear at the end of 2008.

B. THE SCOPE OF DAMAGES IN FILE SHARING CASES

If a copyright owner managed to establish a peer-to-peer defendant’s liability, the court then had to consider the matter of remedies. Plaintiffs would often seek monetary damages as well as injunctions to prevent the uploaders from continuing to distribute their works online. Given the lack of evidence discussed in Section III.A, plaintiffs had no way of knowing how much damage the defendants’ infringement caused. The Copyright Act offers statutory damages without proof of harm, allowing the plaintiff to collect damages within a very broad range. Within this range, the proper amount of statutory damages to award per infringed work had not yet been determined for online peer-to-peer activity.

1. Applicable Law

In addition to injunctive relief, the Copyright Act offers the owner of a copyright the choice of two monetary damage remedies upon infringement. Where the owner has proof of damages suffered by the owner, profits earned by the infringer as a result of the infringement, or both, the owner may recover the sum of these damages and profits. Alternatively, if the infringed

69. Id.
70. 579 F. Supp. 2d 1210 (D. Minn. 2008); see infra Section III.C (discussing other aspects of this case).
71. Id. at 1225.
works have been previously registered,74 the owner may elect to receive damages selected from within a range set out in the statute, without having to show proof of damages or profits.75 The standard range of statutory damages is between $750 and $30,000 per infringed work, “as the court considers just,” but several factors may affect this range.76 If the infringement was committed “willfully,” meaning “with knowledge that the defendant’s conduct constitute[d] copyright infringement,”77 the maximum award increases to $150,000 per work.78 On the other hand, if the infringer proves that he “was not aware and had no reason to believe that his or her acts constituted an infringement of copyright,” the court may decrease the minimum award to as low as $200 per work.79 Finally, if the infringer “believed and had reasonable grounds for believing” that his use of the work constituted a fair use, or in very narrow circumstances involving libraries and public broadcasting entities, statutory damages may be remitted entirely.80

2. Statutory Damages Awarded in File Sharing Cases

Notwithstanding the large number of suits the RIAA filed, rulings on statutory damages were rare, as the vast majority of defendants chose to settle out-of-court rather than fight.81 Once courts began awarding statutory damages, they appeared to set a precedent for awards on the low end of the statutory range. In Atlantic Recording Corp. v. Lopez82 and in Atlantic Recording Corp. v. Howell,83 courts awarded the plaintiffs the statutory minimum of $750 per infringed work.

However, these awards were unusual for at least two reasons. First, perhaps because neither defendant had legal representation—Lopez defaulted and Howell appeared pro se—the plaintiffs requested only minimum

76. Id.
77. 4 MELVILLE B. NIMMER AND DAVID NIMMER, NIMMER ON COPYRIGHT § 14.04[B][3][a] (2009).
79. 17 U.S.C. § 504(c)(2) (2006). In practice, courts have made this a particularly difficult standard to meet—“even an innocent defendant generally cannot remit statutory damages below the mandatory minimum, unless the subject work was unpublished, bore an invalid notice, or was inaccessible to that defendant.” NIMMER, supra note 77 at § 14.04[B][2][a].
81. See Editorial, Stopping Music Piracy, CHI. TRIB., Dec. 27, 2008 at 28 (“Most of the targets . . . settle and agree to pay. Cases almost never go to trial.”).
82. 2007 WL 2010752 (S.D. Tex. July 5, 2007)
statutory damages. Second, a judge determined each damage award because neither case reached a jury. Thus, although courts awarding statutory damages in earlier file sharing cases favored the low end of the statutory range, these cases differed enough from a typical trial to jury verdict that there was reason to doubt their precedential value.

C. RECENT DEVELOPMENTS IN FILE SHARING CASE LAW: THOMAS AND TENENBAUM

In the summer of 2009, juries returned verdicts in Capitol Records Inc. v. Thomas and Sony BMG Music Entertainment v. Tenenbaum, the only two individual file sharing cases defended all the way to a jury verdict. Each of these decisions offered insight into how courts would apply the theories of liability and damages discussed supra in Sections III.A and III.B absent settlements and summary judgments.

1. Shifting Standards of Liability in Thomas

The first district court trial of Capitol Records Inc. v. Thomas, decided in late 2007, followed the “making available” theories enjoying considerable success at the time. Investigators hired by the RIAA found that an individual using the IP address assigned to Thomas shared 1,702 music files over the KaZaA network, including at least twenty-four recordings copyrighted by the plaintiffs. Jury Instruction No. 15 plainly stated that “[t]he act of making copyrighted sound recordings available for electronic distribution on a peer-to-peer network . . . violates the copyright owners’ exclusive right of distribution, regardless of whether actual distribution has been shown.” Following this instruction, the jury found that Thomas had infringed all twenty-four recordings in question. With this verdict, a court based its final judgment in an online infringement case on the “making available” theory of liability for the first time.

However, the wave of file sharing cases in 2008 that upheld an actual dissemination standard made an impression on the judge who presided over

86. See supra Section III.A.1.a).
87. Statement of Case at 2, Virgin Records America, Inc. v. Thomas, No. 06-1497 (D. Minn. Sept. 17, 2007). In this statement of the plaintiff’s case, they allege investigators found 26 infringing songs, but by the time of trial there were only 24 in question. Id.
90. See supra Section III.A.1.b).
the original *Thomas* trial. Concerned that the “making available” language in Jury Instruction No. 15 had been contrary to Eighth Circuit precedent and based on an authority overturned by *Atlantic Recording Corp. v. Howell*, Chief Judge Davis ordered the parties to submit briefs on the issue. After considering the parties’ arguments, he ordered a new trial. The order discussed at length all of the most common arguments of “making available” proponents, but found them insufficiently persuasive. It concluded that since *National Car Rental* was not only binding but also consistent with “the logical statutory interpretation of §106(3), the body of Copyright Act case law, and the legislative history of the Copyright Act,” proof of actual dissemination is required to prove distribution.

On retrial, the district court issued a modified version of the instruction on proving distribution that read “[t]he act of distributing copyrighted sound recordings to other users on a peer-to-peer network, without license from the copyright owners, violates the copyright owners’ exclusive distribution right.” The jury found in favor of the plaintiffs once again, despite the lack of “making available” language in the new instruction. Barring another doctrinal shift, Chief Judge Davis is unlikely to overturn this verdict as being contrary to the law. In his opinion ordering a retrial, he held that even if the only evidence available is proof that an investigator downloaded a copyrighted recording, “distribution to an investigator, such as MediaSentry, can constitute unauthorized distribution.” He later held that plaintiffs may use circumstantial evidence to prove actual dissemination.

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93. Including plain meaning of the word “distribution;” equation of “distribution” with “publication,” an act which does not require actual dissemination; a theory of infringement based on authorizing distribution; an opinion letter by the Register of Copyrights supporting liability by making available, and other arguments based on legislative history, U.S. treaty obligations, and so on. Id. at 1216–26.
94. Id. at 1226.
95. Final Jury Instructions at 21, Capitol Records, Inc. v. Thomas-Rasset, No. 06-1497 (D. Minn. June 18, 2009) (“The act of distributing copyrighted sound recordings to other users on a peer-to-peer network, without license from the copyright owners, violates the copyright owners’ exclusive distribution right.”).
97. Thomas, 579 F. Supp. 2d at 1216.
98. Id. at 1225; see Kasunic, supra note 30, at 1160 (“The production of evidence of a defendant’s distribution of a copyrighted work to an agent constitutes direct evidence of infringement of the work or works distributed to the agent. But such evidence may also be used as circumstantial evidence of additional infringement.”).
Therefore, Chief Judge Davis clarified that liability for distribution of copyrighted works requires proof of actual dissemination, but the *Thomas* retrial demonstrated that this standard is not as distinct from the “making available” standard as it once seemed. Under the evidentiary standards established in the retrial order, the type of evidence gathered by the RIAA to prove that a defendant made works available will likely suffice as circumstantial evidence of actual dissemination.

2. *Support for Fair Use in Tenenbaum*

In a recent order in *Sony BMG Music Entertainment v. Tenenbaum*, Judge Gertner offered the first in-depth consideration of fair use in the context of a peer-to-peer file sharing case. The defendant was a KaZaA user, like many defendants in peer-to-peer cases, but with a twist: Tenenbaum admitted sharing copyrighted music over the network for years, but argued that his actions constituted a fair use of the copyrighted works. His primary argument was that his private enjoyment of the songs did not “diminish[] the record companies’ revenues nor curtail[] overall artistic creation,” but he offered no factual evidence to dispute the plaintiffs’ argument to the contrary. This showing failed to impress Judge Gertner, who granted partial summary judgment for the plaintiffs.

However, Judge Gertner made interesting remarks in dicta regarding when a file-sharing defendant “could assert a plausible fair use defense.” She acknowledged that, in the late 1990s, paid outlets were not readily available and both law and technology were unsettled. “A defendant who shared files during this interregnum but later shifted to paid outlets once the law became clear,” in Judge Gertner’s view, “would present a strong case for fair use.” Returning to the considerations of modern defendants, she suggested that a defendant who space-shifted by ripping MP3s of legally purchased audio CDs, or a defendant who sampled copyrighted songs and then deleted the files, could plausibly claim fair use as well. Thus far, these

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100. *Id.* at 5–6.
101. *Id.* at 6.
102. *Id.* at 35.
103. *Id.* at 35–36.
104. *Id.* at 36. *But see* Am. Geophysical Union v. Texaco, Inc., 60 F.3d 913, 930–32 (2nd Cir. 1994) (holding that, although copyright holder had not established a “conventional market” for the works being infringed, market harm to an alternative licensing system was a substantial factor favoring the copyright holder in a fair use analysis).
theories have not been tested in court, but they offer reassurance that file sharing defendants can plausibly use the fair use doctrine.

Moving for new trial or remittitur, Tenenbaum raised several new fair use arguments. First, he insisted that Judge Gertner’s “interregnum” period should not have ended in August 2004, but rather should have continued until 2007. He reasoned that all of the songs available from legitimate online music stores featured cumbersome Digital Rights Management (DRM) protection until 2007, so there was no legally available alternative to the unencumbered songs available through peer-to-peer networks. Second, Tenenbaum argued that the record companies’ “aggressive promotion” of their works distributed on unprotected audio CDs, combined with their refusal to offer legal DRM-free downloads, created a sort of digital “attractive nuisance” that should have been weighed in the fair use consideration. Finally, he contended that the court erred by considering the adverse effects on the plaintiffs of holding file sharing such as Tenenbaum’s to be fair use, without balancing those costs against “the effects on everyone else of not recognizing a defense of fair use.” The court has not responded to these arguments at the time of writing.

3. Statutory Damages Disputes in Thomas and Tenenbaum

The verdict in the first Thomas trial set a dramatically different precedent from earlier statutory damages awards, assessed at summary judgment or default. Some authors had been reluctant to believe that juries would order statutory damages awards against individual uploaders, but the Thomas jury dispelled such concerns. They found that the defendant willfully infringed all twenty-four songs in question, and awarded the plaintiffs $9,250 per work, for a total of $220,000. Although well within the specified statutory range

107. Id.
108. Id. at 5–6 (“They failed to fence off the songs they published on CD by encrypting them, and they refused to provide an unencrypted online alternative for obtaining them. In consequence Tenenbaum, along with millions of others like him, fell into the vast, unfenced pool of unauthorized peer-to-peer file-sharing.”).
109. Id. at 7.
110. See supra Section III.B.2.
111. *See, e.g.,* Lemley & Reese, *supra* note 1, at 1404 (expressing “skepticism that severe civil or criminal sanctions will really be enforced. It is true that a large number of people participate in p2p file sharing, and it is possible that they would . . . serve on juries and return nullifying verdicts”)
per work for willful infringement, Thomas argued that the amount of the total award was “excessive and in violation of . . . Due Process” and moved for a new trial or remittitur.113

When a retrial was granted (albeit on other grounds),114 the jury awarded a greater amount.115 The jury once again found that the defendant had infringed all of the works in question willfully, but this time awarded the plaintiffs $80,000 per work, for a total of $1.92 million.116 The defendant has appealed this award.

In her motion appealing the damage award, Thomas argued that the ratio of actual harm suffered by the plaintiff to the total statutory damages awarded is so high as to be “grossly excessive.”117 Upon this point she built two arguments against the award: First, it should be set aside because it is so excessive that it is punitive rather than compensatory, and as such violates the protections of the Due Process Clause under the precedents of State Farm Mutual Automobile Insurance Co. v. Campbell118 and BMW of North America, Inc. v. Gore.119 Alternatively, the amount of the award is sufficiently “shocking” and “monstrous” that remittitur is appropriate “as a matter of federal procedural law.”120

The RIAA countered that the damages were appropriate, given the fact that the defendant was sharing as many as 1,700 songs over a long period of time, and considering her reprehensible conduct involving perjury and

113. Defendant’s Motion for New Trial, or In the Alternative, Remittitur at 1, Capitol Records, Inc. v. Thomas, No. 06-1497 (D. Minn. Oct. 15, 2007).
114. See supra Section III.A.1.b) (discussing Judge Davis’s order for a new trial).
116. Special Verdict Form, Capitol Records, Inc. v. Thomas-Rasset, No. 06-1497 (D. Minn. June 18, 2009). Some have suggested that the increased damages resulted from the jury’s perception that Thomas was dishonest. See Nate Anderson, Thomas Verdict: Willful Infringement, $1.92 Million Penalty, ARS TECHNICA, June 18, 2009, http://arstechnica.com/tech-policy/news/2009/06/jammie-thomas-retrial-verdict.ars (reporting that Thomas’s counsel believed “the jury thought Thomas-Rasset was a liar and were ‘angry about it,’ thus leading to the $80,000 per-song damages”).
117. Motion for a New Trial, Remittitur, and to Alter or Amend the Judgment at 2–4, Capitol Records, Inc. v. Thomas, No. 06-1497 (D. Minn. July 6, 2009). Thomas’s counsel notes that each song in question could be purchased on iTunes for $1.29, but was the subject of $80,000 of statutory damages in the award in question, a ratio of 1:62,015. Id.
120. Motion for a New Trial, Remittitur, and to Alter or Amend the Judgment, supra note 117, at 4–10.
destruction of evidence. The plaintiff argued that the Gore and Campbell standards cited by the defendant were improper because they apply to punitive damages, rather than statutory damages, and because their motivating concern is a lack of notice, which does not apply when the range of damages is given in the statute. Rather, the correct standard is the one established under St. Louis, I.M. & S. Railway Co. v. Williams, which is “extraordinarily deferential” to damage awards within statutory limits, and which has never been used to reduce or eliminate an award for due process concerns. The RIAA further argued that the award was not “grossly excessive” enough to justify altering the jury’s award via remittitur.

The court recently issued an order finally addressing the substance of these arguments. Without ruling on the constitutionality of copyright statutory damages, the opinion discussed appropriate amounts of damages at length. The court held that “statutory damages must still bear some relation to actual damages,” even though plaintiffs are not obligated to show proof of actual damages. The court explained that the high statutory damages maximum was meant to be a deterrent against the “enormous and enticing” gains of commercial infringement, but determined that deterrence alone cannot justify granting such high awards against individual infringers.

122. Id. at 13–14.
123. 251 U.S. 63 (1919).
125. Plaintiffs’ Response in Opposition to Defendant’s Motion for a New Trial, Remittitur, and to Alter or Amend the Judgment at 21–24, Capitol Records, Inc. v. Thomas-Rasset, No. 06-1497 (D. Minn. Aug. 14, 2009). The RIAA acknowledged the possibility of an acceptable remittitur in the interest of helping to end costly litigation, but urged the court to be guided by the damage amounts awarded by the juries in the Thomas trials and in Tenenbaum. Id.
127. Id. at 26.
128. Id. at 8–26.
129. Id. at 2.
130. Id. at 15.
Acknowledging Thomas’s willful misconduct and lack of remorse, Chief Judge Davis ruled that remittitur to three times the statutory minimum would be appropriate. Therefore, he reduced the damages award to a total of $54,000, an amount he nonetheless described as “significant and harsh” and “higher . . . than the Court might have chosen to impose in its sole discretion.”

The damages awarded in the Tenenbaum trial offered an idea of what types of damages a jury might award in a rather different scenario. In this instance, the defendant confessed to sharing copyrighted music online, and his defense strategy focused on convincing the jury to grant a minimal statutory damages award. The result fell between the two Thomas awards. The jury found that the defendant had willfully infringed all thirty songs at issue, and awarded the plaintiffs $22,500 per song, for a total award of $675,000.

In his motion for new trial or remittitur, Tenenbaum advanced several theories to argue that this award was excessive. Like Thomas, he argued that the awards raise due process concerns under the precedents of Gore and Campbell. However, he also attacked the award under the Williams standard, contending that the damages were “so severe and oppressive as to be wholly disproportioned to the offense” and offering contrasts to the circumstances in Williams in areas such as the defendants’ abilities to pay, the reprehensibility of the defendants’ actions, and the ratio of penalty to actual damages. Finally, he asserted that the award might constitute an “excessive

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131. Id. at 21.
133. Id. at 3. Considering the likelihood that Thomas-Rasset would infringe again in the future, the court also permanently enjoined her from future infringement of the plaintiffs’ sound recordings. Id. at 29–35.
137. Id. at 15–17. In response to the constitutional question, the Department of Justice submitted a brief in which they asserted that the Gore and Campbell standards to not apply to statutory damages, as they did in response to the appeal in Thomas. United States of America’s Memorandum in Response to Defendant’s Motion for New Trial or Remittitur and in Defense of the Constitutionality of the Statutory Damages Provision of the Copyright Act, 17 U.S.C. §504(e), Sony BMG Music Ent. v. Tenenbaum, No. 07cv11446-NG (D. Mass. Jan. 19, 2010).
fine” under the Eighth Amendment. Tenenbaum also argued that Congress never intended for statutory damages amounts in the Copyright Act to apply to noncommercial consumer infringement, or for such awards to be determined by a jury, and urged the court to remit the damages award to the statutory minimum.

One striking similarity between the two cases is that both Chief Judge Davis and Judge Gertner inserted pleas to Congress for statutory damage reform into opinions addressing the subject. In his order for a new trial, Chief Judge Davis “implore[d] Congress to amend the Copyright Act to address liability and damages in peer-to-peer network cases.” He emphasized that Thomas’s acts of infringement were for personal reasons and were not comparable to the activities of a large-scale commercial infringer. As such, he considered the damages awarded in the first trial to be “unprecedented and oppressive,” yet still not a deterrent against for-profit piracy. Echoing Chief Judge Davis’s language, Judge Gertner urged Congress to amend the Copyright Act in her order granting summary judgment for the RIAA on the fair use defense. Acknowledging the harm caused by infringement, she nevertheless found “something wrong with a law that routinely threatens teenagers and students with astronomical penalties for an activity whose implications they may not have fully understood.” But despite the judges’ sympathy, they appear to acknowledge that these high statutory damage awards are proper under the current Copyright Act.

D. THE MIXED RESULTS OF THE RIAA’S LITIGATION CAMPAIGN AGAINST INDIVIDUALS

Over the course of five years, the RIAA filed lawsuits against about 35,000 uploaders, but achieved only mixed success in its stated goals of

139. Id. at 17–18 (arguing that Tenenbaum “does not fit into the class of persons for whom the statute was principally designed” as he download music for noncommercial, personal use and the Copyright Act was intended to deter commercial infringement (quoting United States v. Bajakajian, 524 U.S. 321, 337 (1998))).
141. Id. at 23–25.
142. Id. at 25–26.
144. Id. at 41–42.
145. Id. at 41–43.
147. Id. at 34–35.
148. McBride & Smith, supra note 27.
increasing public awareness of the illegality of file sharing and shifting downloaders to legal markets. Survey evidence shows that the awareness prong of the campaign was quite effective. One RIAA representative reported that the portion of those surveyed who believed that file sharing was illegal rose from thirty-seven percent in 2003 to seventy-three percent in 2008.\footnote{149} Another survey from 2004 indicated that eighty-eight percent of children between eight and eighteen years of age believed that peer-to-peer music downloading was illegal.\footnote{150} Sales of sound recordings in legal online markets have soared since the beginning of the campaign. The iTunes Store has sold 8.5 billion songs since 2003,\footnote{151} and became the largest music retailer in the United States in 2008.\footnote{152} Other companies, such as Amazon.com and Wal-Mart, have introduced successful music stores as well.\footnote{153}

However, the campaign's effectiveness in deterring illegal file sharing is debatable. One survey conducted between fall 2006 and fall 2007 indicated that the portion of teenagers downloading music over peer-to-peer networks had decreased, and the portion purchasing music from legitimate online stores had increased.\footnote{154} In contrast, a study by piracy consulting firm Big Champagne indicated that the number of people sharing music on peer-to-peer networks and over the newer BitTorrent protocol increased between 2006 and 2007.\footnote{155} Although data from a consulting firm cited by the RIAA in 2008 indicated that the percentage of Internet users who illegally download music had remained constant for several years, it also showed that the volume of shared music had increased.\footnote{156} In total, the International


\footnotesize{156. McBride & Smith, supra note 27.}
Federation of the Phonographic Industry (IFPI) Digital Music Report 2009 found that “around 95 per cent of music tracks are downloaded without payment to the artist or the music company that produced them.”

Considering this mixed record, the RIAA’s exact reasons for ending their campaign are unclear. The RIAA suggested that the move resulted from a strategic shift from individual lawsuits to larger-scale agreements with Internet Service Providers (ISPs). However, others felt that the lawsuits “had outlived their usefulness,” and an RIAA spokesperson admitted that the record labels had lost money on the program. Despite the campaign’s success in raising public awareness, it attracted negative attention from both the public and the courts.

By the time the RIAA concluded its campaign, the numerous lawsuits it pursued across a wide variety of districts offered judges the opportunity to fit the modern problems of peer-to-peer file sharing within the paradigms of the 1976 Copyright Act. Courts considered new theories of liability, novel applications of existing doctrines, and creative arguments against prevailing interpretations. However, the recent Thomas and Tenenbaum decisions show that these innovations have not found favor in the eyes of the law. Liability for distribution once again requires proof of actual distribution, despite the difficulty of establishing this proof in peer-to-peer cases. Courts accepted no new applications of the fair use defense, and they upheld traditional statutory damage awards even while decrying their injustice to defendants. In the end,


158. McBride & Smith, supra note 27.

159. Id.


161. See Natividad, supra note 29, at 472 n. 15 (noting that “[t]he RIAA’s suits against direct infringers have resulted in negative publicity because of the general unpopularity of the suits . . . and the outcry of civil rights organizations and public interest groups”); see also McBride & Smith, supra note 27.

162. Decision and Order to Show Cause, Elektra Ent. Group, Inc. v. O’Brien, No. 06-5289 (C.D.Cal. March 2, 2007), available at http://www.lrweb.com/viewILRPDF.asp?filename=elektra_obrien_070302Decision (expressing concern that “in these lawsuits, potentially meritorious legal and factual defenses are not being litigated, and instead, the federal judiciary is being used as a hammer by a small group of plaintiffs to pound settlements out of unrepresented defendants”).
the current state of the law seems much like the status quo from five years ago.

IV. A PROPOSAL TO ADAPT LEMLEY AND REESE’S 2004 PROPOSAL

In response to the problems apparent at the end of the first phase of RIAA lawsuits, Professors Mark A. Lemley and Anthony R. Reese proposed a new system for copyright owners to enforce their rights more effectively in their 2004 paper, *Reducing Digital Copyright Infringement Without Restricting Innovation.* Although content providers face a different set of problems today, the system that Lemley and Reese proposed five years ago could improve upon shortcomings in the current state of the law in ways that would benefit both copyright owners and alleged infringers.

Section IV.A describes Lemley and Reese’s original proposal. Section IV.B explains why reform is still necessary, even though the RIAA has ended their end user litigation campaign. Section IV.C discusses how the Lemley and Reese approach would address some of these needs, and how it could prove advantageous for both copyright holders and the public. Section IV.D recommends a few modifications to the original proposal to account for modern developments. Section IV.E addresses some of the criticisms of Lemley and Reese’s original proposal.

A. LEMLEY AND REESE’S 2004 PROPOSAL

When Lemley and Reese wrote their original paper, the RIAA had recently filed its first rounds of lawsuits against a few hundred individuals. Thus, they were writing at the end of several years of lawsuits against the operators of networks that facilitated copyright infringement. They argued that shutting down peer-to-peer distribution networks failed to address the burgeoning end user distribution problem and imposed societal costs in the form of lost efficiency. Lemley and Reese contended that injunctions against facilitators would practically lump together legal and illegal conduct, and facilitators policing content would “tilt[] the [balance of] the law too far in favor of copyright owners” without proper incentives to avoid removing lawful content. They used the experiences of Napster as a case study

164. *Id.* at 1399 n. 15.
165. *See supra* Part II.
167. *Id.* at 1379–81.
168. *Id.* at 1385–86.
supporting the idea that requiring facilitators to police their own content is infeasible. Finally, they posited that enforcement actions against facilitators “restrict[] innovation directly, and therefore reduce[] social welfare by the net social value of that innovation.”

Lemley and Reese recognized two alternative approaches to online infringement: increasing the “effective sanctions” on end users by seeking civil or criminal penalties against large-scale infringers, or lowering the cost of enforcement. They discussed the former approach rather briefly. Conceding that the criminal penalties and civil statutory damages available for copyright infringement should be sufficient to deter at least some infringement, they claimed that these penalties had not yet served as compelling deterrents because the record industry had only recently begun suing individual uploaders at the time of writing. Still, the authors acknowledged that a small percentage of peer-to-peer users perform the majority of the uploading, and that sanctions against a portion of this group might “significantly reduce widespread peer-to-peer infringement.”

However, the authors identified several problems with this approach. They worried that imposing stiff penalties on a few users in order to deter many times more would seem “unfair and disproportionate.” They recognized that such a lawsuit campaign could also impose costs on the wrongfully targeted, and could deter potentially fair uses. Finally, they expressed concern that U.S. Attorneys and jurors in civil trials might be unwilling to enforce judgments against individuals for engaging in an activity as common as file sharing.

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169. Id. at 1383–85. Lemley and Reese note that, even in its modified form, the Napster injunction served as “an outright prohibition on the Napster system” because of lengthy (and costly) disagreements over how to redesign the network to comply. Id.
170. Id. at 1386–90.
171. Lemley & Reese, supra note 1, at 1395–1425.
172. Id. at 1395–96 (describing the statutory damages range as probably “ample” to deter major uploaders, and “arguably far too high already to do much good” against college students).
173. Id. at 1398–99; see supra Part III (discussing the RIAA’s litigation campaign against end users).
174. Lemley & Reese, supra note 1, at 1399–1401. The authors estimated that of 3 million users of the Morpheus network, 90,000 might be “high-volume uploaders,” and “su[ing], and impos[ing] severe sanctions on” 1,500–4,500 of these uploaders might be enough. Id.
175. Id. at 1405 (arguing that “we put up with random enforcement of traffic offenses because the sanction is so minor, but we might feel differently if speeders had to spend a year in jail”).
176. Id. at 1402–03.
177. Id. at 1403–04.
In response to these concerns, Lemley and Reese recommended two ways of lowering enforcement costs: charging a compulsory license fee on acts such as downloading, and establishing a quick and inexpensive alternative to the court system for resolving online copyright disputes.178 Both methods had existing precedents: compulsory licenses in the Audio Home Recording Act of 1992 and in systems in Canada and several European nations,179 and an alternative dispute resolution model in the Uniform Dispute Resolution Policy (UDRP) used for trademark disputes involving Internet domain names.180 While lauding the benefits that a compulsory license would offer in the realms of enforcement costs and reasonable penalties, the authors conceded that rate-setting and measurement would present difficulties.181

In light of these shortcomings, and inspired by the success of the UDRP,182 the authors ultimately recommended that Congress amend the Copyright Act to offer copyright owners the option to pursue certain copyright claims in a quick and inexpensive proceeding in front of a Copyright Office administrative judge.183 The system would be available only in limited circumstances—where the alleged uploader had made available “at least one copy of at least 50 copyrighted works during any 30-day period” 184 and the infringement did not involve edge cases like a wrongly identified defendant or distribution of out-of-print works.185 Rather than a face-to-face proceeding, the parties would present their respective evidence online.186 The plaintiff would need to show proof of registration and ownership of the copyright to the works, documentation that they were distributed at a certain time from a given IP address, and some evidence that the IP in question was assigned to the defendant at the time of infringement.187 In response, the defendant would have to provide convincing evidence supporting any applicable defenses such as fair use.188

178. Id. at 1405–06.
179. Id. at 1406–07.
180. Lemley & Reese, supra note 1, at 1411.
181. Id. at 1409–10.
182. Id. at 1411–12.
183. Id. at 1413–25; see also Mark A. Lemley & R. Anthony Reese, A Quick and Inexpensive System for Resolving Peer-to-Peer Copyright Disputes, 23 CARDOZO ARTS & ENT. L.J. 1 (2005).
184. Lemley & Reese, supra note 1, at 1413.
185. Id. at 1415–17. Claims falling outside of the system’s limits or presenting “plausible disputes of law or fact that are better resolved in court” would be dismissed from the alternative proceeding. Id. at 1417–18.
186. Id. at 1417–18.
187. Id. at 1413–15.
188. Id. at 1417.
Once the parties made their respective showings, the administrative judge assigned to the matter would then have two months to issue a short written decision and, if necessary, to award monetary or nonmonetary relief. The authors contended that a penalty of $250 per work, or slightly greater than the statutory damage award for innocent infringement, would serve as a sufficient deterrent. As nonmonetary relief, the court could officially designate the defendant as a copyright infringer, which would help Internet service providers comply with their requirement under the Digital Millennium Copyright Act to terminate the accounts of “repeat infringers.”

Lemley and Reese added that this system would be flexible and would yield better outcomes for both sides of each dispute. They maintained that the system would reduce the costs of enforcement for copyright owners, while resulting in more reasonable penalties against uploaders. They also described ways that it could be adapted for use in a hybrid approach with systems of levies, filtering, or collective licensing. Other authors have since cited the proposals in articles about topics such as rebalancing the provisions of the Digital Millennium Copyright Act (DMCA) and setting up an alternative system for the resolution of international copyright disputes. Thus far their system has not been implemented.

B. THE CONTINUING NEED FOR REFORM

The vast majority of online copyright infringement litigation to date has involved copyrighted sound recordings, and the system’s inherent problems remain even though the RIAA is no longer suing individual uploaders. Any type of creative work that can be stored in a digital format faces the threat of unchecked online infringement. Publishers have seen e-book infringement increase with the popularity of the Amazon Kindle and other e-book readers, and a surprisingly high number of users illegally download iPhone

189. Id. at 1418.
190. Lemley & Reese, supra note 1, at 1418–22.
191. Id. at 1418.
192. Id. at 1420–22.
193. Id. at 1423–24.
194. Id. at 1424–25.
195. Martha Pollack, Rebalancing Section 512 to Protect Fair Users From Herds of Mice-Trampling Elephants, or a Little Due Process is Not Such a Dangerous Thing, 22 SANTA CLARA COMPUTER & HIGH TECH. L.J. 547 (2006).
197. See supra Section III.D.
applications that often cost little more than a song on iTunes.\(^{199}\) Technological developments may expose previously “safe” industries to widespread piracy as well. In the same way that the spread of broadband Internet access facilitated music sharing\(^{200}\) and MP3 player ownership correlates with illegal downloading,\(^{201}\) the deployment of even faster Internet access\(^ {202}\) and the growing popularity of mobile phones that play video\(^ {203}\) may lead to increased piracy of movies and television programs. Even though the RIAA has stopped suing individuals, copyright owners in other industries may consider enforcing their copyrights against end users at some point.

However, the negative publicity effects of the RIAA’s campaign may discourage them from doing so.\(^ {204}\) This negative attention was often a response to the magnitude of damage awards granted. As Lemley and Reese explained, the economics of modern copyright law were based on a premise that there would be few counterfeiters, because there would be significant costs to acquiring the necessary equipment, facilities, and materials to make perfect copies.\(^ {205}\) Now that perfect digital copies can be made on a device as cheap and ubiquitous as a mobile phone, it seems disproportionate to apply the statutory damages originally intended for sophisticated and well-equipped counterfeiters to the non-commercial infringer.

At the same time, copyright owners have to seek high damages to justify the high costs of litigation. Lemley and Reese cite figures suggesting that it may cost $250,000 to litigate a low-stakes copyright case to a final judgment, and over $25 million for the high-stakes equivalent.\(^ {206}\) Sony BMG’s head of litigation admitted that the company spent millions of dollars and lost money

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199. See Paul Hyman, *iPhone Piracy: The Inside Story*, GAMASUTRA, Nov. 18, 2009, http://www.gamasutra.com/view/feature/4194/iphone_piracy_the_inside_story.php (revealing statistics that over 60% of iPhone applications have been pirated, and 90% or more of the copies of some popular applications are unauthorized).

200. See supra Section II.A.


204. See supra Section III.D.

205. Lemley & Reese, supra note 1, at 1373–78.

206. Id. at 1376 n.121.
on their enforcement campaign, which she described as a “money pit.” The costs of litigation present a paradox: the more expensive each enforcement action, the fewer actions a copyright owner can afford to bring, which lowers the probability that infringers will face consequences, thus necessitating that damages be higher to serve as an adequate deterrent, which in turn could heighten the sense that damages are unfairly high and lead to a public backlash. Defendants may find even settlement offers unfair when litigation costs are so high that they feel forced into settling.

If this expensive, publicly damaging process resulted in reduced infringement, there would at least be an arguable benefit. However, as shown by numerous studies, the dozens of thousands of RIAA lawsuits had no clear deterrent effect. There is some evidence to suggest that this was because piracy was so widespread that infringers felt that they would not be among the relatively few infringers “caught,” even with thousands of lawsuits filed. In short, the current system for enforcing copyrights against online infringement appears to be critically flawed.

C. THE ADVANTAGES OF THE PROPOSAL OVER TRADITIONAL LITIGATION

Two of the key benefits of the system proposed by Lemley and Reese are its quick pace and low cost. These features could prove invaluable for addressing the problems of traditional copyright litigation discussed in Section IV.B. If copyrights can be enforced against infringement for a lower cost, then copyright owners could seek lower damages and still recoup the

207. See Bangeman, supra note 160.

208. In one instance, a defendant to an RIAA infringement suit filed a counterclaim alleging that the RIAA engaged in extortion by simultaneously serving hundreds of defendants with both complaints and settlement papers. See Defendant Demands a Trial by Jury, Sony Music Ent. Inc. v. Scimeca, No. 03-5757 (D. N.J. Feb. 4, 2004), available at http://w2. eff.org/IP/P2P/RIAA_v_ThePeople/Sony_v_Scimeca/20040204_counterclaim.php; see also Assaf Hamdani & Alon Klement, The Class Defense, 93 Calif. L. Rev. 685, 688–89 (2005) (describing a situation where a defendant with a meritorious defense may settle rather than pay the cost of defending against the lawsuit).

209. See supra Section III.D.

210. See Jacqui Cheng, Study Suggests Economics, Not Morality Key to Online Movie Piracy, ARSTECHNICA, Jan. 25, 2007, http://arstechnica.com/old/content/2007/01/8703.ars (discussing a study that found that “[t]he illegal downloader looks at the risk vs. reward equation, factors in other terms like convenience and price, and ultimately finds the illegal download overwhelmingly more attractive than the legal download”); Posting of engimax to TorrentFreak, http://torrentfreak.com/fearless-pirates-dont-care-about-lawsuits-071013/ (Oct. 13, 2007) (relating that “as ever more serious headline-grabbing events come and go, file-sharers are getting wise and making their own risk assessments, probably based on: ‘I’m clicking every day, they never find me. Or any of my friends. Or their friends’”.


costs of enforcement. Since the system in the Lemley and Reese proposal would need to be added as a new section of the Copyright Act, these lower damages could be implemented while leaving the higher range of statutory damages intact for use against offline infringers or large-scale online pirates. Moreover, lower costs would mean copyright owners could afford to engage in more enforcement actions, and the quick pace of the process would allow for more rapid turnaround than traditional lawsuits. Thus, although each individual damage award would be lower, the copyright owner would be able to act against more infringers, improving the overall deterrent effect.

Alleged infringers would likely find this process to be fairer than the existing system. Lemley and Reese specified that their process would be streamlined, allowing parties to submit arguments and evidence online. As a result, defendants would no longer need to bother hiring an expensive lawyer just to respond. They designed the process to be quick, so defendants would not have to spend years engaging in litigation, like Jammie Thomas. And the smaller awards would seem more just than the massive statutory damage awards seen in *Thomas* and *Tenenbaum*. By avoiding the apparent unfairness of the current system, this proposal would allow copyright owners to protect their works effectively without incurring the reputational harm the RIAA suffered in their aborted campaign.

D. **SUGGESTED MODIFICATIONS TO THE ORIGINAL PROPOSAL.**

While the mechanics of Lemley and Reese’s plan remain advantageous, some of the details must be changed for the system to be effective in modern online infringement scenarios.

First, the original system was designed to deal only with infringement taking place over peer-to-peer networks. Although infringement over peer-to-peer networks is still a problem today, pirates have turned increasingly to other sources for copyrighted content. The same evidence gathering strategies used over peer-to-peer networks can be adapted for use with any service where copyrighted content is sent directly from user to user. It would be elementary to modify existing investigation methods to identify users sharing files using older methods, such as serving files in IRC channels. With some effort, these same means could be adapted for use over the BitTorrent protocol, which has become an extremely popular means for sharing copyrighted content in recent years. However, other common

211. Lemley & Reese, *supra* note 1, at 1417–18.
212. Internet Relay Chat (IRC) is a protocol that allows for text-based chat and other features, including file transfers.
213. *See supra* notes 17 and 155.
means of infringement, such as uploading files to online “cyberlockers” or storage sites, would not allow for the same type of evidence collection and would probably be better dealt with using DMCA takedown notices.214

Second, Lemley and Reese’s plan set a fixed penalty of $250 per work, and set a minimum threshold of fifty works distributed per month. If all possible works were approximately the same size and value, these hard limits would be more reasonable, but the types of copyrighted works distributed online vary greatly. An infringer should probably not face the same penalty for sharing a $1.25 MP3 and a $600 software suite, and the administrative court should not turn away cases involving the distribution of forty movies for being too frivolous, only to consider the distribution of fifty images to be substantial. There are simply too many different forms of digital media to be able to define and set independent rates for each category in the statute, and assessing a penalty based on the size of the files transferred would skew damages awards towards works such as movies and games and away from works such as songs and e-books.

Perhaps the level of damages should be assessed as a multiple of the market value of the illegally shared media, instead of some fixed value per work. This way, the penalties assessed for a given set of works would be proportionate to the cost of legally purchasing them. At the same time, the minimum threshold for bringing an infringer before the proposed system could be set as a minimum damages amount rather than a minimum number of works shared, to take into account the differences in the number of files necessary to qualify as a high-volume uploader of large, expensive works as opposed to small, inexpensive works. Furthermore, the damages threshold should probably be raised, if the system is intended only for those engaging in large-scale uploading.215

214. Users of peer-to-peer software transfer songs directly to each other, allowing an investigator to pose as another user and log the IP addresses of users distributing copyrighted media. Users of “cyberlocker” sites simply upload files to a general-purpose online storage service, and other users may later download those files from the same site. This leaves investigators no analogous means for recording the IP addresses of infringers. However, “cyberlocker” sites operating in America are likely to take advantage of the “safe harbor” provision offered under the DMCA for services that offer “storage at the direction of a user.” This protection requires such services to accept notifications of claimed infringement and to remove the content reported in these takedown notices. See 17 U.S.C. §512(c) (2006).

To demonstrate how the above changes would work in practice, consider a damages multiplier of 100 times the retail value of the work and a minimum damages threshold of $25,000. With these values, copyright owners could bring claims in the proposed system against an uploader who distributed 200 $1.25 songs, around seventeen $15.00 movies, five $50.00 video games, or one $250.00 software suite. Since the appropriate threshold level that indicates high-volume uploading, or the damages multiplier that serves as the most effective deterrent, may change over time, it may be preferable to set them in a periodically updated regulation rather than in the language of the statute itself.

Finally, in light of the deals that the RIAA has negotiated with universities and ISPs since the end of their litigation campaign, it might be worth considering a hybrid approach that enlists the assistance of universities and ISPs in the dispute resolution process. Under the current system, many ISPs cooperate with the RIAA to provide escalating notice and sanctions to their subscribers in response to reports of alleged infringement. If ISPs and universities operated administrative courts to resolve disputes in the manner described in this proposal, it could greatly reduce the burden on the Copyright Office. However, such an arrangement would probably lead to due process concerns over such matters as the objectivity of the private courts, uniform punishment of similar offenses across courts, and defendants’ inability to appeal decisions to a higher court.

E. POTENTIAL DRAWBACKS TO THE ADAPTED PROPOSAL

First and foremost, the costs of proceedings under the proposed system must be significantly lower than the current system for it to offer the advantages discussed in previous sections. One author expressed concern that there would be “no incentive” to use Lemley and Reese’s system since it would lack the economies of the “assembly line” litigation [strategy], where large numbers of individuals are sued in waves on virtually identical grounds” and the vast majority settle or default soon thereafter. Although valid, this outlook discounts the impression that the “assembly line” strategy makes on both customers and courts and the cost of the associated reputational

216. See McBride & Smith, supra note 27.
217. See, e.g., Greg Sandoval, Is AT&T Violating DMCA by Not Booting ‘Repeat Infringers’?, CNET NEWS, Apr. 1, 2009, http://news.cnet.com/8301-1023_3-10208747-93.html (describing AT&T’s policies, which include sending warning letters to alleged infringers, but relying on court judgments to identify “repeat infringers”).
Another factor to consider is that the discovery costs of hiring an agent such as MediaSentry to collect the necessary evidence are likely to remain constant. Perhaps investigators will achieve efficiencies with improved hardware, more experience, or sheer volume of work, but infringement cases for trial and for the proposed system require the same evidence. If Lemley and Reese’s alternative system can operate as cheaply as they envisioned, it should be less expensive than the process used by the RIAA. Otherwise, copyright owners may continue to choose traditional litigation over the alternative system.

One commentator noted that this discretion given to the plaintiff to choose whether or not to bring claims in the alternative system could lead to unjust outcomes for defendants who cannot afford to fight in traditional courts. The most just solution is probably the one proposed later in the same paper: to allow either party to a dispute to remove the matter to the alternative resolution system, if it could adjudicate the claims involved. However, this solution fails to address the commentator’s concern that the administrative courts must reject cases involving mistaken identity, fair use, and other complex determinations. Lemley and Reese wanted to “keep the process streamlined and focused on straightforward cases of infringement” by resolving such disputes in a traditional court, but regular court proceedings could unfairly burden poor defendants. While there is no easy solution to the problem of mistaken identity, Lemley and Reese imply that there is hope for fair users. They write that plausible fair use cases “should be considered and resolved in the first instance by a court.” Perhaps after a traditional court has made a determination that a particular act qualifies as a fair use, later administrative judges can follow its precedent rather than summarily refusing to hear similar claims.

Others expressed concern over the proposed system’s policy of targeting high-volume uploaders for various reasons. Some feared that a small number of offshore or anonymous high-volume uploaders, unreachable within the...
proposed system, could sustain a viable peer-to-peer network. Lemley and Reese downplayed such concerns, pointing out that truly anonymous networks are difficult to scale, that infringers would be unable to take refuge in any of the hundreds of TRIPs or Berne signatory nations, and that these uploaders could evade lawsuits in ordinary courts just as easily. One author suggested that targeting “hard-core file sharers” was futile because they are unlikely to switch to legal channels for acquiring copyrighted media; instead, copyright owners should target “marginal file sharers” who are more likely to be swayed. Lemley and Reese’s proposal shares the same ultimate goal—making sharing less attractive for “marginal file sharers”—they just differed on how best to accomplish it. Noting that a small percentage of users upload the vast majority of the files on peer-to-peer networks, they hoped that enforcement against enough high-volume uploaders would lead to a cascade effect of deterrence that would eventually cut off the supply to the entire network, high-volume and marginal file sharers alike.

Finally, several authors have raised concerns about the ultimate fairness of the proposed system to defendants. Whereas UDRP proceedings only affected the ownership of a particular domain name, the administrative court in this proposed system would be able to award damages to plaintiffs. Even the minimum damages award under this dispute resolution process would be much higher than the typical settlement amount in an RIAA individual file sharing lawsuit. This increase could lead to a different sort of public outcry, in spite of the fairness advantages of the alternative system. Concerned copyright owners could always continue offering cheaper settlements to alleged infringers, and defendants are less likely to see these offers as extortion since they would be able to present their side of a case cheaply and without counsel under the proposed system, but many defendants will probably still be upset. The “repeat infringer” designation also worried commentators, who feared that denial of Internet access to...
repeat infringers could lead to a “digital divide”\textsuperscript{234} or an “online class system.”\textsuperscript{235} These concerns are certainly valid, but the termination of repeat infringers is a requirement placed upon service providers by the DMCA, not by this dispute resolution system.\textsuperscript{236} Since the DMCA provides no definition for the term “repeat infringer,” Lemley and Reese proposed to give it a clear meaning.\textsuperscript{237} Moreover, this resolution process is a much fairer way of labeling a subscriber an infringer than simply accepting allegations from copyright holders without question, as many urge today\textsuperscript{238} and as future copyright legislation has proposed making the rule.\textsuperscript{239}

V. CONCLUSION

Six years ago, Professors Mark A. Lemley and R. Anthony Reese proposed a dispute resolution process as an alternative to lawsuits against facilitators of peer-to-peer file sharing in an effort to combat online infringement without harming innovation. At the same time, technological developments were making lawsuits against facilitators impracticable. In the years that followed, RIAA attorneys and their opponents fought to establish a framework for enforcing copyrighted works against individual online infringers within existing doctrines of copyright law. Unfortunately, while such enforcement is possible, it has proven to be so problematic as to be unsustainable on a large scale. The process costs an obscene amount of money, fails to deter infringement, and appears to the public to force defendants into settling or accepting unfairly high damage awards.

With a few modifications to account for modern developments, Lemley and Reese’s proposal offers a superior alternative to the current process. The quick pace and low cost allow for lower damage awards that are fairer to defendants, and a higher rate of coverage that should improve deterrence. The streamlined proceedings, conducted online with no need for counsel, give defendants a chance to fight their charges instead of feeling coerced into

\begin{itemize}
\item \textsuperscript{234} Yu, \textit{supra} note 215, at 731–32.
\item \textsuperscript{236} 17 U.S.C. §512(i)(1)(A) (limiting liability only for service providers who have “adopted and reasonably implemented … a policy that provides for the termination in appropriate circumstances of subscribers and account holders … who are repeat infringers”).
\item \textsuperscript{237} See Lemley & Reese, \textit{supra} note 1, at 1420–21.
\item \textsuperscript{238} \textit{Id.}
settling by prohibitive legal costs. With a little work, Lemley and Reese's proposal could give copyright holders and Internet users alike a fairer, more efficient, and more effective means of conflict resolution than our current system.
TWO CONFLICTING APPROACHES TO § 512(C):  
Io v. Veoh and UMG v. Veoh

Kuruvilla J. Olasa

Nicknamed Web 2.0, today’s Internet has democratized the creation and distribution of content. Blogs, wikis, video sharing websites, and social networking sites allow individuals to reach a global audience at a relatively low cost and without any special technical knowledge. This possibility of cheap, broad distribution has led to an explosion in content submitted by individuals and end users, dubbed user-generated content (UGC). UGC covers a broad spectrum: software, original digital videos, news and commentary, and even pornography.

The rise of UGC threatens the traditional content creation industry in at least two ways. The first threat is through increased competition, which occurs because these new sources of content now vie for consumer attention. This competitive threat can prove socially useful because it gives users more choices and may force the traditional content industry to innovate. Unfortunately, the same platforms that make UGC possible also threaten the content industry in a less socially useful way—through rampant copyright infringement. Some users take advantage of the distribution services that UGC platforms make possible to illicitly distribute copyrighted content to a wide audience.

Understandably threatened, and unwilling or unable to go after every end user, the content industry has instead targeted the service providers that host...
Given the scale of alleged infringement and the large damages available under the Copyright Act, these lawsuits against service providers threaten to put them entirely out of business. Fortunately for service providers, copyright law grants them a powerful tool that could potentially protect their business models and shield them from liability—§ 512 of the Digital Millennium Copyright Act (DMCA) and its four safe harbors.

Enacted in 1998, the DMCA gives qualifying service providers access to a number of safe harbors that dramatically limit their liability. However, determining whether a service provider qualifies for a safe harbor has been a difficult question that has recently troubled courts and commentators. Although the DMCA was enacted over a decade ago, the measured pace of judicial process has meant that much of the statute is only now being interpreted by the courts.

One requirement to qualify for two of the safe harbors, §§ 512(c) and (d), is that the service provider must not directly benefit from infringing activity if it also has the right and ability to control the infringing activity. For service providers that do benefit from infringing activity on their systems, the safe harbor could turn on a single question: when does a service provider have the right and ability to control infringing activity? Two recent cases address this issue.

In *Io Group, Inc. v. Veoh Networks, Inc.* and *UMG Recordings, Inc. v. Veoh Networks Inc.*, two different plaintiffs sued the same online video provider.

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10. See Metro-Golden-Mayer Studios, Inc. v. Grokster, LTD, 545 U.S. 913, 929–30 (2005) (“When a widely shared service or product is used to commit infringement, it may be impossible to enforce rights in the protected work effectively against all direct infringers, the only practical alternative being to go against the distributor of the copying device for secondary liability . . . .”); see, e.g., Complaint at 2–3, Viacom Int’l, Inc. v. YouTube, Inc. No. 07 CV 2103 (S.D.N.Y. Mar. 13, 2007).
15. 17 U.S.C. § 512(c)(1)(B) (stating that to qualify for safe harbor a service provider must “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”); 17 U.S.C. § 512(d)(2) (same).
for copyright infringement. In both cases the defendant, Veoh Networks, won summary judgment under the theory that it was entitled to a safe harbor under § 512(c) of the DMCA.\textsuperscript{18}

Although the \textit{Io} and \textit{UMG} courts both found that Veoh did not have the right and ability to control infringing activity, the opinions reveal that both courts had different, incompatible understandings of § 512(c). The Note explains that the \textit{Io} court’s view of § 512(c) focused on the \textit{practical} ability of a service provider to control infringement, holding that § 512(c) does not shield against vicarious liability claims. In contrast, the \textit{UMG} court did not consider a service provider’s practical ability to control infringement, holding that § 512(c) can shield a service provider against vicarious infringement claims. Finally, the Note argues that the \textit{UMG} court better interprets § 512(c).

I. THE DMCA AND § 512(C) SAFE HARBOR

A. THE DMCA

The DMCA, enacted in 1998, is the most significant amendment to the Copyright Act of 1976.\textsuperscript{19} According to its legislative history, the DMCA was “designed to facilitate the robust development and world-wide expansion of electronic commerce, communications, research, development, and education in the digital age.”\textsuperscript{20}

Title I of the DMCA implements two treaties of the World Intellectual Property Organization, to which the United States is a party.\textsuperscript{21} One of its provisions, known as the “anti-circumvention” provision, effectively outlaws the circumvention of technical measures used to safeguard a copyrighted work.\textsuperscript{22} For example, this provision outlaws removing the digital rights management (DRM) used to protect a downloadable movie. The DMCA’s legislative history indicates that Title I was intended to encourage content providers to make their content available electronically.\textsuperscript{23} By providing copyright owners enhanced copyright protection, such as the anti-circumvention provision, the legislation tried to give owners “reasonable assurance that they will be protected against massive piracy.”\textsuperscript{24} It was thought that this assurance would “facilitate making available quickly and

\textsuperscript{18} \textit{Io}, 586 F. Supp. 2d at 1154–55; \textit{UMG}, 665 F. Supp. 2d at 1118.
\textsuperscript{20} S. REP. NO. 105-190, at 1–2 (1998).
\textsuperscript{21} Id. at 2.
\textsuperscript{23} S. REP. NO. 105-190, supra note 20, at 8.
\textsuperscript{24} Id.
conveniently via the Internet the movies, music, software, and literary works that are the fruit of American creative genius.” 25 Initially, this part of the DMCA attracted the most attention and concern from commentators. 26 However, more recently, Title II has begun to emerge from the shadow of Title I. 27

While Title I was intended to address the concerns of the content industry, Title II was aimed at allaying the concerns of internet service providers (ISPs). 28 Congress recognized that courts had already begun to apply common law principles of liability to the online setting. Instead of abrogating these common law doctrines in favor of a statutory scheme, Congress decided to create certain safe harbors, islands of protection from the common law. 29

Title II provides four safe harbors to online service providers that meet certain criteria. 30 Its purpose is to provide “certainty for copyright owners and Internet service providers with respect to copyright infringement liability online.” 31 The explosion of internet services has made Title II’s safe harbors play a significant role in the often contentious battle between content producers and content distributors. 32

B. Section 512(c) Safe Harbor and “the Right and Ability to Control” Clause

Section 512(c) safe harbor is one of the four safe harbors made available by Title II of the DMCA. 33 It shields a service provider from most liability for information residing on their systems or networks at the direction of a user. 34 Section 512(c) is probably the most important of the safe harbors for

25. Id.
28. S. REP. NO. 105-190, supra note 20, at 8.
29. Id. at 19 (“Rather than embarking upon a wholesale clarification of [secondary copyright liability] doctrines, the Committee decided to leave current law in its evolving state and, instead, to create a series of ‘safe harbors,’ for certain common activities of service providers.”).
31. S. REP. NO. 105-190, supra note 20, at 2.
33. The DMCA’s four safe harbors cover (1) transitory network communications (2) system caching (3) information residing on systems or networks at the direction of a user and (4) information location tools. 17 U.S.C. § 512.
34. See id.
user-generated content sites because the entire business model of these sites often relies on hosting user content.

The statute specifies a number of requirements a service provider must meet in order to benefit from § 512(c)'s safe harbor. One of these requirements is that a service provider must not financially benefit from the infringing activity at issue while simultaneously possessing the right and ability to control the infringing activity. For a number of reasons discussed in this Part, the meaning of this clause has been in dispute. Specifically, courts and commentators disagree on what it means for a service provider to have the “right and ability to control infringing activity.” The crux of the dispute is whether courts should independently interpret “right and ability to control” in the context of the DMCA or whether this clause actually codifies the doctrine of vicarious copyright infringement.

1. The Vicarious Infringement View

The dispute over the correct meaning of § 512(c)'s right and ability clause begins with its language. The language of § 512(c)(1)(B) resembles the language used to describe vicarious liability. Section 512(c) covers only service providers that “do[] 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.” Similarly, a defendant infringes vicariously where it “profits directly from the infringement and has a right and ability to supervise the direct infringer.” This closeness in language has led some people to assume that § 512(c)(1)(B) codifies the elements of vicarious liability. To these commentators, “the right and ability to control”
under § 512(c) is the same as “the right and ability to supervise” under vicarious liability.

One implication of the view that § 512(c)(1)(B) codifies vicarious liability is that vicarious liability claims are effectively excluded from the ambit of § 512(c). In other words, under this view, § 512(c) does not shield service providers from vicarious infringement claims. Though the Io court adopted such an interpretation, the Note argues that this position is incorrect. But to understand why, it is first necessary to examine the doctrine of vicarious liability.

The Copyright Act does not directly provide for any form of secondary liability. Instead, theories of secondary copyright liability are judge-created doctrines. Vicarious liability, in particular, was developed “as an outgrowth of the agency principles of respondeat superior.” As Professor David Nimmer notes, vicarious liability traditionally arose in the “context of landlords of premises where infringement takes place.”

The Supreme Court addressed secondary liability and vicarious liability in the landmark cases of Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd. and Sony Corp. v. Universal City Studios, Inc. But in both of these cases, the Court did not have an opportunity to examine the meaning of right and ability to control because it based its decisions on different doctrinal principles. However, the Ninth Circuit—dubbed “the court of appeals for the Hollywood circuit” by Judge Kozinski—has had the opportunity to address this doctrine a number of times. Because the doctrine of vicarious copyright infringement is well-developed in the Ninth Circuit, and because the Note focuses on the conflict between two cases arising within the Ninth Circuit’s jurisdiction, this discussion considers Ninth Circuit case law.

Under Ninth Circuit precedent, a service provider’s right and ability to control an infringing activity appears to depend on three factors. First, a provider’s right and ability to control is linked to the boundaries of its

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40. Lemley, supra note 39.
41. Grokster, 545 U.S. at 930 (“[T]he Copyright Act does not expressly render anyone liable for infringement committed by another.” (quoting Sony Corp. v. Universal City Studios, Inc., 464 U.S. 417, 434 (1984))).
42. Id.
43. Fonovisa, Inc. v. Cherry Auction, Inc., 76 F.3d 259, 261–62 (9th Cir. 1996).
44. 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 12.04[A][2] (2008).
46. 464 U.S. at 417.
The provider is not responsible for infringement outside its premises but is responsible for policing its premises to the fullest extent. Second, the provider must be able to actually stop the infringing activity and not just deter it. It is not enough for the provider to make the infringement financially unattractive or more difficult. Finally, the capacity to stop infringement must be practical. The theoretical possibility of stopping infringement is not enough.

_Fonovisa, Inc. v. Cherry Auction, Inc._ 48 and _A&M Records, Inc. v. Napster, Inc._ 49 demonstrate that a service provider’s premises define its right and ability to control infringing activity. In _Fonovisa_, the Ninth Circuit considered the vicarious liability of a swap meet operator for copyright infringement conducted by vendors it rented to. 50 The defendant, Cherry Auction, operated a swap meet where it rented booth space to vendors for a daily rental fee. 51 As part of the agreement, Cherry Auction provided advertising and parking, and it also retained the right to terminate vendors for any reason. 52 The court found that Cherry Auction’s ability to exclude vendors was sufficient to give it the right and ability to control infringing activity. 53

_Napster_ applied _Fonovisa_’s principle to the online context. In _Napster_, the defendant’s systems acted as a matchmaking service, connecting users searching for a file with users advertising that they had the file. 54 The defendant’s system did not interact with the files themselves, nor did it transfer the files between users. Instead, the defendant possessed a database of file names that were matched up against the internet addresses of users who had the file. 55 The Ninth Circuit panel in _Napster_ applied _Fonovisa_ in a two-step process. First, it defined the extent of Napster’s premises—the area it controlled. 56 Second, the court asked whether Napster policed its premises “to the fullest extent,” as required by _Fonovisa_. 57

To the first question, the court held that Napster’s premises, the area it had a right and ability to control, were cabined by its system’s architecture. 58 Napster had no ability to control or monitor the files or activity on its users’ systems, but it did have the ability to monitor and control the central index it

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48. 76 F.3d at 262–63.
49. 239 F.3d 1004, 1023–24 (9th Cir. 2001).
50. 76 F.3d at 261.
51. Id.
52. Id. at 261–62.
53. Id. at 262–63.
54. See Napster, 239 F. 3d at 1012–13.
55. See id.
56. See id. at 1023–24.
57. Id.
58. Id. at 1024 (“Napster’s reserved ‘right and ability’ to police is cabined by the system’s current architecture.”).
Therefore, the court defined Napster’s premises to be its “file name indices.”

The court answered the second question, whether Napster fully exercised its control over its premises, in the negative. According to the court, Napster had the ability to look through its search indices and, based on file name, remove those file names that corresponded to infringing content. In this way, end users would not be able to locate these files. By failing to remove the names of infringing files from its network the defendant had failed to fully police its premises, and, by implication, had failed to exercise its right and ability to control the infringement.

Therefore, taken together, Napster and Fonovisa stand for a simple proposition: A service provider’s right and ability to control infringing activity extends to the boundary of its properly defined premises. And in the online context, as the Napster court indicated, a service provider’s right and ability to control is “cabined” by its system’s architecture.

Next, a service provider does not have a right and ability to control infringing activity simply because it can control any activity related to the infringement. Instead, through its actions the service provider must be able to actually stop the infringement. In Perfect 10, Inc. v. Amazon.com, Inc., the court distinguished between an ability to discourage infringement and an ability to actually control it. The copyright owner, Perfect 10, sued Google for linking to third party websites that contained infringing images and for marketing advertising space on these websites. Google retained the power to terminate its contract with any website that committed copyright infringement, but allegedly did not exercise this power. The court held that Google’s power to terminate its business relationship with a website did not equate to the power to actually control infringement on that website: “An infringing third-party website can continue to reproduce, display, and distribute its infringing copies of Perfect 10 images after its [relationship with Google] has ended.” Similarly, in Perfect 10, Inc. v. Visa International Service Association, the court expanded on this distinction between the ability to deter and the ability to control. According to the court, “the mere ability to

59. Id.
60. Id.
61. Id.
62. Id.
63. 487 F.3d 701 (9th Cir. 2007).
64. See id. at 730.
65. Id. at 725–26.
66. Id. at 730.
67. Id.
68. 494 F.3d 788 (9th Cir. 2007).
withdraw a financial ‘carrot’ does not create the ‘stick’ of ‘right and ability to control.’

Napster is consistent with this view. Although the actual infringement did not occur on the defendant’s systems, the defendant still had the power to entirely stop the infringement through control of its system. By searching its indexes for copyrighted song names, Napster could effectively prevent its users from trading in those songs.

Finally, at least one Ninth Circuit panel has found that this ability to control, as opposed to discourage, infringement must also be practical. The Amazon court held that in addition to a legal right to terminate infringing activity, a defendant had to have a “practical ability” to detect and terminate the activity. The court held that the defendant, Google, lacked the right and ability to control infringement because it could not practically detect which images it linked to were infringing and which were non-infringing. Amazon’s holding with respect to a practical ability to control is echoed in Napster as well. Like in Amazon, the Napster court focused on the defendant’s actual ability to police its search indices.

2. The Opposing View

Others reject the idea that the “right and ability” clause in § 512(c) is meant to reflect the common law meaning of vicarious liability, and that the statute cannot shield providers from vicarious liability claims. This camp points to the legislative history as well as the language of the DMCA to make their case.

The legislative history contradicts the idea that § 512(c) excludes vicarious liability in two distinct ways. First, the legislative history states that Congress both recognized that courts had begun to apply vicarious liability to online service providers and wished to leave that law in its currently evolving state while carving out certain safe harbors. Second, the record indicates

69. Id. at 803.
70. Perfect 10, Inc. v. Amazon.com, Inc., 487 F.3d 701, 730 (9th Cir. 2007).
71. Id. at 731.
72. Id.
73. See A&M Records, Inc v. Napster, Inc., 239 F.3d 1004, 1024 (9th Cir. 2001).
75. S. REP. NO. 105-190, supra note 20, at 19 (“Rather than embarking upon a wholesale clarification of [secondary copyright liability] doctrines, the Committee decided to leave current law in its evolving state and, instead, to create a series of ‘safe harbors,’ for certain common activities of service providers.”).
that Congress believed the safe harbors would be used to shield service providers from vicarious liability.76

Furthermore, those who oppose the “vicarious liability view” point out that interpreting the benefit and control exclusion as a codification of vicarious liability would render the statute internally inconsistent.77 The inconsistency arises because the DMCA presumes that service providers already have the right and ability to control their systems. In the view of these commentators, it would be illogical for the DMCA to deny service providers access to the safe harbor because of something the DMCA itself requires them to be able to do. Therefore, these commentators argue that the “right and ability to control” language in the statute should be interpreted as a departure from the meaning of that phrase in the vicarious liability context.78

II. IO GROUP & UMG’S SAFE HARBOR ANALYSIS

A. BACKGROUND ON VEOH NETWORKS

Veoh Networks is a video service provider that allows users to upload their own videos and share them with others. Since its inception, hundreds of thousands of users have uploaded and shared videos on Veoh’s systems.79 To upload a video to Veoh’s systems, a user must first create an account.80 After the account is created, the user can upload video in a variety of file formats.81 As part of this upload process, Veoh automatically converts the video into the “Flash” format and extracts several still images from the file.82 Veoh occasionally spot checks videos to ensure that they comply with its terms of use.83

Veoh has published a “Terms of Use” as well as an “Acceptable Use Policy.”84 These documents inform users that Veoh reserves the right to block content or terminate users for violations of Veoh’s policies, including

76. See id. at 40 (“The limitations in subsections (a) through (d) protect qualifying service providers from liability for all monetary relief for direct, vicarious and contributory infringement.”).
78. See id.; Lee, supra note 27, at 237.
80. Id.
81. Id.
82. Id. at 1138–40.
83. Id. at 1140.
84. Id. at 1137–38.
the unauthorized posting of copyrighted material. Nevertheless, many users upload infringing content onto Veoh’s servers.

B. Io Group v. Veoh Networks

In Io Group v. Veoh Networks, Io Group, an adult content creator, sued Veoh for copyright infringement. According to Io, Veoh was liable for infringement because it allowed users to upload and share Io’s copyrighted content. Specifically, Io claimed to have discovered that clips from ten of its films had been uploaded and viewed on Veoh without authorization. Io moved for summary judgment on the issue of liability, and Veoh cross-moved for summary judgment on the applicability of the § 512(c) safe harbor. The court first addressed Veoh’s motion and held that Veoh was shielded from liability under § 512(c). As a result, the court found that Io’s motion was moot because the relief it sought was precluded by the safe harbor.

In its opinion, the Io court methodically determined that Veoh met every requirement of the § 512(c) safe harbor. One of these requirements is § 512(c)(1)(B), which excludes a service provider from the safe harbor if it receives a direct financial benefit from the infringing activity while having the right and ability to control the activity. After adopting a form of the “vicarious liability” view of § 512(c), the court ruled that Veoh did not have a right and ability to control infringement because it lacked the practical ability to limit infringing activity.

The court started its analysis by holding that § 512(c)(1)(B)’s “right and ability to control” clause codifies the similar language from vicarious copyright liability. Essentially, the court adopted the “vicarious liability” view discussed in Part II. The court did not provide a reason for this holding, except to note that in Perfect 10, Inc. v. CCBill LLC, the Ninth Circuit had held that § 512(c)’s “financial benefit” clause should be interpreted consistent with the similar language from vicarious infringement. Thus, it appears that

85. Id. at 1138.
86. Id. at 1136.
87. Id. at 1135.
88. Id. at 1136–37.
89. Id.
90. Id. at 1135.
91. Id. at 1154–55.
92. Id.
93. See supra Part II.B.
95. Id. at 1150.
96. Id. (citing Perfect 10, Inc. v. CCBill LLC, 488 F.3d 1102, 1117 (9th Cir. 2007)).
the *Io* opinion implicitly accepts that the Ninth Circuit’s reasoning regarding “financial benefit” should be applied to “right and ability to control” as well.

After the court adopted the vicarious liability view, it was able to make use of vicarious liability case law in order to assess whether Veoh had the right and ability to control infringing activity on its system.\(^{97}\) According to the court, “a defendant exercises control over a direct infringer when he has both a legal right to stop or limit the directly infringing conduct, as well as the practical ability to do so.”\(^{98}\)

Looking at the specific facts in the case before it, the court found that Veoh did not have the right and ability to control infringing activities on its system because it lacked the practical ability to identify and remove infringing videos. As the court noted, “no reasonable juror could conclude that a comprehensive review of every file [uploaded to Veoh] would be feasible.”\(^{99}\) And, according to the court, “Veoh’s ability to control its index does not equate to ability to identify and terminate infringing videos.”\(^{100}\) Simply put, in the view of the *Io* court, although Veoh had the legal right to block infringing videos and the technological ability to do so as well, it lacked the necessary “practical” ability to both identify and block such videos.

An important implication of the *Io* court’s approach to the § 512(c) safe harbor is the way it ties system design and capability to eligibility for the safe harbor. This implication is a consequence of importing the “practical” ability to control standard from vicarious liability into safe harbor design. As the court noted: “At least one court has observed that the requisite ‘right and ability to control’ ‘presupposes some antecedent ability to limit or filter copyrighted material.’”\(^{101}\) Veoh did not have the practical ability to control infringement because its system did not give it such an antecedent ability.\(^{102}\) In contrast, according to the court, Napster’s system did have such an antecedent ability, and therefore was found to have the requisite right and ability to control.\(^{103}\)

The strongest support for the idea that under *Io*, system design and right and ability to control are strongly intertwined is explicitly found in the court’s own language: “Perhaps most importantly, there is no indication that Veoh has failed to police its system to the fullest extent permitted by its

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97. *See* Part II.
98. *Io*, 586 F. Supp. 2d at 1150 (citing Perfect 10, Inc. v. Amazon.com, Inc., 508 F.3d 1146, 1173 (9th Cir. 2007)).
99. *Id.* at 1153.
100. *Id.*
102. *Id.* at 1153.
103. *Id.*
Therefore, Veoh’s ability to control its network is closely informed by its system design.

As the next section shows, the UMG court took a drastically different approach to interpreting right and ability—an approach in which a service provider’s “right and ability to control” infringing activity is significantly less dependent on system design.

C. UMG RECORDINGS v. VEOH NETWORKS

Universal Music Group (UMG), a record company, sued Veoh for reasons similar to those in Io. \(^{105}\) UMG claimed that Veoh was liable for infringement because it stored and disseminated audiovisual works owned by UMG. As in Io, Veoh moved for summary judgment that it was entitled to § 512(c)’s safe harbor.

Although the issues in UMG and Io are extremely similar, there was at least one important factual difference. In UMG, the plaintiff claimed that the defendant took too long to implement a filtering system known as “Audible Magic.” \(^{106}\) Audible Magic is a third party product that is designed to filter out copyrighted content. It works by taking a “fingerprint” of each video and comparing it to a database of copyrighted works. \(^{107}\) Veoh began to use Audible Magic to screen files as users uploaded them, but UMG complained that Veoh should have adopted the technology sooner. \(^{108}\) UMG also argued that Veoh should have run Audible Magic on its “back catalog”—works that had been uploaded before Audible Magic was used. \(^{109}\)

The UMG court recognized that the DMCA’s text constrained the court’s interpretation of “right and ability to control” in two ways. One constraint was that the DMCA already presupposes that a service provider can control its own network. \(^{110}\) The second constraint, and the one that separated UMG’s analysis from Io’s, was § 512(m), which states that the applicability of the four safe harbors should not be conditioned on a service provider taking any affirmative steps to police its network. \(^{111}\)

UMG’s initial analysis is congruent with Io’s. As in Io, the UMG court recognized that it is untenable to read “right and ability to control” to mean...
no more than the service provider’s ability to control its own network. As the court recognized, “Congress could not have intended for courts to hold that a service provider loses immunity under the safe harbor provision of the DMCA because it engages in acts that are specifically required by the DMCA.”

UMG parts ways with Io when it recognizes an additional constraint in interpreting the statute. Section 512(m) provides: “[n]othing in this section shall be construed to condition the applicability of subsections (a) through (d) on . . . a service provider monitoring its service or affirmatively seeking facts indicating infringing activity . . . .” According to the court, any interpretation of § 512(c) would need to be consistent with § 512(m) as well. Therefore, § 512(c)’s applicability could not be conditioned on requiring a service provider to affirmatively police its network.

The additional constraint imposed by § 512(m) effectively precludes holding that right and ability to control retains its common law meaning because the common law standard for vicarious liability conditions liability on whether a provider has fully policed its system and excluded infringing users. For example, in Napster, the defendant was liable because it failed to fully police its file indexes. Interpreting “right and ability to control” to be a codification of one of the elements of vicarious liability, as the Io court did, would contravene the clear meaning of § 512(m) and render the statute inconsistent.

Therefore, the UMG court recognized that: (1) right and ability to control could not mean the mere ability to exclude users, but (2) neither could it mean the same as vicarious liability’s “right and ability to control” requirement. As a result, the court was forced to apply its own statutory analysis.

To resolve this tension, the court employed a different approach from the approach in Io. Instead of trying to qualitatively distinguish control of a system from control of an activity, the UMG court found that the level of control required to trigger the exclusion was simply quantitatively more than

112. Id. at 1113.
113. Id. at 1112.
114. Id. at 1113 (quoting Hendrickson v. eBay, Inc., 165 F. Supp. 2d 1082, 1093–94 (C.D. Cal 2001)).
116. UMG, 665 F. Supp. 2d at 1113.
117. See supra Part II.B.
118. See UMG, 665 F. Supp. 2d at 1115.
119. Id.
mere ability to control ones system. In the court’s view, the right and ability to control infringement has less to do with the service provider policing their own system, and more to do with the level of control exerted in the content distribution process. The court looked to two cases to determine the level of control necessary to trigger the exclusion.

In *Perfect 10, Inc. v. Cybernet Ventures, Inc.*, the court found that a defendant had the “right and ability to control” infringement with regards to § 512 when it prescreened websites, gave them extensive advice, and prohibited the proliferation of other identical websites. Similarly, the court pointed to *Corbis Corp. v. Amazon.com, Inc.*, which held that a defendant did not have a right and ability to control infringement under § 512 because it did not involve itself in any way with transactions on its website. Thus, although the court did not explicitly say so, it is possible that the key distinction lies between service providers that passively accept content, and those that partake in some kind of an active editorial role.

### III. COMPETING APPROACHES TO § 512(C)

Because *Io* and *UMG* came to the same conclusion regarding Veoh’s right and ability to control infringement, one might at first glance view the decisions as interchangeable. But such a conclusion would miss key distinctions between the courts’ reasoning. Although both cases reached the same result, they employed fundamentally different approaches that could have important implications going forward.

First, the *Io* reasoning would permanently link § 512(c) with common law vicarious liability; both would necessarily evolve together under this view. In contrast, the *UMG* view would ensure that interpretation of § 512(c) will not restrict the broader evolution of vicarious liability. Second, the standard established in *Io* would require courts to closely consider the design and practical limitations of a service provider’s system in order to determine the extent of its right and ability to control. Finally, under the *Io* view, a service provider’s ability to control infringement might encompass affirmative policing of its network. *UMG* instead provides a simpler conduct-based rule. Perhaps the clearest way to see the incompatibility between the two approaches is to apply *Io*’s reasoning to the slightly different facts in *UMG*.

120. See id.
121. See id.
123. See *UMG*, 665 F. Supp. 2d at 1114 (citing *Cybernet*, 213 F. Supp. 2d at 1181–82).
124. See id. (citing *Corbis Corp. v. Amazon.com, Inc.*, 351 F. Supp. 2d 1090, 1110 (W.D. Wash. 2004)).
A. UNIFICATION

Io's approach unifies the right and ability clause in vicarious liability with the right and ability clause under § 512(c). This unification could have one of two effects: It could either restrict the evolution of the vicarious liability doctrine in a way consistent with the DMCA, or it could create internal inconsistencies within the DMCA. By contrast, UMG's approach allows vicarious liability and § 512(c) to develop independently, but risks undermining the coherence of copyright law.

Io's approach links the interpretation of § 512(c)'s right and ability clause to the continually evolving doctrine of vicarious copyright liability. Under this approach, when a court needs to decide whether a service provider has the right and ability to control infringement, the court can and should look to precedent that applies the clause in either the safe harbor context or the vicarious liability context. Vice-versa, a court considering an issue of vicarious liability must consider decisions in both contexts as well. The essential point is this: now that they are linked, the vicarious liability “right and ability” clause and the § 512(c) “right and ability” clause must evolve in lockstep. Decisions interpreting the clause in any context affect both versions of the clause.

This lockstep evolution affects the development of the vicarious liability doctrine in a crucial way—it requires the doctrine to evolve in a way consistent with the DMCA. A court decision interpreting “right and ability” in a non-service provider context will still need to consider the DMCA. This is because when the court interprets the clause that interpretation will now also control in cases that are subject to the DMCA. In effect, the language of the DMCA will constrain the development of the common law doctrine of vicarious liability.

One example of such a constraint is § 512(m). This section of the DMCA states that a service provider’s liability cannot be conditioned on any affirmative steps it takes to police infringement. Any interpretation of “right and ability to control” in the DMCA context must conform to this restriction. But now, in addition, a court interpreting “right and ability” in an ordinary landlord-tenant context must adhere to this restriction as well and not impose any affirmative duties on landlords. If the court does impose affirmative duties it risks introducing an inconsistency into the DMCA.

UMG's approach sidesteps this problem, but in a potentially messy way. Under UMG, vicarious liability is free to develop on its own, without additional statutory restrictions. Separate inquiries as to a service provider's “right and ability to control” infringement are made in the liability context.

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and in the safe harbor context. Furthermore, a decision of a court in the safe harbor context need not affect the analysis of a court in the liability context.

However, *UMG*'s approach is messy—it undermines the possibility of a coherent copyright doctrine. Terms such as “direct financial benefit” and “right and ability to control” have traditionally held single, if constantly evolving, meanings. *UMG*'s approach destroys the possibility of such terms to have universally understood meanings. However, by explicitly creating affirmative safe harbors, the DMCA may, arguably, have intended to fragment copyright law.

B. **Different Standards**

A second, more fundamental, difference between *Io* and *UMG* is found in the standard each court developed. *Io*’s standard focuses on the practical ability of a service provider to stop infringement, an approach that requires the court to closely consider overall system design. And *Io*’s approach may also require a service provider to take affirmative steps in exercising this practical ability to control infringement. On the other hand, *UMG*'s approach requires the court to consider conduct and does allow for any affirmative duties on a service provider’s part.

The *Io* decision focuses on “practical” limitations. As discussed in Part II, Veoh was held not to have the right and ability to control infringement because it simply was not capable of detecting infringing videos from the hundreds of thousands of videos it received. The court’s analysis therefore proceeds as follows: (1) what are the overall capabilities of the defendant’s system, including technical capabilities and business capabilities, and (2) given these capabilities was it practical for the defendant to detect and block infringement.

Determining the contours of a defendant’s capabilities can be a highly technical task. For example, things like the efficacy of filters, the usefulness of spot-checks, and the usefulness of user-flagging systems can all be very empirical questions. Analyzing the issue of filters alone may require both sides to present expensive technical reports.

The second step is equally problematic. Given the defendant’s capabilities, the court must determine whether it was “practical” for the defendant to block infringement. It is unclear what this means, but arguably the court could apply a tort-like “reasonableness standard” and assess the costs of policing the network against the potential benefits. One of the possible effects of this rule is that it allows ISPs with fewer capabilities to have less of a duty to police their networks. As such, it creates an incentive for ISP’s to act strategically and not implement or design ways to reduce copyright infringement.
In contrast, the UMG approach does not consider the practical capabilities of the service provider in determining the applicability of § 512(c). Instead the court looks to the level of involvement between the service provider and the infringing activity.

C. THE IO AND UMG APPROACHES CANNOT BE RECONCILED

More than just representing different approaches to interpreting benefit and control, the Io and UMG decisions are fundamentally incompatible with each other. The clearest way to see this incompatibility is by applying the Io court’s analysis to the facts from UMG. If the UMG court had adopted Io’s analytical framework, the case’s outcome would likely have been completely different.

One of the major reasons the Io court found that Veoh was not excluded from the safe harbor was because there was no indication that Veoh did not police its network to the fullest extent possible.126 To the Io court, determining whether Veoh policed its network to the fullest extent possible was a matter of practicalities: Veoh did not have the practical ability to comb through hundreds of thousands of videos.127 Therefore, the court determined that there was no right and ability to control infringement.128 In the view of the court, Veoh’s ability to police its network was “cabined” by its architecture.

In UMG, the facts were subtly different. In that case there was evidence that Veoh had an automated filter to process and identify copyrighted content.129 Veoh used the filter to identify copyrighted works being uploaded, but failed to apply the filter to its back-catalog of works already on the system.130 Arguably, Veoh had not policed its system to its fullest extent—its ability to do so was no longer constrained by its architecture. In fact, its new architecture made it possible for it to employ at least limited policing.131 Therefore, under the Io court’s analysis, Veoh most likely would not be entitled to safe harbor because it was capable of policing its premises.

In contrast, the UMG court viewed the Audible Magic system as an affirmative effort on the part of Veoh, one that it was not required to undertake.132 Although such affirmative efforts do not lead to additional

127. Id.
128. Id.
130. Id.
131. Id.
132. Id. at 1113.
liability under UMG’s analysis, they might under Io’s. This is because under Io, a service provider like Veoh could alter the current architecture of the system and thereby alter the extent of policing required.

IV. UMG, IO, AND STATUTORY INTERPRETATION.

Two strands of statutory interpretation support UMG’s interpretation of § 512(c) over Io’s. First, § 512’s text supports UMG’s view that § 512(c) does not codify the doctrine of vicarious liability. Second, the legislative history of § 512 supports UMG’s view.

A. SECTION 512’S TEXT

Statutory text is generally the best starting point in interpreting a statute.133 In the case of § 512(c)’s benefit and control clause, the statutory text is extremely ambiguous. This is entirely unsurprising because if the text of § 512(c) were clear, courts would have little trouble interpreting it. In fact, the text provides strong support for both the Io interpretation of § 512(c) as well as the UMG interpretation.

The Io view finds support in the similarity of language between § 512(c) and the way many courts have described vicarious liability. When interpreting a statute, any “special senses” a particular word or phrase has acquired should be considered.134 Therefore, it seems reasonable that § 512(c) should be interpreted consistent with the “special sense” of vicarious liability its language seems to convey. But there are two problems with this argument. First, although the language is similar, it is not exact. As Professor Edward Lee notes, no court has ever used § 512(c)’s exact language to describe vicarious liability.135 This undercuts the idea that the exact language used in the statute has any special meaning. But more importantly, if Congress did want to encapsulate vicarious liability into section § 512(c), a much simpler label existed: the term “vicarious liability” itself. If § 512(c) was intended to incorporate the special meaning of a common law principle then it could have done so by either using the exact language of the doctrine or, more simply, the well-understood name of the doctrine.

Additionally, the existence of § 512(m) undercuts the Io view and supports the UMG view. A statutory provision’s meaning can be illuminated by considering a separate section of the statute. Here, § 512(m) sheds light on the meaning of § 512(c)’s benefit and control clause. According to § 512(m), the applicability of the safe harbors should not be conditioned on a service

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134. Id.
135. See Lee, supra note 27, at 240.
affirmatively monitoring its service.\textsuperscript{136} \textit{Io}'s view of the statute does not take § 512(m) into account. In fact, under \textit{Io}'s view a service provider does have a duty to police its network where feasible. In contrast, \textsl{UMG}'s view does not require a service provider to take any affirmative acts.

Therefore, the statutory text is ambiguous at best. While there is support for the idea that § 512(c)'s language has a “special sense,” the support is not unequivocal. Furthermore, there is support for the argument that § 512(c) cannot encapsulate vicarious liability because of § 512(m). This ambiguity can be resolved by looking to the history and the purpose of the statute.

\section*{B. LEGISLATIVE HISTORY AND PURPOSE}

The legislative history and purpose of the DMCA strongly support \textsl{UMG}'s view over \textit{Io}'s view. In the legislative history of the DMCA, Congress explicitly mentions that instead of clarifying the common law doctrines of copyright liability, it instead decided to carve out four safe harbors.\textsuperscript{137} The common law doctrines were to be left in their evolving state. This strongly supports the view that Congress wished to create statutory safe harbors that would protect a service provider under whatever common law regime of liability existed at the time. Interpreting § 512's right and ability to control to be a codification of vicarious liability would not further Congress's goal. Instead it would closely tie the common law standards to the statutory safe harbor, frustrating Congress's purpose.

Congress also intended that the DMCA provide service providers “certainty.” The standards of liability at the time were direct infringement as well as the common law doctrines of secondary liability—doctrines that Congress seemed especially concerned about. If Congress viewed the existing regimes of liability as too uncertain for service providers, it would make no sense to then import these standards.

Furthermore, moving from the abstract to the practical, the \textit{Io} approach provides significantly less certainty to service providers than \textsl{UMG}'s approach. As discussed, \textit{supra}, in Part II, \textit{Io}'s approach makes a service provider's liability depend on its system design, in contrast to \textsl{UMG}'s approach, which focuses more on the provider's editorial control. This makes \textit{Io}'s approach significantly more uncertain because each provider's capabilities to police its system will need to be tested in court. In contrast, by focusing on a service provider's extent of involvement with infringement, a


\textsuperscript{137} S. REP. NO. 105-190, \textit{supra} note 20, at 19 (“Rather than embarking upon a wholesale clarification of [secondary copyright liability] doctrines, the Committee decided to leave current law in its evolving state and, instead, to create a series of ‘safe harbors,’ for certain common activities of service providers.”).
provider can more easily limit its liability by just figuring out where courts have drawn the line.

For example, under the *Io* approach, the service provider’s ability to filter or review every video is an important consideration. But this capability is likely to be constantly in flux as technology or available resources change. But under the *UMG* approach, the service provider’s liability is more closely tied to its business model and level of involvement. Regardless of the underlying system, technology, or capabilities a protected business model will be protected for all service providers.

Finally, in at least one place the legislative history of the DMCA explicitly indicates that it is intended to apply to claims of vicarious liability. This makes sense; vicarious liability claims are likely the most common claims a service provider will encounter. A safe harbor regime that does not cover such claims would be a half solution indeed. The presence of such clear language in § 512’s legislative history provides ample support for *UMG*’s view.

### V. CONCLUSION

Considering the high stakes, § 512 and its four safe harbors are likely to play an increasingly important role in conflicts between service providers and the content industry. Therefore, it is crucial that courts become familiar with interpreting and administering these safe harbors. Perhaps more importantly, to reduce legal costs and uncertainly, courts need to develop uniform, consistent interpretations of the complex provisions of these safe harbors.

The disagreement over how to interpret § 512(c)’s right and ability to control clause is just one, albeit important, conflict that must be resolved in order for courts to develop a uniform, consistent § 512 jurisprudence. The *Io* and *UMG* courts have provided us with two very different interpretations of § 512(c). In *Io*, the court found that § 512(c)’s right and ability clause codifies the common law doctrine of vicarious copyright infringement. This interpretation means that a service provider’s right and ability to control infringement is closely tied to its practical ability to control infringement. Furthermore, under this view a service provider may be under an obligation to take affirmative steps to police its network. In contrast, the *UMG* court rejects the idea that § 512(c) codifies vicarious liability. Instead, for the *UMG* court, a service provider’s “right and ability” to control is connected to its level of involvement with the infringing activity. Although both approaches

138. *Id.* at 40 (“The limitations in subsections (a) through (d) protect qualifying service providers from liability for all monetary relief for direct, vicarious and contributory infringement.”).
find support in the text of § 512(e), the UMG approach appears to better reflect Congress’s goal in creating the safe harbors.
THE ASSOCIATED PRESS V. ALL HEADLINE NEWS:  
HOW HOT NEWS MISAPPROPRIATION WILL SHAPE 
THE UNSETTLED CUSTOMARY PRACTICES OF 
ONLINE JOURNALISM

Daniel S. Park

I. INTRODUCTION

The newspaper industry has entered “something perilously close to a 
freefall.” Profits are declining, daily newspapers have lost about 17% of 
their staff since 2001, and some fear deterioration into a vicious cycle of 
lost quality and further cost cutting. In a recent interview, President Obama 
worried that a failing industry would adversely affect the quality of reporting 
to the point that the news would become “all blogosphere, all opinions, with 
no serious fact-checking.” He emphasized that “serious investigative reporting . . . is absolutely critical to the health of our democracy.” The 
president echoed a growing—and increasingly shared—concern about the future of the media. Rep. Henry Waxman observed recently that “[a] 
vigorous free press and a vigorous democracy have been inextricably 

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2. PEW PROJECT FOR EXCELLENCE IN JOURNALISM, Overview, THE STATE OF THE NEWS MEDIA 2009: AN ANNUAL REPORT ON AMERICAN JOURNALISM, http://www.stateofthemedia.org/2009/printable_overview_chapter.htm (“Newspaper ad revenues have fallen 23% in the last two years. Some papers are in bankruptcy, and others have lost three-quarters of their value.”) [hereinafter PEW, Overview].
3. PEW, Newspapers, supra note 1.
5. Dave Murray, Newspaper Journalism Gets Words of Praise; Print Media’s Role Vital, Obama Says, TOLEDO BLADE, Sept. 20, 2009, http://www.toledoblade.com/apps/pbcs.dll/article?AID=/20090820/NEWS16/908200326; see also PEW, Newspapers, supra note 1 (“Fewer people and less space equates to significant erosion of the serious, accountability reporting that newspapers do more than any other medium.”).
6. Murray, supra note 5.
linked . . . . We cannot risk the loss of an informed public and all that means because of a ‘market failure.’”

The ease of disseminating information over the Internet has caused deep structural distress within the reporting industry.\(^8\) News aggregators have become a prominent new player, gathering articles written by news reporting agencies and offering a combination of headlines, ledes, summaries, and links back to the original story. In so doing, aggregators provide a useful service to consumers and generate their own ad revenue. Newspapers, however, struggle to capture a larger share of the ad revenue attached to their stories since large portions now go to aggregators.\(^9\) In short, customary practices in the news-reporting world are in a state of flux.

The Associated Press (“AP”), the largest and oldest news organization in the world,\(^10\) took one news aggregator to court for copying its news. In January 2008, AP sued All Headline News (“AHN”) for copying, rewriting, and reselling AP’s news.\(^11\) AP alleged that AHN committed, among other improprieties,\(^12\) the tort of “hot news” misappropriation.\(^13\) Judge Castel of the Southern District of New York denied AHN’s motion to dismiss the misappropriation claim.\(^14\) He found that the action, though originating from an old case of federal common law, was viable under New York law.\(^15\)

The parties settled in June 2009. Although the terms of the agreement were confidential, an AP spokesperson emphasized in a joint press release that the settlement would “safeguard[] AP’s investments in journalism, and [would] serve[] as notice to others that AP will fully defend its intellectual property rights against unfair competition.”\(^16\) AHN also acknowledged its

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8. Pew, Newspapers, supra note 1 (estimating that roughly half of newspapers’ recent distress can be attributed to cyclical problems such as the recession, with the rest of it due to structural problems).
9. Id.
11. Id.
12. The other claims are briefly described infra Part III.B, but are outside this Note’s scope.
15. Id. at 458–59.
improper use of AP’s content and that the tort of hot news misappropriation had been ruled viable and applicable in the case.\textsuperscript{17} Implicit in the settlement, particularly when coupled with AP’s earlier announcement that it would aggressively pursue claims of misappropriation to protect its content,\textsuperscript{18} was AP’s underlying theory that an enforceable claim of hot news misappropriation strongly serves its news reporting interests.

This Note argues that the doctrine of hot news misappropriation will play an important role in shaping the online newspaper journalism landscape. Cases like \textit{All Headline News} signal to an adapting industry that some behaviors are unsustainable and cannot become customary practices. Part II of this Note describes how the newspaper industry once thrived, now struggles, and is poised to adapt in the Internet age. Part III explains that the doctrine of hot news misappropriation reflects the customary practices of traditional newspaper journalism. Part IV argues that hot news misappropriation in \textit{All Headline News} will serve as a significant but behind-the-scenes anchor as new customary practices develop in online journalism.

\section*{II. JOURNALISM: THEN AND NOW}

\subsection*{A. TRADITIONAL NEWSPAPER JOURNALISM}

Historically, media industries—including newspapers, magazines, and television—delivered regular content to a stable audience and faced little competition for readers across local markets or for advertiser dollars.\textsuperscript{19} They were able to turn consistently exceptional profits, almost regardless of the quality of their product.\textsuperscript{20}

About 80\% of newspaper revenue traditionally derived from advertising dollars, most of it from classified and retail ads.\textsuperscript{21} Subscription prices

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{17} \textit{Id.}
\item \textsuperscript{18} See Dean Singleton, Chairman, The Associated Press, Remarks at the AP Annual Meeting (Apr. 6, 2009), http://www.ap.org/pages/about/pressreleases/pr_040609c.html.
\item \textsuperscript{20} Letter from Warren E. Buffett, Chairman of the Bd., Berkshire Hathaway Inc., to Shareholders of Berkshire Hathaway Inc. (Feb. 28, 1992), available at http://www.berkshirehathaway.com/letters/1991.html (observing that newspaper, television, and magazine properties were what he described as “franchises”—needed or desired, not easily substitutable, and not subject to price regulation—and therefore earned high returns regardless of the quality of management or product).
\item \textsuperscript{21} Jon Leibowitz, Chairman and Comm’r of the Fed. Trade Comm., Opening Remarks at the Federal Trade Commission News Media Workshop: “Creative Destruction” or Just “Destruction”: How Will Journalism Survive the Internet Age? (Dec. 1, 2009),
\end{enumerate}
\end{footnotesize}
accounted for only a minority of newspaper revenue; in other words, newspapers were sold to readers at a price that did not offset the costs of gathering the news, writing and editing articles, and printing the paper. This pricing model worked because reader and advertiser demand were interdependent: a lower subscription price attracted more readers, which attracted advertisers who wanted to target those readers. Newspapers could reinvest advertising revenue to improve their product and thus attract even more readers. In short, advertising dollars heavily cross-subsidized investigative reporting.

B. JOURNALISM TODAY

Print media today is characterized by reduced circulation, fewer advertising dollars, and increased layoffs. These trends began well before the Internet boom in the mid-1990s, but the huge shift to online media and the recession exacerbated the trends. It remains unclear where the bottom lies: as David Evans noted, print is either going the way of the typewriter or settling into the reduced but stable existence of the bicycle.

A primary driver of print media’s downward trend has been vastly increased competition for readers’ eyes on the Internet. As sources of the news, newspapers face competition from myriad low-cost entrants into the news reporting and commenting sphere—namely, bloggers. But newspapers also must indirectly compete for advertising dollars with websites such as


22. Some scholars call this kind of industry a “two-sided platform market.” See, e.g., David S. Evans, The Antitrust Economics of Multi-Sided Platform Markets, 20 YALE J. ON REG. 325, 329 (2003). Other examples of two-sided platform markets include video game consoles (players and game developers), shopping malls (shoppers and retailers), and payment cards (cardholders and merchants). Id. at 328.

23. PEW, Newspapers, supra note 1 (“The print circulation slide from 2001 to 2008 totals roughly 13.5% daily and 17.3% Sunday.”).

24. Id. (finding that the advertising revenue has fallen 23% in two years).

25. Id. (giving a low estimate of “roughly 25% of the industry’s news workforce lost in nine years”).


27. See generally PEW, Newspapers, supra note 1.


29. PEW, Newspapers, supra note 1. Note, however, that “roughly half of the downturn in the last year was . . . related to the economic downturn.” Id.
Craigslist and careerbuilder.com and even video games. These alternative channels are especially attractive to advertisers because their targeted audiences facilitate more focused advertising.

The downward trend is worrisome because it reflects far more than the cyclical problems brought by a recession. Newspapers, as Rep. Waxman noted, may be falling into a vicious cycle of cost-cutting and reduced quality attracting fewer readers and less revenue. The fear is that the downward trend will be permanent, because “[a] serious, protracted economic crisis can result in changes in consumer behavior that persist after the end of the crisis. A change in consumption, even in some sense involuntary, can be a learning experience. . . . [Readers and businesses] may never go back.”

Newspapers also struggle because they failed to monetize online distribution methods. The New York Times (“NYT”), for example, has until recently adopted the free distribution model, perhaps under the assumption that, like in traditional print media, the revenue generated from online advertising would offset the costs of gathering, writing, and distributing the news. This calculus proved faulty. When factoring in online readers, readership of newspapers has in fact increased in recent years. Half of those readers, however, obtain their news online where the industry produces only 10% of its revenue.

30. Id. (highlighting the effect of these sources of competition on newspaper advertising revenue).
32. Waxman, supra note 4.
34. Pew, Newspapers, supra note 1 (“[A] mistake may have been to make website content, much of it still drawn from big and expensive legacy newsroom operations, available for free.”).
The Wall Street Journal ("WSJ") chose a different approach and offered its content over the Internet for a yearly subscription fee. Rupert Murdoch claims that WSJ's subscriber model has largely succeeded and plans to extend the pay-to-read model to his other holdings, such as Times of London. Other papers such as The Economist employ alternative steps to charge for content, such as for older or premium articles. Note, however, that although the charging model may perform better than the free model, WSJ's subscription fee has increased over the years at a rate far outstripping the rate of inflation, suggesting uncertainty in WSJ's ability to value its own model.

Those problems and models aside, online reporting raises another new challenge to traditional newspaper journalism: the news aggregator. News aggregators gather stories from content originators and repackage it for a reader. Many aggregators exist. For example, Google News is a large aggregator that automatically gathers headlines and ledes and provides links to the full stories. However, viewership and revenues have grown but not nearly enough to offset the decline in ad revenues.


44. Compare Media Advisory, Dow Jones, supra note 39 (showing that in 1996 WSJ's online subscription price was $49 annually), with Wall Street Journal, Subscribe Now, supra note 39 (showing an increase in online subscription price by 210% to $103 annually). Comparatively, a dollar in 1996 now has the buying power of approximately $1.41, showing a total inflation of 37%. See Dollar Times, Inflation Calculator, http://www.dollartimes.com/calculators/inflation.htm (last visited Jan. 31, 2010).
to the original stories. Others, such as Huffington Post or Breitbart.com, contribute opinion reporting or editorial summaries of the news items in addition to or in place of links to the source of the original story. Individual bloggers can also act as small-scale aggregators, providing summaries of stories and links, usually to a very specialized audience. And some outfits behave as All Headline News once did, by copying, rewriting, and repackaging others’ news stories as their own.

News aggregators are easy to establish due to the low cost of entry into the market. The majority of newspapers adhered to the free model and made their content available for free online. Ease of access to content combined with the low cost of aggregation and linking provided aggregators the means to build a new industry. Aggregators provide a useful and valuable service by catering to consumers’ limited time and have quickly proven profitable.

Moreover, news aggregators provide economic value to content originators because most aggregators link to original sources. Linking is more than a courtesy to the original source; it lies at the heart of Internet economics as the “distinguishing feature of the Web.” News aggregators generate their own revenue by displaying ads alongside aggregated or summarized content. Newspapers frequently argue that aggregators take more than their fair share of the advertising revenue attached to a story. Nonetheless, the majority of newspapers’ online readers arrive via search engines and news aggregators. Although online revenue contributes only 10% of the newspaper industry’s revenue, and in its current form cannot alone sustain the costs of news gathering, newspapers are loath to lose any

48. See Complaint, supra note 10, ¶ 5.
51. Pew, Newspapers, supra note 1 (“Newspapers are reconciled to having many visitors arriving by search or from sites that aggregate news reports from many sources, at the same time hoping to have enough to offer that local users will linger. The companies seem to be betting that online advertising, disappointing in the last several years, will increase in volume and command higher rates with better targeting.”).
readers at all. For example, although major news sites could remove themselves from Google’s search results, they generally do not.

C. THE MULTI-PRONGED EFFORT TO SAVE NEWSPAPER JOURNALISM

Commenters have pitched various approaches to preserving the quality of journalism in the Internet age. None are panacean. Instead, each approach may contribute to a sustainable, multi-pronged ecosystem that supports quality news-gathering and profitable dissemination. The most frequently discussed approaches include: (1) protecting news content through sui generis legislation, (2) focusing on niche or hyperlocal reporting, which can lead to new pay models, (3) sharing revenue with aggregators, (4) controlling unauthorized dissemination through technological means, (5) offering new payment models, and (6) receiving public support.

1. Legislative Proposals

One proposed legislative solution would bolster federal copyright law either to award reporters temporary rights in the news they gather, or to provide a federal cause of action for hot news misappropriation. In 2009, for example, Judge Richard Posner wrote that it might be necessary to “[e]xpand[] copyright law to bar online access to copyrighted materials without the copyright holder’s consent, or to bar linking to or paraphrasing copyrighted materials without the copyright holder’s consent.”

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53. Rupert Murdoch has stated that he will be removing News Corp content from Google’s search. Johnson, supra note 50, at 1.

54. See, e.g., Ryan T. Holte, Restricting Fair Use to Save the News: A Proposed Change in Copyright Law to Bring More Profit to News Reporting, 13 J. TECH. L. & POL’Y 1, 32–33 (2008) (proposing that the Copyright Act be amended to give news reporters rights in their gathered facts for 24 hours).


56. Posner, The Future of Newspapers, supra note 33. Note that this blog entry marks a significant shift from Posner’s position in 2008 that “copyright law cannot prevent [the free-riding behavior of bloggers], because a newspaper can prevent the copying of its articles—that is, the verbal form in which the information in an article is expressed—and not the information itself.” Posting of Richard Posner to The Becker-Posner Blog, Are Newspapers Doomed?, http://www.becker-posner-blog.com/archives/2008/06/are_newspapers.html (June 29, 2008) [hereinafter Posner, Are Newspapers Doomed].
Senator Benjamin L. Cardin (D-MD) recently introduced a different kind of bill called the Newspaper Revitalization Act of 2009. This bill targets only small local newspapers and allows them to operate as non-profits, thereby exempting them from paying taxes on advertising and subscription revenue. Newspapers electing to take on tax-exempt status would be prohibited from making political endorsements, but would retain independence in all other operations, and would essentially be treated like public broadcasting stations.

2. Niche and Hyperlocal Reporting

Niches offer a promising target for many smaller newspapers and subsidiaries of larger newspapers. By offering news keyed to a particular location or a specialized audience, newspapers can create monopolies with a stable audience, albeit on a smaller scale than in the heyday of traditional journalism. These monopolies would enable niche newspapers to secure steady advertising revenue, and perhaps even adopt new subscription models. Arguably, WSJ’s pay-to-subscribe model has succeeded because WSJ offers specialized financial news not otherwise readily obtainable.

A recently developing joint venture between private equity founder Warren Hellman, KQED-FM public broadcasting, and the Berkeley Graduate School of Journalism is working to create a nonprofit local news website. The website would fill a local niche and be paid for by benefactors, similar to public broadcasting. The project emerged during an effort to save the existing area paper, The San Francisco Chronicle, but quickly shifted toward an entirely new direction in order to “support[] local journalism in any form,

58. Id. § 1.(k).
60. See, e.g., www.WickedLocal.com, which features over a hundred hyperlocal blogs in Massachusetts (last visited Jan. 31, 2010).
61. As indicated by Rupert Murdoch, supra note 40, at 11, and Peter Kann, supra note 38, at 2.
62. Kann, supra note 38 (WSJ’s content was “distinctive and very largely unduplicated”)
64. Id.
and] to pick up some of what newspapers have dropped." Hyperlocal reporting in the context of the Hellman-Berkeley endeavor refers to the creation of a neighborhood-specific website, or one specific to a single type of news, such as the arts in the Bay Area. Once established as a community fixture, these kinds of sites could enjoy customer loyalty. Sites like these also benefit from a lead time advantage over competitors, if competitors exist.

3. Sharing Revenue With Aggregators

Another major effort of the news industry has focused on developing relationships with aggregators to recapture advertising revenue directed at aggregators’ sites. For example, Google pays AP an undisclosed license fee to aggregate AP’s content on Google News. The parties are actively negotiating compensation schemes going forward. AP considers receiving the licensing fee akin to being “thrown a bone” in lieu of receiving the much larger compensation possible through sharing advertising revenue.

Google, however, has showcased new technologies in addition to its existing AdSense service that could change the way that content producers earn revenue. Three technologies in particular may change the game for revenue sharing: FastFlip, the DoubleClick Ad Exchange, and a micropayments platform. FastFlip is an automated aggregator that acts as a

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65. Id.
66. Id.
67. See also Smith, supra note 62.
69. Note, however, that a potential drawback to a lack of competition could be a lack of quality checks.
71. Id.
hub for news from many different sources, but notably offers a share of associated advertising revenue to the content originator. DoubleClick Ad Exchange is a real-time auction for Internet ads that allows publishers to increase the number of advertisers. The micropayments platform facilitates the monetization of digital content. Such technologies have the potential to more fairly distribute advertising dollars to news companies.

But Google will not be monopolizing the future of content aggregator relationships. News Corp has reportedly been in talks with Microsoft about creating an exclusive partnership for the Bing search engine: News Corp would block other search engines from displaying its stories, and Bing would link only to News Corp stories.74 Apple made headlines as well when it recently announced the upcoming iPad, which is designed to integrate closely with print media.75

Newspapers and aggregators face a substantial hurdle: overcoming an Internet-is-free mentality,76 or at least a consumer expectation for free news that newspapers may have themselves created by adopting the free online distribution model.77 A basic tenet of the Internet link economy is that the aggregation of content by linking generates ad revenue both for the aggregators and the linked-to sites. Furthermore, some scholars contend that anyone who posts content to the web naturally consents to linking, at least to some reasonable degree.78 The problem with the link economy is that being linked to is far less lucrative than being the linker.79 Aggregators receive far more ad revenue, especially when they provide enough of a headline or summary that readers need not click through to the originating site.

4. **Controlling Unauthorized Dissemination through Technological Means**

AP and others sponsor a Digital Rights Management approach to controlling and monetizing their content. In July 2009, AP announced that it would build a news registry to “encapsulate AP and member content in an

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76. See O’Rourke, * supra* note 49, at 615. (“The Internet is rooted in a tradition of openness and information sharing, and the web is intentionally designed to facilitate this through linking.”).
78. See O’Rourke, * supra* note 49, at 620.
informational ‘wrapper’ that includes a digital permissions framework.”80 In other words, AP would track all of its content to assure compliance with terms of use.81

Attributor offers a similar line of products called “FairShare” that periodically scans billions of web pages to look for unauthorized copies of a copyrighted work to help a copyright holder enforce its rights.82 FairShare works by digitally fingerprinting the essential features of protected content. AP is counted among its customers.83

5. New Payment Models

Some newspapers attempt to generate revenue directly from readers. The charge model requires an annual subscription to gain access to the paper’s full content.84 Other newspapers have attempted partial subscription models, such as the short-lived NYT “TimesSelect” program, which required a subscription to access editorial content.85 Some commenters have encouraged the development of a micropayments model much like iTunes,86 emphasizing the smaller unit of consumption typical with consumers’ use of the Internet.

However, a newspaper largely subsidized by readers’ direct payment for content—as opposed to traditional newspapers’ cross-subsidization by advertising revenue—raises the question of whether the quality of reporting could decline as a result. Rupert Murdoch extolled News Corp’s “good record” in “looking for ways—whether better content or delivery—to meet [its] customers’ needs and interests.”87 News Corp gives readers what they want to read, but at what cost? The market for newsworthy but unpopular

81. Id.
84. See Wall Street Journal Online, Subscribe Now, supra note 39.
87. Murdoch, supra note 40, at 6.
stories diminishes when those stories can no longer be bundled with merely popular stories.88

6. Public Funding

An October 2009 report entitled The Reconstruction of American Journalism makes several recommendations to save local media, one of which would enable public funding through a system similar to the National Endowment for the Arts.89 Funding could flow from a surcharge for radio and television licenses, spectrum auctions, or Internet service provider fees.90 The report downplayed a potential counterargument in the loss of reporters’ autonomy by highlighting public broadcasting’s resilience to political pressure.91

III. HOT NEWS MISAPPROPRIATION REFLECTS CUSTOMARY PRACTICES IN TRADITIONAL JOURNALISM

A. THE ORIGIN OF HOT NEWS MISAPPROPRIATION IN INTERNATIONAL NEWS SERVICE

In 1918, AP was a large cooperative organization, gathering news from all over the world and distributing it daily to its 950 member newspapers.92 Under AP’s bylaws, members agreed to publish in their newspapers only the news disseminated by AP.93 Members could make no other use of that news.94 The International News Service (“INS”) directly competed in newsgathering and dissemination though at a somewhat smaller scale, reaching 400 newspapers across the nation.95

88. See OSCAR WILDE, THE SOUL OF MAN UNDER SOCIALISM (Kessinger Publishing 2004) (“The fact is, that the public have an insatiable curiosity to know everything, except what is worth knowing.”) (emphasis omitted).


91. Id. at 86.


93. Id. at 230.

94. Id.

95. Id.
At issue in the case was INS's practice of copying news from AP's published bulletins during World War I. This practice emerged in light of two developments—the first technological and the other political. First, the invention of the telegraph enabled INS to take the news from bulletins published in eastern cities and transmit it to western papers for instant publication. Second, Britain and France banned INS from reporting from the front lines because the Hearst papers—then in control of INS—showed sympathy for the German cause. INS's inability to otherwise report on the War notwithstanding, AP filed a bill to restrain INS's “pirating of [its] news” for constituting an unfair competition in business and for violating AP's property right in the news.

The Supreme Court's analysis turned on the unusual nature of the business at issue—that news has a “peculiar value ... in the spreading of it while it is fresh; ... [a value that] cannot be maintained by keeping it secret.” Making the news of current events known to the world was an “innocent but extremely useful” trade. Due to the character and circumstance of this valuable trade, the Court accepted as unquestionable the right of the public to uncopyrighted news after the moment of first publication. The Court focused instead on the relative right of exclusion between AP and INS. “[A]s between them, [the news] must be regarded as quasi property, irrespective of the rights of either as against the public.”

The Court held that AP had earned a temporary “quasi property” right against INS, for such duration as to prevent INS from “reaping the fruits of

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96. Id. at 231.
97. Id. at 238–39. The Court explained:
[S]ince in speed the telegraph and telephone easily outstrip the rotation of the earth, it is a simple matter for defendant to take complainant’s news from ... eastern cities and at the mere cost of telegraphic transmission cause it to be published in western papers ... sometimes simultaneously with the service of competing Associated Press papers, occasionally even earlier.

Id.
100. Id. at 231–32. AP also filed for restraint to stop INS from bribing employees to obtain news earlier and from inducing AP members to violate the AP by-laws. Those matters were not argued before the Court. Id. at 232.
101. Id. at 235.
102. Id.
103. Id. at 236.
104. Id.
[AP’s] efforts and expenditure.” The Court perceived INS’s free-riding conduct as inequitable: “[News] has all the attributes of property necessary for determining that a misappropriation of it by a competitor is unfair competition because [it is] contrary to good conscience.” The Court, standing in equity, assigned to the news an evaporating property right to reward the great cost in acquiring it and the great value in its distribution and exchange.

The Court’s decision was accompanied by a partial concurrence by Justice Holmes and a somewhat longer dissent by Justice Brandeis. In his concurrence, Justice Holmes stressed that property, a creation of law, does not necessarily flow from the exertion of labor. He agreed with the majority that INS was engaged in potentially fraudulent and unfair appropriation of AP’s news, but concluded that an accurate acknowledgement of the source of news by INS would defeat a claim of misappropriation.

On the other hand, Justice Brandeis dissented from the majority’s creation of a quasi property right in news because he viewed property as a positive legal construct that had never before “conferred the attributes of property” to the news. Brandeis conceded that INS’s practice of appropriating AP’s news and using it for profit “may be inconsistent with a finer sense of propriety” but separated this notion of propriety from the law’s definition of property. According to Brandeis, absent a showing of malice or intent to commit fraud, “the law sanctions, indeed encourages, the pursuit.” He allowed that there were some instances where public policy would require awarding property rights to knowledge, but noted that such cases typically included artistic creations, inventions, or discoveries. He saw no merit in protecting the “mere record of isolated happenings, whether in

105. Id. at 241.
106. Id. at 240 (emphasis added).
107. The Court further treated INS’s practice as fraudulent, even though it conceded that INS had not clearly attempted to palm off its goods as those of AP. The Court instead determined that INS had been fraudulent in a more “direct and obvious” manner, by selling AP’s goods as its own. Id. at 240.
110. Id. at 248.
111. Id. at 251 (Brandeis, J., dissenting).
112. Id. at 257.
113. Id. at 259.
114. Id. at 251.
words or by photographs not involving artistic skill.”115 He argued that only legislatures, and not the courts, were equipped to decide matters of public policy that could have such far-reaching effects in an increasingly complex society.116

B. MISAPPROPRIATION REAPPLIED IN ALL HEADLINE NEWS

Ninety years later, AP once again alleged misappropriation of its content in All Headline News.117 AP was still a newsgathering and disseminating organization, albeit on a larger scale than at the time of International News Service.118 The notable difference between the cases is that AHN, unlike INS, did no original reporting.119 As AP alleged, AHN hired “poorly paid individuals” to find news stories on the Internet, copy or rewrite them, and resell them in competition with AP.120 AHN sold those rewritten stories as their own product either without attributing AP as an original source, or by attributing stories to AP and giving the false impression that it was a licensed member of AP.121

AP filed a bill in the Southern District of New York to restrain AHN from “free riding” on AP’s original stories.122 AP brought its complaint against AHN on six counts: (1) hot news misappropriation; (2) copyright infringement; (3) violation of the Digital Millennium Copyright Act (“DMCA”) by altering or removing copyright-management information; (4) trademark infringement of the trademarks “AP,” “ASSOCIATED PRESS,” and “THE ASSOCIATED PRESS”; (5) unfair competition under the Lanham Act; and (6) unfair competition under New York common law. AHN moved to dismiss all claims but the second, copyright infringement.123 This Note only examines count one.124

115. Id. at 254.
116. Id. at 264.
118. See Complaint, supra note 10, ¶ 2.
119. See id.
120. Id.
121. Id.
122. All Headline News, 608 F. Supp. 2d at 458.
123. Id. at 457.
124. The court handled the remaining motions to dismiss for each count as follows: (3) denied because AHN did not show that the copyright management information section of the DMCA would not apply here; (4) granted because AP’s trademark claim was thin and AP’s conclusory allegations of confusion among clients lacked factual support; (5) granted because AP’s unfair competition claim should not be extended to situations of no consequence to purchasers; and (6) denied because AHN failed to support its motion and because preemption of New York unfair competition law was unclear. Id. at 454–55.
The *All Headline News* court first noted that *International News Service* turned on federal common law and was consequently non-binding after *Erie*.125 Hot news misappropriation, however, still appears in the laws of some states. Therefore, two issues remained: whether *All Headline News* should be decided under New York law, which recognizes hot news misappropriation, and if so, whether AP had a valid hot news misappropriation claim.

AHN argued that the law of Florida, which lacks a state hot news misappropriation claim, should apply because AHN located its servers there.126 The district court applied New York law because it was the state where AP was incorporated and headquartered, where it suffered economic loss, and where AHN maintained an office.127

The court then turned to the Second Circuit’s decision in *National Basketball Association v. Motorola, Inc.*,128 which “unambiguously held that [hot news misappropriation under New York law] is not preempted by federal law.”129 The Second Circuit defined the claim as surviving preemption if it met five elements:

(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 (v) the ability of other parties to free-ride on the efforts of the plaintiff or others would so reduce the incentive to produce the product or service that its existence or quality would be substantially threatened.130

After acknowledging the existence of the New York claim for misappropriation and noting AHN’s failure to address this claim, the district court denied AHN’s motion to dismiss count one.131 The court did not adjudicate AP’s claim on the merits.

In July 2009, five months after the district court denied AHN’s motion to dismiss the hot news misappropriation claim, the parties settled on terms favorable to AP.132 AHN agreed to cease making competitive use of AP’s

125. *Id.* at 458–59 (citing *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938)).
126. *Id.*
127. *Id.* at 460–61.
128. *Nat’l Basketball Ass’n v. Motorola, Inc.*, 105 F.3d 841 (2d Cir. 1997).
130. *Nat’l Basketball Ass’n*, 105 F.3d at 845.
content, paid AP an unspecified sum, admitted to using AP’s content improperly, and acknowledged the validity and applicability of the tort of hot news misappropriation. AP also used the joint press release as an opportunity to declare its willingness to “fully defend its intellectual property rights against unfair competition,” echoing its statement in April that it would “take all actions necessary to protect the content of the Associated Press . . . from misappropriation on the Internet.”

C. CRITICISMS OF THE DOCTRINE OF HOT NEWS MISAPPROPRIATION

International News Service has been questioned and criticized ever since its publication. The criticism comes from two corners. First, some argue the case depends on non-binding federal common law and is preempted by federal copyright law. Second, some argue the Pitney majority simply got it wrong and that Holmes’s or Brandeis’s dissents were either more cohesive with intellectual property law or represented better policy.

After Erie, the federal courts abandoned the authority to create federal common law, which rendered INS “no longer . . . legally authoritative.” The INS doctrine, however, persists in some states, and was never specifically overturned by the Supreme Court in any later decision. Some have argued that the misappropriation doctrine was never adopted into federal copyright statutes and therefore Congress intended to preempt the doctrine. The Second Circuit nonetheless held that a narrowly constructed, five-element hot news misappropriation claim survives.

Another criticism derives from the exclusion of facts from the protection of copyright. As the Supreme Court explained, facts are unoriginal, not copyrightable, and “free for the taking.” Copyright law would allow a news aggregator to use the facts underlying a reported story, though mere reproduction would violate the copyright in the writing of the story. Critics argue that hot news misappropriation runs counter to a primary purpose of

133. Id.
134. Id.
135. Singleton, supra note 18.
137. Id. at 629.
138. See, e.g., Nat’l Basketball Ass’n, 105 F.3d 841, 843 (2d Cir. 1997).
139. Nat’l Basketball Ass’n, 105 F.3d at 845.
141. Id.
copyright: to “encourage[] others to build freely upon the ideas and information conveyed by a work.”142

One response to this criticism is that the extreme time-sensitivity of the news adds an extra element that sets it apart from typical, uncopyrightable facts. Intellectual property often struggles to balance the interests of rights holders against those of the public; here, the public has a strong interest in preserving the quality of news reporting agencies, and those agencies depend on being able to profit from the timeliness of its news.143

Other critics focus on the case’s creation of a cause of action without clearly defining any boundaries.144 In 2003, Judge Posner argued that *International News Service* was not only invalid law, but also based only on the vague and unproven assumption that free-riding constituted significantly harmful activity and therefore made it difficult to calculate the proper duration of an injunction against misappropriation.145 Such critics prefer that the legislature and not the courts determine the proper lead time.

Some of the loudest criticism of misappropriation comes from the bloggers’ corner. Bloggers responded clamorously to Judge Richard Posner’s 2009 posting, which supported misappropriation; they argued the misappropriation cause of action would “outlaw linking”146 and that Posner was “out of touch with social media.”147 They argued that a strengthened copyright law and the application of hot news misappropriation would lead to absurd results,148 that such a change would harm newspapers more than

142. Id. at 350.
144. See, e.g., Posner, Misappropriation, supra note 136, at 637–38. Again, however, note that Judge Posner has as recently as July 2009 viewed misappropriation in a more positive light. See Posner, *Are Newspapers Doomed*, supra note 56.
148. Posting of Danny Sullivan to Daggle, *Justice Richard Posner’s Copyright Law No One Can Talk About (Or Link To)*, http://daggle.com/posner-copyright-law-798 (June 29, 2009) (describing as ludicrous a situation in which the first person to report Michael Jackson’s death would be the only one to report it).
help them, and that newspapers should be allowed to fail in order to make way for new and better substitutes.

Rep. Henry Waxman voiced the primary counterargument in his recent address to the FTC:

*Journalism on the Internet could try to fill the void. But it is not certain that it can generate replacement revenues of such an extent as to ensure a restoration of the resources devoted to journalism by mainstream media over the past several decades—or anything close to it.*

It remains to be seen whether newspapers are too important to fail.

**D. HOT NEWS MISAPPROPRIATION IN *INTERNATIONAL NEWS SERVICE* REFLECTS CUSTOMARY PRACTICES**

This Note adopts Richard Epstein’s view that Justice Pitney’s majority opinion in *International News Service*, whether purposefully or not, created a rule that aligned with customary practices within the news industry. The relevant custom, as AP described it in its brief in *International News Service*, was that taking a story in whole or in part without independent investigation was improper, whereas using a story as a basis for independent investigation or verification is proper. Pitney’s rule essentially added that custom to federal law by creating a temporary, quasiproperty right enforceable against competitors—but only to the extent that no independent investigation occurred.

This custom likely developed from the fact that AP and INS were frequent competitors with repeated interactions. It was a classic prisoner’s

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150. Posting of Gary Becker to the Becker-Posner Blog, *The Social Cost of the Decline of Newspapers*, http://www.becker-posner-blog.com/2009/06/the_social_cost.html (June 23, 2009) (“Although the printed newspaper industry is doomed, . . . they are being replaced by good substitutes in the form of blogs, social networks like Facebook and Twitter, online news gathering by various groups, including newspapers, and other electronic forms of communication.”).


152. Epstein, *supra* note 98, at 124 (“[T]he INS decision . . . reached results consistent with the custom of the news-gathering industry, although [Justice Pitney] did not purport to derive [his] rules from custom.”).

153. *Id.* at 115.

154. *Id.* at 98 (citing AP’s brief).

155. *Id.* at 101.
dilemma: if either INS or AP defected and began misappropriating the other's news, then the other would retaliate in kind, and both would suffer. Thus INS and AP followed conventional rules of independent investigation in order to avoid upsetting the equilibrium, the benefit being that they could use each other's stories as tips for independent investigation.  

The resilience of this self-enforced system is highlighted by INS misappropriating AP's news about the war in Europe. INS limited its acts of misappropriation only to those cases where it could claim necessity due to its political ban from reporting in Europe. But this does not represent a breakdown in self-enforcement; on the contrary, AP sued instead of misappropriating INS's news in kind. AP's lawsuit represented not retaliation, but rather reinforcement of the established antipathy toward misappropriation.  

As scholars noted, however, courts should not always defer to customary practices. Mark A. Lemley argues that customary practices change over time, only work for homogeneous groups, have no clear enforcement mechanism, and may not account for externalities that affect those outside the industry. Perhaps the strongest response to these criticisms is simply that customary practices are particularly useful when “there are repeat and reciprocal interactions between the same parties, for then their incentives to reach the correct rule are exceedingly powerful,” but should only apply to situations where customary practice was developed by directly competing parties. Also, when externalities affecting those outside of the industry trigger the public’s interest, then courts should not blindly follow customary practices.

156. Id. at 102.
157. Id. at 105.
158. Id. at 91–92.
159. Id. at 105–06.
160. Professor Epstein notes that INS perhaps should have prevailed with a defense of necessity, or at least that Justice Pitney should have left open such a defense to hot news misappropriation in certain cases. Id. at 118.
163. Id. at 1270.
164. Id. at 1284.
165. Id. at 1277.
166. Epstein, supra note 98, at 126.
167. Id. at 122.
IV. THE ROLE OF HOT NEWS MISAPPROPRIATION IN SHAPING UNDEVELOPED CUSTOMARY PRACTICES IN ONLINE JOURNALISM

Part IV.A explains how All Headline News is similar to International News and that both cases represent a manifestation of strong customary practices. Part IV.B argues that, going forward, hot news misappropriation actions should apply when the defendant’s behavior leads to unsustainable practices. On the whole, however, the doctrine will serve as a quiet influence as the news industry adapts to online journalism.

A. ALL HEADLINE NEWS AND INTERNATIONAL NEWS SERVICE BOTH MIRROR CUSTOMARY PRACTICES

AP’s strategy in All Headline News becomes apparent after answering the following questions: (1) Why AHN and why now? and (2) Why settle? Many news aggregators, large and small, perform functions similar to AHN. And yet content originators rarely raise claims of hot news misappropriation. This Note argues that the similarities between the International News Service and All Headline News cases, coupled with AP’s other litigious endeavors, exemplify AP’s attempt to shape industry custom—a process that must occur between parties and not solely through the courts.

1. AHN was a Perfect Candidate

The similar facts in All Headline News and International News Service bridge a ninety-year gap. Both cases feature the same party, AP, a news-gathering entity that today continues to practice independent investigation when verifying tips gleaned from outside sources. Both cases also feature the right to control the news a party has gathered, at least against a competitor. The main differences are that the technology underlying the misappropriation has shifted from the telegraph to the Internet and that the defendant in All Headline News does not perform its own independent news gathering.

AHN’s status as a pure aggregator deserves further scrutiny because a vital element in a hot news misappropriation claim is that the parties must


compete directly. At a glance, AHN and AP may not seem like direct competitors because the former engages only in news aggregation and the latter invests heavily in original reporting. But this difference is illusory. A defendant need not follow the exact same business model as the plaintiff in order to be a direct competitor; as National Basketball Association shows, a direct competitor is in competition with a product or service offered by the plaintiffs, so it does not need to employ the same means.

This result—that a misappropriator and a news gatherer may in fact compete directly—is in accord with the development of customary practice, in which the essential requirement is that the parties have repeated and reciprocal interactions. AHN, and news aggregators like it, reciprocates with AP by potentially offering tips to stories it takes from sources other than AP. Additional reciprocity occurs when aggregators direct readers via links to the original stories, and newspapers, by allowing indexing of their stories, generate hits for the aggregators.

The difference between All Headline News and International News Service is one of degree: AHN acted worse than INS. Both directly competed with AP, but only INS actually performed its own news gathering and therefore had a very strong incentive to maintain a good relationship with AP going forward. INS could even try to argue that it acted out of necessity. AHN, in unscrupulously performing an almost entirely free-riding service in competition with AP, was an apt target for applying International News Service. AHN's behavior is an outlier, which helps to explain why it suffered the lawsuit instead of any number of other news aggregators.

2. AP Endeavored to Shape Industry Practice

AP tried to apply hot news misappropriation in other cases before it sued AHN. In Associated Press v. Drudge Retort, a suit that lasted all of one week,

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170. Int'l News Serv., 248 U.S. 215, 239 (1918) (applying quasi property in consideration of the “rights of complainant and defendant, competitors in business, as between themselves”) (emphasis added); Nat’l Basketball Ass’n, Inc., 105 F.3d 841, 845 (2d Cir. 1997) (stating that the fourth factor to be considered is whether “the defendant is in direct competition with a product or service offered by the plaintiffs.”).

171. Nat’l Basketball Ass’n, 105 F.3d at 845.

172. Epstein, supra note 98, at 126.

173. Id. at 105.

174. See Int’l News Serv., 248 U.S. at 240 (finding that a competitor committing misappropriation to the disadvantage of complainant is behavior “contrary to good conscience”).

175. AP also sued Moreover Technologies, a headline and news aggregation service, under copyright infringement and misappropriation theories, but the case settled on undisclosed terms. See Press Release, The Associated Press, AP Settles Lawsuit Against
AP sued a news aggregator that published quotations of 33 to 79 words from several AP stories for the purpose of creating a liberal parody of the conservative Drudge Report.\textsuperscript{176} AP sued under theories of copyright infringement and hot news misappropriation.\textsuperscript{177}

In a “quick about-face,” AP caved to pressure from well-known bloggers and withdrew its lawsuit.\textsuperscript{178} AP stated that it would “challenge blog postings containing excerpts of AP articles ‘when [it] feel[s] the use is more reproduction than reference, or when others are encouraged to cut and paste.’”\textsuperscript{179} AP promised to issue guidelines for fair use by bloggers,\textsuperscript{180} but those standards are still forthcoming.

\textit{Drudge Retort} reveals a persistent but remarkably cautious effort by AP to shape the industry custom. Jim Kennedy, the vice president and strategy director of AP, said, “We don’t want to cast a pall over the blogosphere by being heavy-handed, so we have to figure out a better and more positive way to do this.”\textsuperscript{181} Kennedy displayed awareness of a reciprocal relationship that AP shared with bloggers and aggregators.

In contrast with \textit{Drudge Retort}, AP’s persistence in \textit{All Headline News} indicates that AP felt compelled to show that hot news misappropriation claims remained viable. It is rare enough that hot news misappropriation cases surface at all, and commenters frequently criticize those that do.\textsuperscript{182} Nonetheless, AP, by carefully picking its target, and not retreating, reaffirmed an old and controversial doctrine.

But why would AP settle rather than win, or attempt to win, on the merits? This question lies at the heart of the theory that an industry’s customary practices should guide the law: competitors develop customs.\textsuperscript{183} AP’s actions, whether consciously or not, represent a step toward creating a sustainable relationship with news aggregators instead of allowing a judge—who may not fully understand the newspaper industry—to interfere by

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\textsuperscript{176} Bright, supra note 168.
\textsuperscript{177} Id.
\textsuperscript{179} Id.
\textsuperscript{180} Id.
\textsuperscript{181} Id.
\textsuperscript{182} See supra, Section III.C.
\textsuperscript{183} Lemley, supra note 162, at 1270.
imposing rules of positive law.\textsuperscript{184} The risk of allowing a court to interfere on the merits is too high.

B. THE ROLE HOT NEWS MISAPPROPRIATION WILL PLAY IN ONLINE JOURNALISM

With All Headline News and the subsequent settlement, AP struck a powerful blow against at least one unsustainable online model: an aggregator that commits large-scale copying, rewriting, and reselling of a newspaper’s stories. The role that the case will play going forward is to remind industry participants that in order to develop customary practices, repeated and reciprocal interactions are required, and those interactions have to be sustainable.

This role, however, should not encourage AP to spring off its success in All Headline News to engage in more litigation. On the contrary, it should serve only as a warning to particularly aggressive aggregators like AHN. Aggregators and newspapers must both understand that, like it or not, they are in it for the long haul. Aggregators provide an extremely useful service for the public. Newspapers will continue to provide content valuable to a functioning democracy. They need each other to survive.

Because they are engaged in a repeating and reciprocal relationship, both newspapers and aggregators have a very strong incentive to create efficient and sustainable customary practices.\textsuperscript{185} And there is plenty of reason to be optimistic that this can and will occur.\textsuperscript{186}

V. CONCLUSION

The future landscape of news reporting is still evolving. The newspaper industry has suffered a tremendous drop in revenue due to both the recession and the advent of news dissemination online. The industry has actively pursued new methods of saving quality journalism, such as emphasizing niche reporting and implementing new revenue streams through subscription models. There is hope that such new methods, in concert, will help chart the future of the industry.

Another, more controversial method has been to establish a working relationship with news aggregators, which raises the question of whether and

\textsuperscript{184} See Epstein, supra note 98, at 117 (“The risk of seeking out the immutable rules of positive law is that, had the composition of the Supreme Court been different, the three dissenting voices in [International News Service] would have established the legal norms for an industry whose internal operation they scarcely understood.”).

\textsuperscript{185} See id. at 126.

\textsuperscript{186} See supra Section II.C.3.
to what extent aggregators may use the content generated by reporters and agencies such as the Associated Press. The boundary between fair appropriation and misappropriation remains unclear despite the recent decision in *All Headline News*.

The very presence of *All Headline News* will influence the future relationships of newspapers and aggregators. Its primary significance, however, is as an indication of the evolving customary practices that, in combination with other newspaper-saving methods, will help create a sustainable equilibrium of newsgathering and dissemination.
ADDITIONAL DEVELOPMENTS—COPYRIGHT LAW

Asset Marketing Systems, Inc. v. Gagnon
542 F.3d 748 (9th Cir. 2008)

The U.S Court of Appeals for the Ninth Circuit recently held that an independent contractor had, in the absence of a written agreement, granted an implied, unlimited software license to the company who had commissioned the software. The decision is notable because the panel’s analysis did not distinguish implied licenses of software programs from implied licenses of other types of copyright.

Asset Marketing Systems, Inc. (AMS) hired Gagnon’s company to write several custom software programs to assist AMS in its business. Though the two parties agreed to several written instruments delineating the parties’ obligations, none of the documents clarified the terms and conditions of AMS’s use of the Gagnon’s software. When their business relationship terminated in acrimony, Gagnon sued AMS for copyright infringement on the theory that AMS did not have the right to use and modify the software programs written by Gagnon. The district court granted summary judgment to AMS on the basis that Gagnon had granted AMS an implied, nonexclusive license to use the software without limitations.

On appeal, the Ninth Circuit affirmed the lower court’s ruling. To determine whether AMS had a license to use Gagnon’s software, the panel announced that it would apply its test from Effects Assocs., Inc. v. Cohen, in which the Ninth Circuit considered the grant of an implied license in the context of audiovisual copyrights. The Effects test finds that an implied license is granted if (1) the purported licensee requests creation of the work, (2) the creator makes the work and delivers it to the purported licensee, and (3) the creator intends that the purported licensee exercise one or all of the protected rights associated with the copyrighted work.

Applying the Effects test, the Ninth Circuit found that (1) AMS requested Gagnon to create the software program, (2) Gagnon created the software and delivered it to AMS; and (3) Gagnon intended that AMS be permitted to use and modify the software. The court found persuasive that Gagnon never expressed intent to retain exclusive control of the software or otherwise limit AMS’s use. Thus, Gagnon granted AMS an implied license to its software, and the district court’s summary judgment dismissal of Gagnon’s copyright infringement claim was appropriate.
EMI RECORDS LIMITED V. PREMISE MEDIA CORP. L.P.

The New York Supreme Court for New York County held that fair use was a defense to a claim of common law copyright infringement.

Premise Media Corp. (Premise) produced a documentary film titled Expelled, which incorporated a portion of John Lennon’s recording of “Imagine” (Imagine Recording). Premise had not obtained a license from EMI Records Ltd. (EMI), the owner of the Imagine Recording. Because the Imagine Recording was made in 1971, before Congress amended the Copyright Act to include sound recordings, Imagine Recording was protected by common law copyright rather than federal copyright law. Accordingly, EMI brought suit against Premise in New York State Court for common law copyright infringement.

In response to EMI’s filing for a preliminary injunction against Premise’s exhibiting of the film, Premise argued that utilizing the Imagine Recording was permitted as a fair use. The issue of fair use as a viable defense to infringement of a common law sound recording was a matter of first impression for the court.

The court ultimately held that fair use was indeed available as a defense. Although several prior decisions had rejected the defense of fair use in common law copyright protection, the court distinguished them as applying only to unpublished works. Common law recognized that an author’s interest in a literary work was absolute until it was published, at which point it would be available for third party use subject to federal copyright protection, which supersedes common law protection. Sound recordings prior to 1972, however, had common law copyright protection regardless of their availability to the public. Thus, the reasons for not allowing pre-publication fair use for literary works did not apply to common law sound recordings.

Having decided that fair use was a defense to a common law copyright infringement claim of a sound recording, the court proceeded to evaluate whether Premise’s use of the Imagine Recording might constitute fair use regarding EMI’s motion for preliminary injunction. The court looked to the four fair use factors set forth in 17 U.S.C. § 107 to inform its analysis. It held that the factors weighed in favor of Premise’s use as being fair use. Consequently, the court denied EMI’s preliminary injunction motion on the grounds that EMI did not show a “likelihood of success” on its claim that Premise infringed the common law copyright of the Imagine Recording.
**Twelve Inches Around Corp. v. Cisco Systems, Inc.**  
No. 08 Civ. 6896 (S.D.N.Y Mar. 12, 2009)

The United States Court for the Southern District of New York held that applying sanctions under the Digital Millennium Copyright Act (DMCA) for damages incurred from misrepresentations in copyright take-down notices to the trademark context would be inconsistent with the intent of Congress when it passed the statute.

Plaintiff, Twelve Inches Corp. (Twelve Inches) ran a “Rent A Cert” website that helped companies to find individuals with particular technology certifications in exchange for a commission. On October 30, 2007, Cisco Systems Inc. (Cisco) sent Twelve Inches a letter stating that Rent A Cert’s website infringed Cisco’s trademarks and that Rent A Cert’s program of “renting” Cisco certified technicians to companies so that they could attain Cisco discounts was fraudulent. Cisco demanded that any reference to their trademarks be removed from its website. Cisco also sent a notice to the Internet Service Provider demanding the take down of the Rent A Cert website on the basis of fraud and trademark infringement. Twelve Inches sued Cisco for misrepresentation under 17 U.S.C § 512, libel; fraud; unfair business practices under New York General Business Law § 349; and tortious interference with existing business relationships; prospective business relationships, existing contractual relations, and prospective business advantage.

The court held that Section 512 (f) misrepresentation should be limited to misrepresentations of copyright infringement for consistency with the language of the DMCA as a whole and dismissed the claim. The court reasoned that while Section 512 (f) is not explicitly limited to misrepresentation of copyright infringement, it requires that the misrepresentation be “under Section 512” which deals exclusively with copyright infringement. The court held that a take-down notice must have an “identification of the copyrighted work claimed to have been infringed” to have any legal effect under Section 512.
BEYOND RESCUECOM v. GOOGLE: THE FUTURE OF KEYWORD ADVERTISING

Kristin Kemnitzer

In Rescuecom Corp. v. Google Inc., the Second Circuit addressed the meaning of the phrase “use in commerce” in the Lanham Act. The court held that Google’s sale of the trademarked term “Rescuecom” was a “use in commerce” within the meaning of the Act. The court did not, however, decide whether Google’s actions equated to trademark infringement.

Now that the Second Circuit has resolved the threshold “use in commerce” question, the case will turn on whether Google’s use of Rescuecom’s trademark causes a likelihood of confusion among consumers. Likelihood of confusion requires a factual, casebycase analysis. Plaintiffs in trademark keyword cases have also relied on the theory of initial interest confusion, a subset of likelihood of confusion, to find infringement in Internet cases. Internet trademark cases do not neatly fit within the traditional likelihood of confusion test because of the different circumstances facing online shopping. Courts should be wary of applying the newer theory of initial interest confusion too liberally in keyword cases. Furthermore, no circuit court has addressed the issue of likelihood of confusion in the case of trademarked keywords, most likely because defendants are more likely to settle out of court than to risk a precedential decision in favor of the trademark owners.

This Note argues that a court’s analysis of likelihood of confusion (if and when one addresses the issue) must ultimately turn on consumer sophistication. If search engine users can distinguish the source of advertisements in a specific case, then courts should not find likelihood of confusion, or initial interest confusion. This Note first addresses the history of search engines and search engine advertising. It then addresses trademark infringement under the Lanham Act and in the Second Circuit. Next, it discusses previous trademark infringement cases involving the Internet, and
Rescuecom specifically. Finally, it examines whether Google will ultimately be found liable under likelihood of confusion, or initial interest confusion.

I. BACKGROUND

The Second Circuit in Rescuecom addressed “use in commerce” in terms of keyword advertising, but the issues involved are not new. The controversy surrounding keyword advertising evolved with the proliferation of search engines and online advertising. This Part will discuss the history of search engines and online advertising, Google’s AdWords program, infringement analysis under the Lanham Act, and prior Internet cases involving trademark infringement.

A. HISTORY OF SEARCH ENGINES AND CONSUMER CONFUSION ON PAID SEARCH LISTINGS

By the time Larry Page and Sergey Brin founded Google in September 1998 in a garage in Palo Alto, numerous search engines were already in existence, including Lycos, Netscape, Yahoo!, AltaVista, and Ask Jeeves. While these search engines and others provided organic results based on internal algorithms that determined the relevancy of results, GoTo.com pioneered paid search based on the sale of the top spot to the highest bidder.6

Today, Google is the most widely used search engine in the world, but this was not the case with advertisers or consumers in the late 1990s. Google did not discover how to monetize its site through advertising until 2002.7 Furthermore, it was competing against the numerous other search engines for users. A Business Week article described Google in 1999:

6. See Stephen H. Wildstrom, Search Engines with Smarts: A Number of New Web Sites Make it Easier to find those Elusive Facts, BUSINESSWEEK, Feb. 8, 1999, available at http://www.businessweek.com/archives/1999/b3615032.arc.htm#B3615032 (last visited Dec 9, 2009) (comparing and contrasting the benefits and drawbacks of different search engines in 1999). GoTo.com became Overture, and was purchased by Yahoo! in July 2003. Organic results are those produced by the search engine algorithm, based solely on relevancy. Conversely, search engines sell advertisement placement for sponsored links to the highest bidder. For a further discussion of Google’s AdWords program, see infra 1.B.

7. See Search Engine History Homepage, http://www.searchenginehistory.com/ (last visited Dec 9, 2009). Google first launched AdWords in 2000. However, this first version was not very successful because Google had not yet discovered how to properly price the sale of its advertisements. Google re-launched AdWords in 2002, using the auction model it still uses today to sell ads. Additionally, Google factored in a pay-per-click model into AdWords so advertisers would pay when users clicked on their ads.
Google, like its inspiration Yahoo! Inc., is the brainchild of a couple of Stanford University students, and it looks and feels like a work in progress. Google is designed to be what Yahoo! was in its preportal days: an easy-to-use directory of Web sites. It is especially good at finding organizational home pages with a minimum of fuss.\(^8\)

Google was far from the international behemoth it is today.

In the early years, search engines were still attempting to find a balance between “profitability and relevancy.”\(^9\) Some search engines sold listings to top bidders while others ranked websites based on internal relevancy algorithms. These different approaches led to quite different results, which confused search engine users when they compared the results received.\(^10\) Consumers may not have understood why the results differed so significantly from one search engine to another. As recently as 2004, only thirty-eight percent of Internet users understood the difference between sponsored links and organic results.\(^11\) Only one sixth of users could always distinguish the two types of results.\(^12\) Consumer confusion ran rampant in the early world of search engines.

To help consumers delineate organic results from advertisements, the Federal Trade Commission (FTC) enacted regulations in 2002. It released a statement recommending that search engines clearly label paid results from organic results to prevent likelihood of confusion.\(^13\) However, the regulations also mentioned the beneficial role of clearly delineated advertising:

To the extent that paid inclusion does not distort the ranking of a Web site or URL, many of these programs provide benefits to consumers, by incorporating more Web sites—or content—into an individual search engine’s database than might otherwise be the case. This can give consumers a greater number of choices in search results lists.\(^14\)

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12. *Id.*
14. *Id.*
According to the FTC, search engine advertising aids consumers as long as search engines clearly mark the two types of results. While the FTC’s policy addressed online advertising, it did not specifically address whether the selling of keywords would constitute trademark infringement.

Today, many of the early search engines no longer exist. Google, Yahoo!, and Microsoft’s Bing control virtually the entire U.S. market. Google controls the greatest share by far, with close to sixty-five percent of the market.15 These three sites all distinguish their organic results from their sponsored links. However, this does not mean that Internet users have become so sophisticated that they could never be confused about the source of an advertisement.16

On the whole, Internet users are more sophisticated than they were ten years ago, simply given that Internet usage has increased so drastically. Between 2000 and 2009, Internet usage almost doubled.17 Online shopping more than doubled from 2000 to 2007, with revenues increasing fivefold.18 Eighty-one percent of Americans have performed online research for a product they considered buying.19 Most consumers are not as likely to be confused about whether the results of their queries are organic results or advertisements as they were in the early days of search engines because of

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16. While the FTC regulation attempts to cut down on consumer confusion, confusion still exists. See supra note 21. On Google, paid searches are delineated by a light yellow box on the top of the screen, and by a line on the right hand side. Each one is marked by the phrase “sponsored links” in fairly small font. Though Google’s advertisements comply with the FTC standards, it is possible to see how a consumer might not be able to distinguish advertisements from organic search results.


19. Id. at 17.
search engines’ delineation of paid and organic searches, and because of the increase in online commerce.20

However, while search engine usage has increased dramatically in the past decade, potential for confusion remains. Thirty-two percent of users are confused during their online shopping searches.21 Furthermore, the more sophisticated the users become, the more sophisticated advertisers become at displaying their advertisements. Users may now be able to distinguish between organic results and sponsored links, but may not be able to discern whether an advertisement is for the brand they searched for, or a competitor. While consumers have become more Internet savvy since the late 1990s, the playing field keeps changing and new challenges constantly arise.

B. GOOGLE’S ADWORDS PROGRAM

Google is the world’s most popular search engine and generates the vast majority of its revenue through AdWords, its online advertising system.22 Approximately ninety-nine percent of Google’s revenue comes from its advertising programs.23 When a user types a query into Google, the search engine produces two types of results. First, it produces a list of results based solely on Google’s algorithm for which advertisers are not able pay for a higher ranking. Second, it produces a list of “sponsored links” at the top of the page and to the right of the organic results. These sponsored links are directly targeted at the user’s query. Advertisers are willing to pay a premium for this space on the search results page because the ads are purported to be directly relevant to the specific user. Advertisers hope that a user will find what she is looking for by clicking on the advertiser’s link instead of on the organic search results.

Advertisers can purchase keywords that they believe are relevant to their product through Google’s AdWords program. Additionally, Google may

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20. See, e.g., id. While early online shopping data is unavailable, it is likely that the increase in online purchasing suggests a growing familiarity with online shopping among Internet users.

21. Id. at 25. This survey questioned 2,400 American adults about their online shopping habits by asking them a series of questions regarding their Internet usage.


suggest terms that it believes would be relevant to a specific advertiser. For example, Ford Motor Company may want to target its ads at users who search for the word “car” or the word “automobile.” Ford might also want to target users who search for its competitors, like “Toyota.” Through Google AdWords and its Keyword Suggestion Tool, Ford may purchase any of these terms and more. The Tool suggests both synonyms and competitor’s trademarks. That way, Ford reaches not only users who are directly interested in the product that Ford sells, but also users that are interested in the products of Ford’s competitors. This means that Ford can successfully target customers who are interested in potentially purchasing Ford’s product with more specificity than was previously possible in the advertising arena.

As one surveyor put it, “[p]aid search works. Lining up brief, text-based advertisements against the queries of those hundreds of millions of searchers results in extremely efficient marketing leads, and marketing leads are the crack cocaine of business.” However, not all trademark owners are as quick to praise the business practices of search engines. Many believe that Google’s practice of selling trademarks as keywords to competitors is trademark infringement because it is a “use in commerce” that creates a likelihood of confusion.

Since 2004, Google has allowed advertisers in the United States, the United Kingdom, and Ireland to purchase competitors’ trademarks as keywords. However, the search engines Yahoo! and Bing do not allow advertisers in any country to purchase competitors’ trademarks. Google claims that its keyword advertising policy gives advertisers more options by letting them use comparative advertising. On June 4, 2009 (two months after the Second Circuit’s decision in Rescuecom) Google announced that it would expand the keyword policy to 190 other countries. European Union countries such as France, Germany, and Austria were not included in the

24. Google uses a “Cost-Per-Click” (CPC) method wherein Google makes money every time a user clicks on an advertiser’s link. Thus, Google’s profit is directly tied to the search engine’s ability to display the most relevant ads that it believes will be useful to users.


26. See infra Section I.D.

27. Laura Covington, Associate General Counsel, Yahoo! Inc., Panel on Keywords and Search Engine Liability at the University of San Francisco Symposium The Brand as Property: Trademark Law and its Challenges in the New Era (Nov. 4, 2009) (notes on file with the author).

expanded list of countries. It is unclear whether Google planned on announcing its new global trademark policy before the Rescuecom decision, or whether the policy was a response to it. Regardless, the decision demonstrates that Google believes its practices do not result in trademark infringement.

C. INFRINGEMENT UNDER THE LANHAM ACT

At its core, trademark law exists both to regulate unfair competition and to protect consumers. Trademark owners are protected from others using their identity and potentially free-riding on the goodwill and quality associated with the trademark. The Supreme Court noted the intent behind trademark protection in Two Pesos, Inc. v. Taco Cabana, Inc.:

The purpose underlying any trade-mark statute is twofold. One is to protect the public so it may be confident that, in purchasing a product bearing a particular trade-mark which it favorably knows, it will get the product which it asks for and wants to get. Secondly, where the owner of a trade-mark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats. This is the well-established rule of law protecting both the public and the trade-mark owner.

The Trademark Act of 1946 (“Lanham Act”) codifies these policy goals.

Trademark infringement requires three essential elements. First, there must be a valid trademark. Second, the defendant must have used the trademark in commerce without the permission of the trademark owner. Third, this use must be likely to cause customer confusion as to the source of origin of the product or service. Thus, “use in commerce” is a threshold
issue that must be met before infringement may be found. As codified in section 1127 of the Lanham Act, a mark is “used in commerce”:

(1) on goods when
   (A) it is placed in any manner on the goods or their containers or the displays associated therewith or on the tags or labels affixed thereto, or if the nature of the goods makes such placement impracticable, then on documents associated with the goods or their sale, and
   (B) the goods are sold or transported in commerce, and

(2) on services when it is used or displayed in the sale or advertising of services and the services are rendered in commerce, or the services are rendered in more than one State or in the United States and a foreign country and the person rendering the services is engaged in commerce in connection with services.35

Section 1114 imposes liability on anyone who uses a trademark in commerce without the consent of the trademark owner in a manner that is likely to cause confusion.36 The Lanham Act states that the threshold is a likelihood of confusion. The plaintiff does not need to rise to the level of proving actual confusion.

Notably, the wording of the original statute only included trademark infringement in cases where the purchaser was likely confused about the origin of the product.37 In a 1962 revision, Congress removed the word “purchasers.”38 Since 1962, a consumer need not actually purchase a good for infringement to apply. Actionable likelihood of confusion can occur prior to purchase. This amendment of the Lanham Act opened the door for courts to find infringement based on the theory of initial interest confusion. Initial interest confusion refers to situations where the consumer is confused as to the source of a good or service, but the confusion is cleared up prior to purchase. Many courts now use this theory as a basis for trademark infringement.39

approval of his or her goods, services, or commercial activities by another person.

37. Prior to 1962, the Lanham Act prohibited uses that were “likely to cause confusion or mistake or to deceive purchasers as to the source of origin of such goods or service.” Lanham Act Pub. L., § 32, No. 79-489, 60 Stat. 427, 437 (1946).
39. See infra Section I.D.
D. INFRINGEMENT IN THE SECOND CIRCUIT

Likelihood of confusion occurs when a large number of “reasonably prudent” consumers are likely to be confused by the source of origin for a product. The Second Circuit uses an eight part test devised in Polaroid Corp. v. Polarad Electronics to determine likelihood of confusion: (1) the strength of the plaintiff’s trademark, (2) the degree of similarity between the plaintiff’s and the defendant’s marks, (3) the comparative proximity of the two products in the marketplace, (4) the chance that the plaintiff is likely to move into the defendant’s market, (5) evidence of actual confusion of the marks, (6) evidence of the defendant’s good faith in adopting its own mark, (7) the quality of the defendant’s product, and (8) the sophistication of the consumers. However, defendants may raise nominative fair use, in which the plaintiff’s mark is only used to compare products and not to confuse consumers.

Initial interest confusion arose as a court-created subcategory of likelihood of confusion. Under the initial interest confusion theory, competitors attempt to sidetrack consumers into buying their product instead of the one that the consumers initially searched for. This confusion occurs before the time of purchase, and the consumer is not confused at the time she purchases the goods. Even though the consumer realizes the origin before the point of sale, trademark infringement may apply.

The Second Circuit first used initial interest confusion in Grotrian, Helfferich, Schulz, Th. Steinweg Nachf v. Steinway & Sons, a case involving the sale of pianos. The court found that consumers might initially believe that Steinweg pianos have some relation to Steinway pianos. Even in a case with potentially sophisticated purchasers, there was a possibility of confusion. Through consumer surveys, Steinway proved that consumers were initially confused. While this confusion did not exist at the time of purchase, trademark infringement still occurred. The court found that Steinweg
infringed upon Steinway’s trademark by misleading consumers at the early stage.48

However, the Second Circuit demonstrated its wariness of initial interest confusion in the Internet context in Savin Corp. v. Savin Group.49 The Savin court noted that Internet initial interest confusion is quite different from “brick and mortar” initial interest confusion, “[b]ecause consumers diverted on the Internet can more readily get back on track than those in actual space, thus minimizing the harm to the owner of the searched-for site from consumers becoming trapped in a competing site, Internet initial interest confusion requires a showing of intentional deception.”50 This higher standard protects defendants in Internet cases from spurious claims of initial interest confusion.

E. FAIR USE

Trademark law allows two types of fair use: classic fair use and nominative fair use.51 Classic fair use applies when a defendant uses a plaintiff’s mark not as a trademark, but simply to describe the defendant’s goods or services, or to describe the geographic origin of the product.52 Classic fair use only applies to descriptive marks that have secondary meaning.53 In contrast, a nominative fair use argument arises when the defendant uses the trademarked term to identify the plaintiff’s product in a comparative advertising situation.54 The Ninth Circuit created a three part nominative fair use test:

First, the product or service in question must be one not readily identifiable without use of the trademark; second, only so much of the mark or marks may be used as is reasonably necessary to identify the product or service; and third, the user must do nothing

48. Id. at 1342.
49. Savin Corp. v. Savin Group, 391 F.3d 439 (2d Cir. 2004).
50. Id. at 462 n.13
52. Id.
53. Id.
54. Id. The Ninth Circuit described the fair use distinction thusly: The nominative fair use analysis is appropriate where a defendant has used the plaintiff's mark to describe the plaintiff's product, even if the defendant's ultimate goal is to describe his own product. Conversely, the classic fair use analysis is appropriate where a defendant has used the plaintiff's mark only to describe his own product, and not at all to describe the plaintiff's product.

Id. (quoting Cairns v. Franklin Mint Co., 292 F.3d 1139, 1151 (9th Cir. 2002)) (emphasis omitted).
that would, in conjunction with the mark, suggest sponsorship or endorsement by the trademark holder.\textsuperscript{55}

Nominative fair use is at issue in trademarked keyword cases. The third factor is especially important in online advertising, because plaintiffs worry that users are confused as to sponsorship or origin. However, if the defendant is truly using the plaintiff’s mark to compare and contrast the plaintiff’s and defendant’s goods, then there should not be a concern of likelihood of confusion.

F. INTERNET TRADEMARK CASES

Courts have dealt with many trademark issues relating to the Internet, including pop-up advertisements, meta tags, and search engine advertising. While trademarked keywords present their own issues, it is helpful to examine past precedent.

1. Pop-Up Advertisements

Companies that supply pop-up advertisements monitor users’ Internet behavior and then deliver advertisements that are potentially relevant. These advertisements appear as a separate window on the user’s screen and attempt to lure the user to a site different than the one she originally searched for. In the influential case \textit{1-800 Contacts v. WhenU.com} (relied upon by the district court in \textit{Rescuecom}), the Second Circuit found that the internal use of trademarks to trigger pop-up ads is not a “use in commerce” under the Lanham Act.\textsuperscript{56} The plaintiff, 1-800 Contacts, argued that the defendant’s internal software infringed on the plaintiff’s trademark by providing pop-up ads to relevant searches.\textsuperscript{57} The Second Circuit found that the defendant’s pop-up advertisements were not a “use in commerce” of the plaintiff’s trademark because the terms were only used for a “pure machine-linking function.”\textsuperscript{58} The court held “a company’s internal utilization of a trademark in a way that does not communicate it to the public is analogous to an individual’s private thoughts about a trademark. Such conduct simply does not violate the Lanham Act.”\textsuperscript{59} The court used a five part test to examine whether a trademarked term is a “use in commerce:” (1) the trademark must be a valid mark that can be protected under the Lanham Act; (2) the defendant must use the mark (3) in commerce (4) in connection with the sale

\textsuperscript{55} New Kids on the Block v. News Am. Publ’g., Inc., 971 F.2d 302, 308 (9th Cir. 1992).
\textsuperscript{56} 1-800 Contacts, Inc. v. WhenU.com, Inc., 414 F.3d 400 (2d Cir. 2005).
\textsuperscript{57} Id. at 404–05.
\textsuperscript{58} Id. at 408–09.
\textsuperscript{59} Id. at 409.
or advertising of goods or services, and (5) the defendant must do so without the consent of the trademark owner.\textsuperscript{60} In applying this test, the court found that the defendant’s actions did not constitute a “use in commerce.” Without this finding, there was no trademark infringement, and thus the plaintiffs did not state a claim upon which relief could be granted.\textsuperscript{61}

2. \textit{Meta Tags}

Meta tags refer to the descriptive data that communicates the information a document contains to browsers and computers. Some search engines may use information stored in meta tags to index various web pages, but Google does not.\textsuperscript{62} Though meta tag information is not communicated to the consumer, use of another’s trademark in meta tags has been found to constitute a “use in commerce.”

The Ninth Circuit was the first circuit to examine trademark use in meta tags in the controversial case \textit{Brookfield Communications, Inc. v. West Coast Entertainment}.\textsuperscript{63} The parties were in the online movie rental business. Brookfield began selling “MovieBuff” software in 1993.\textsuperscript{64} In 1996, West Coast registered the domain name “moviebuff.com.”\textsuperscript{65} In 1998, Brookfield registered the term “MovieBuff” with the federal register.\textsuperscript{66} The Ninth Circuit found that West Coast’s use of “MovieBuff” as a domain name and as a meta tag created initial interest confusion. The court held that the defendant used the plaintiff’s mark “in a manner calculated ‘to capture initial consumer attention, even though no actual sale is finally completed as a result of the confusion.’”\textsuperscript{67}

The court found that “using another’s trademark in one’s meta tag is much like posting a sign with another’s trademark in front of one’s store.”\textsuperscript{68} Even if the consumer realizes that it has encountered another product and is thus no longer confused, she may not make the effort to find what she was

\textsuperscript{60} Id. at 406–07.

\textsuperscript{61} Id. at 413.


\textsuperscript{63} \textit{Brookfield Commc’ns, Inc. v. W. Coast Entm’t Corp.}, 174 F.3d 1036 (9th Cir. 1999).

\textsuperscript{64} Id. at 1041.

\textsuperscript{65} Id. at 1042.

\textsuperscript{66} Id.

\textsuperscript{67} Id. at 1062 (quoting Dr. Seuss Enters. v. Penguin Books USA, Inc., 109 F. 3d 1394, 1405 (9th Cir. 1997)).

\textsuperscript{68} Id. at 1064.
originally looking for, and instead might purchase the infringer’s product.\textsuperscript{69} The court used the following analogy:

Suppose West Coast’s competitor (let’s call it ‘Blockbuster’) puts up a billboard on a highway reading—‘West Coast Video: 2 miles ahead at Exit 7’—where West Coast is really located at Exit 8 but Blockbuster is located at Exit 7. Customers looking for West Coast’s store will pull off at Exit 7 and drive around looking for it. Unable to locate West Coast, but seeing the Blockbuster store by the highway entrance, they may simply rent there.\textsuperscript{70}

In this example, the consumer knows that she is not renting from West Coast, but does not mind. Blockbuster intentionally deceived her, but she did not care enough to find West Coast Video. She already invested in Blockbuster by exiting the freeway. Note that the billboard example differs from simple comparative advertising. If Blockbuster placed a billboard next to West Coast Video’s, or opened a store next door, initial interest confusion does not apply. Courts must find actual confusion, not just diversion. Courts struggle with this distinction when it comes to online advertising, and not all circuits have addressed the issue of initial interest confusion. The Ninth Circuit decided \textit{Brookfield} in 1999, early in the life of trademark cases involving the Internet. Other courts, and even the Ninth Circuit, have subsequently criticized \textit{Brookfield}'s holding as overly expanding the theory of initial interest confusion.\textsuperscript{71}

3. \textit{Search Engine Advertising: Prior “Use in Commerce” Keyword Advertising Cases}

Many courts have recently addressed cases relating to keyword advertising. As previously mentioned, in \textit{Rescuecom} the Second Circuit held that the sale of trademarked keywords is a “use in commerce” under the Lanham Act.\textsuperscript{72} Now, the central issue becomes whether \textit{Rescuecom} and other plaintiffs will be able to prove consumer confusion (either actual or initial), or whether they have simply succeeded in asserting the threshold issue. Courts are routinely finding trademarked keyword advertising to be a “use in commerce,” but have yet to fully address whether “use in commerce” actually leads to trademark infringement.

\textsuperscript{69} Id.
\textsuperscript{70} Id.
\textsuperscript{71} See \textit{1-800 Contacts}, 414 F.3d at 411; \textit{Playboy Enters., Inc. v. Netscape Commc’ns Corp.}, 354 F.3d 1020, 1026 (9th Cir. 2004).
\textsuperscript{72} See supra Part I.
In *Playboy Enterprises, Inc. v. Netscape Communications Corp.*, the Ninth Circuit found initial interest confusion. Defendant sold advertisement space to advertisers who would “key” their advertisements when users entered certain search terms. When a user entered a search term that an advertiser had purchased, the advertiser’s banner ad would appear at the top or side of the Netscape results page. These banner ads were often poorly labeled or unlabeled, and often confused the user into clicking on the advertisement. The user would then be transported away from the search page and to the page of the competitor. The court denied Netscape’s motion for summary judgment, found “use in commerce” of Playboy’s trademarks, and found evidence of initial interest confusion. Though this case technically dealt with keying of advertisements, the Ninth Circuit analogized keying to meta tags, as described in *Brookfield*.

In *GEICO v. Google Inc.*, the Eastern District of Virginia denied Google’s 12(b)(6) motion to dismiss because the court found that Google’s sale of the trademarked term GEICO to GEICO’s competitors was a “use in commerce.” The court found that Google’s sale of trademarked terms was not an internal use of the terms. Google’s actions came under the “use in commerce” clause of the Lanham Act because Google sold the terms to competitors of the trademark owners.

Similarly, in *800-JR Cigar v. GoTo.com*, a New Jersey District Court found that the sale of JR Cigar’s trademarked name to its competitors by the defendant search engine was a “use in commerce.” GoTo.com allowed advertisers to pay for higher priority on the actual search results. The court found three reasons for finding GoTo.com’s sale a “use” under the Lanham Act:

First, by accepting bids from those competitors of JR desiring to pay for prominence in search results, GoTo trades on the value of the marks. Second, by ranking its paid advertisers before any “natural” listings in a search results list, GoTo has injected itself into the marketplace, acting as a conduit to steer potential

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73. 354 F.3d 1020.
74. *Id.* at 1022–23.
75. *Id.*
76. *Id.* at 1023.
77. *Id.*
78. *Id.* at 1031.
79. *Id.* at 1025.
81. *Id.* at 703–04.
customers away from JR to JR’s competitors. Finally, through the Search Term Suggestion Tool, GoTo identifies those of JR’s marks which [sic] are effective search terms and markets them to JR’s competitors.83 Furthermore, the court noted that GoTo.com could potentially be found to contributorily infringe upon the plaintiff’s trademarks, since the search engine could be found to induce infringement.84

In Google Inc. v. American Blind & Wallpaper Factory, Inc, a Northern District of California court denied Google's summary judgment motion that alleged its use of American Blind’s trademark was not a “use in commerce.”85 The court relied on the Ninth Circuit’s decision in Playboy Enterprises, Inc. to reach its holding.86 The court stated that the decision in Playboy implicitly suggested that trademarked terms used in keyword advertising should be considered a “use in commerce.”87 In reaching its decision, the court did not require the trademarked term to appear in the text of the advertisement for “use in commerce” to be found. 88 Instead, Google’s selling of the keywords was enough to meet the threshold.

Just days before the Second Circuit’s decision in Rescuecom, the District Court of Massachusetts addressed similar facts in Hearts on Fire Co, LLC v. Blue Nile, Inc.89 The diamond retailer, Hearts on Fire, claimed that Blue Nile (a competing diamond retailer) infringed its eponymous trademark.90 The plaintiff claimed it was harmed because “Defendant’s use of the ‘hearts on fire’ trademark confuses consumers, diverting potential internet customers from their original intent to buy the Plaintiff’s diamonds and directing them instead to the Defendant’s website.”91 Judge Gertner denied the defendant’s motion to dismiss, holding that the defendant’s purchase of the plaintiff’s trademark was a “use in commerce.”92 However, the court

83. Id. at 285.
84. Id. at 280.
86. Id. at *6.
87. Id. at *4–6.
88. These cases are settling, indicating that the parties involved recognize that there is some risk involved in having the issue of likelihood of confusion decided by the courts. This explains the volume of cases involving “use in commerce,” yet the scarcity of cases actually deciding the issue of trademark infringement.
90. The facts in this case are slightly different than those in Rescuecom. In Hearts on Fire, the defendant was a competitor and not a search engine.
91. Hearts on Fire, 603 F. Supp. 2d at 279.
92. Id. at 278.
noted that “use in commerce” alone is not enough to prove infringement. Hearts on Fire must also prove that “the allegedly infringing conduct carries with it a likelihood of confounding an appreciable number of reasonably prudent purchasers exercising ordinary care.” 93 The court noted that no evidence was presented that consumers purchased the defendant’s product assuming that the diamonds were “Hearts on Fire” diamonds. 94

Instead of relying solely on the traditional likelihood of confusion claim, the plaintiff also claimed initial interest confusion. 95 The plaintiff alleged initial interest confusion because the user’s search for “Hearts on Fire” results in a choice of clicking on the defendant’s site when it appears in the sponsored link section of the results. The plaintiff argued that this created initial interest in defendant’s product, which could lead the user away from the original search. Initial interest confusion occurs when a producer labels goods so as to confuse and misdirect a consumer, even if the consumer is no longer confused at the time of purchase. 96 The plaintiff argued that pre-sale confusion created enough of a distraction to warrant trademark infringement.

Although the First Circuit has yet to address the issue of initial interest confusion, the District Court of Massachusetts held that Hearts on Fire may assert the claim of initial interest confusion under the Lanham Act. However, the court noted the difficulty in proving initial interest confusion in Internet cases because if a user clicks on a link, she can easily click back if it is not what she wanted. 97 “The ease with which an internet shopper can reverse course counsels against over-expansive trademark protection, as any confusion may be extremely temporary and quickly remedied.” 98 The district court also questioned whether a competitor’s link harms consumers in a meaningful way by confusing them, or whether it benefits consumers by providing the purchaser with options within a market. 99

In addition to the traditional likelihood of confusion factors, the District Court of Massachusetts created a new test for internet cases, based on the content the user saw on the screen and the context of the advertisements. These factors include (1) the ability of the consumer to return to a previous page if what she clicked on was not what she was looking for, (2) the mechanics of the specific search the consumer performed, (3) content of the

93. Id. at 283.
94. Id.
95. Id.
96. See supra Section I.D.
97. Hearts on Fire, 603 F. Supp. 2d at 287.
98. Id.
99. Id.
sponsored link and the corresponding webpage, (4) additional content on the
defendant’s webpage that could potentially add additional confusion, (5) the
technological sophistication of the user, (6) the content the user wanted to
find, and (7) the length of time the confusion lasted. While the court
created a potentially useful test, it seemed to collapse the initial interest
confusion analysis into the traditional likelihood of confusion eight-factor
test. No circuit courts or the Supreme Court have adopted such a test. It is
unclear whether the Massachusetts District Court will ultimately find
infringement under either traditional likelihood of confusion, or initial
interest confusion.

While these previous cases demonstrate a trend in courts finding the sale
of trademarked keywords to be a “use in commerce,” none of them reach
past this threshold issue. No precedent exists that finds that the sale of a
trademarked keyword constitutes trademark infringement. Search engines,
such as Google, have good arguments that keyword sales do not constitute
infringement. However, Google also has a very strong business interest in
settling out of court so as to shield itself from the possibility of an adverse
judgment that could severely affect its business model. Though the results of
these out of court settlements are unavailable, they are surely more favorable
to Google than a finding of trademark infringement. In sum, the previous
cases demonstrate both a trend of finding “use in commerce” in keyword
advertising cases, and a trend of search engines not wanting to move past this
threshold issue.

4. A Split Between Courts and Scholars

Though courts fairly consistently find trademarked keyword advertising
to be a “use in commerce,” prominent scholars argue the contrary position.
Professors Stacey Dogan and Mark Lemley argue that the sale of trademarks
does not constitute a “use in commerce.” Selling advertising space based
on an Internet keyword that is also a trademark does not use that trademark
as a brand. The Internet intermediary is not selling any product or service
using those terms as an identifier. Professor Eric Goldman believes that
initial interest confusion creates a more serious problem. He argues that

100. Id. at 289.
101. See Polaroid Corp. v. Polarad Elecs. Corp., 287 F.2d 492, 495 (2d Cir. 1961) (laying
out the eight factor test, as used by the Second Circuit).
102. Stacey L. Dogan & Mark A. Lemley, Trademarks and Consumer Search Costs on the
103. Id. at 810 (emphasis omitted).
104. See Eric Goldman, Deregulating Relevancy in Internet Trademark Law, 54 EMORY L.J.
507 (2005).
courts could avoid the issue if Congress creates a safe harbor for keyword advertising. “[T]he solution is simple: Deregulate the keyword in Internet searching.”\textsuperscript{105} Professor Goldman’s argument addresses the liability issue, which comes after a finding of “use in commerce,” but demonstrates that he believes search engines should not be liable for trademark infringement. These academics’ arguments cut against courts finding the sale of trademarked terms to be a “use in commerce.”

The prior decisions and scholarly debate demonstrate the breadth of Internet trademark cases courts have encountered. However, the current issue of keyword advertising presents new questions regarding likelihood of confusion, and especially initial interest confusion. Part II addresses the courts’ discussion of trademark infringement in \textit{Rescuecom}.

\section{Rescuecom Corp. v. Google Inc.}

In \textit{Rescuecom Corp v. Google Inc.}, the Second Circuit addressed the meaning of the phrase “use in commerce” in the Lanham Act.\textsuperscript{106} It held that Google’s sale of the term to Rescuecom’s competitors is a “use in commerce” as defined by the Act, and thus the plaintiffs stated a claim upon which relief could be granted.\textsuperscript{107} In doing so the court revisited its decision in \textit{1-800 Contacts, Inc. v. WhenU.com, Inc.}, and clarified its holding in that case.\textsuperscript{108} The court did not, however, address whether or not Google’s use of the Rescuecom trademark is a violation under the Lanham Act.\textsuperscript{109}

\subsection{Facts and Procedural Posture}

Plaintiff, Rescuecom, is a computer service franchise that operates nationally.\textsuperscript{110} It sells and services computers and receives a significant amount of its business over the Internet.\textsuperscript{111} Its website, www.rescuecom.com, receives between 17,000 and 30,000 visitors per month.\textsuperscript{112} The company advertises over the Internet, and uses Google’s services to do so.\textsuperscript{113} “Rescuecom” has been valid registered federal trademark since 1998.\textsuperscript{114}

\begin{footnotesize}
\begin{enumerate}
\item[105.] \textit{Id.} at 596.
\item[106.] \textit{Rescuecom Corp. v. Google Inc.}, 562 F.3d 123 (2nd Cir. 2009).
\item[107.] \textit{Id.} at 127.
\item[108.] \textit{Id.; see 1-800 Contacts v. WhenU.com, 414 F.3d 400 (2nd Cir. 2005).}
\item[109.] \textit{Rescuecom}, 562 F.3d at 124.
\item[110.] \textit{Id.} at 125.
\item[111.] \textit{Id.}
\item[112.] \textit{Id.}
\item[113.] \textit{Id.}
\item[114.] \textit{Id.}
\end{enumerate}
\end{footnotesize}
Rescuecom brought an action against Google in the United States District Court for the Northern District of New York for violations of the Lanham Act. It alleged that Google is liable under 15 U.S.C. §§ 1114 and 1125 for infringement, false designation of origin, and dilution of the Rescuecom trademark. \(^{115}\) Rescuecom made four assertions. First, it argued that Google attempted to “free ride” on the association with Rescuecom’s trademark, and that Google’s actions cause brand confusion. \(^{116}\) Second, Google’s sponsored links lure consumers away from their original searches and thus prevent consumers from reaching Rescuecom’s site. \(^{117}\) Third, Google’s search interface with sponsored links at the top and right side of the screen modify the user’s original search. \(^{118}\) Finally, Google uses Rescuecom’s trademark internally to trigger competitors’ advertisements for sponsored links. \(^{119}\) The company alleged that “by the manner of Google’s display of sponsored links of competing brands in response to a search for Rescuecom’s brand name . . . Google creates a likelihood of confusion as to trademarks.” \(^{120}\)

Google filed a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief can be granted. \(^{121}\) Google asserted nominative fair use and argued that AdWords simply uses competitors’ marks for comparative advertising purposes. Its practices constitute fair business practices and lead to increased choice for consumers. \(^{122}\) Comparative advertising has long been seen to benefit consumers and create a healthier marketplace. \(^{123}\)

Four groups filed amici curiae briefs on behalf of Google. The non-profit Electronic Frontier Foundation argued that finding a “use in commerce” would expand the definition of trademark use and stifle free speech. \(^{124}\) AOL, eBay, and Yahoo submitted a joint amicus curiae brief and argued that search

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115. Id. at 124.
117. Id.
118. Id.
119. Id.
120. Rescuecom, 562 F.3d 123, 131 (2nd Cir. 2009).
121. Id. at 127.
122. Brief for Defendant-Appellee at 19–20, Rescuecom Corp. v. Google Inc., No. 06-4881 (2d Cir. Feb. 12, 2007). Further discussion of the nominative fair use defense is discussed supra Section I.D.
engines generate their revenue from keyword advertising thus making them free for the consumer and producing better results. Professor Goldman submitted an amicus curiae brief on behalf of intellectual property professors. He asserted that Google's practice is not a “use in commerce” and simply promotes pro-competitive business practices. He analogized keyword advertising to product placement in stores. Finally, the watchdog group Public Citizen argued in its amicus curiae brief that the sale of keywords allows public interest groups to identify consumers who search for the names of large corporations. The diversity of groups supporting Google demonstrates that the issues at stake here go far beyond the interests of a single commercial enterprise.

B. ANALYSIS OF THE COURTS

1. District Court Decision

The District Court granted Google's 12(b)(6) motion and dismissed Rescuecom’s complaint. The lower court held that this case was analogous to 1-800 Contacts. In the same way that WhenU.com did not use 1-800 Contacts’ trademark as a “use in commerce,” the lower court found that Google did not use Rescuecom’s trademark as a “use in commerce” and dismissed the complaint.

2. Second Circuit Decision

The Second Circuit reversed the district court’s ruling and found that Google’s use of the trademarked term Rescuecom was a “use in commerce” and therefore the plaintiffs did state a claim upon which relief can be granted. The court distinguished its decision in the present case from its decision in 1-800 Contacts in four ways. First, in 1-800 Contacts, the court stated that the defendant did not use, reproduce, or display the plaintiff’s trademark in a way that would constitute a “use in commerce.” In the present case, the court found that Google’s use of Rescuecom’s trademark as a “use in commerce” was appropriate.

128. Rescuecom Corp. v. Google Inc., 456 F.Supp. 2d. 393 (N.D.N.Y. 2006). In 1-800 Contacts, the plaintiff argued that the defendant's internal software infringed on the plaintiff's trademark by providing pop-up ads to relevant searches. The Second Circuit found that the defendant's pop-up advertisements were not a "use in commerce" of the plaintiff's trademark. Therefore, without finding a "use in commerce," there was no way to find trademark infringement, and thus the plaintiffs did not state a claim. See 1-800 Contacts, Inc. v. WhenU.com, Inc., 414 F.3d 400, 403 (2d Cir. 2005).
129. Rescuecom, 562 F.3d 123, 127 (2d Cir. 2009).
trademark and therefore there was no “use in commerce.”\textsuperscript{130} Instead, the defendant used the plaintiff’s non-trademarked website address.\textsuperscript{131} Second, unlike in the present case, the competitors in the previous case were not able to request to buy another company’s trademark to prompt its ads.\textsuperscript{132} The defendant’s software could not produce certain pop-ups based on a company’s preferences of trademarked terms. The software based the pop-up selection on categories of products or services instead of keywords or trademarked terms.\textsuperscript{133} Third, Google “displays, offers, and sells” Rescuecom’s trademark to the company’s competitors.\textsuperscript{134} Fourth, Google’s Keyword Suggestion Tool encourages the use and sale of trademarked terms.\textsuperscript{135}

Google argued that \textit{1-800 Contacts} held that the use of trademarked terms in “an internal computer directory cannot constitute trademark use.”\textsuperscript{136} Yet, the Second Circuit disposed of this argument. It stated that Google uses other companies’ trademarked terms outside of its internal algorithm by selling and suggesting trademarks such as Rescuecom to competitors.\textsuperscript{137} This sale constitutes a “use in commerce.” The court noted that in \textit{1-800 Contacts}, the pop-ups were triggered by the plaintiff’s website address, which was not trademarked.\textsuperscript{138} Additionally, the court stated \textit{1-800 Contacts} never held that a trademark used in an internal directory precludes a finding of trademark infringement.\textsuperscript{139}

For the above stated reasons, the Second Circuit found that Google’s sale of Rescuecom’s trademark was a “use in commerce” under the Lanham Act. The court vacated the lower court’s dismissal of the case for failure to state a claim, and remanded for further proceedings.\textsuperscript{140} Yet, the court carefully noted that its decision did not address whether Rescuecom will be able to prove that Google violated the Lanham Act and caused likelihood of confusion.\textsuperscript{141}

The opinion also included a statutory interpretation of the Lanham Act in an appendix. Section 1127 states that a mark shall be used in commerce

\begin{itemize}
  \item \textsuperscript{130} \textit{Id.} at 128.
  \item \textsuperscript{131} \textit{Id.}
  \item \textsuperscript{132} \textit{Id.} at 129.
  \item \textsuperscript{133} \textit{Id.}
  \item \textsuperscript{134} \textit{Id.}
  \item \textsuperscript{135} \textit{Id.}
  \item \textsuperscript{136} \textit{Id.} at 129.
  \item \textsuperscript{137} \textit{Id.}
  \item \textsuperscript{138} \textit{Id.}
  \item \textsuperscript{139} \textit{Id.}
  \item \textsuperscript{140} \textit{Id.} at 131.
  \item \textsuperscript{141} \textit{Id.}
\end{itemize}
“when it is used or displayed in the sale or advertising of services and the services are rendered in commerce.” The statute defines the term “use in commerce” as the “bona fide use of a mark in the ordinary course of trade, and not made merely to reserve a right in a mark.” While the appendix is dicta, the lengthy legislative analysis provides insight into the court’s decision. It states that the definition of “use in commerce” provided in § 1127 should only apply to parts of the act that address registration and not infringement. Since the definition uses the phrase “bona fide,” it does not make sense to apply it to cases of infringement, because infringement is, by its nature, not a “bona fide” use of a trademark. The appendix calls on Congress to remedy this ambiguity in the terms.

There are no signs showing that Congress is likely to take up this issue in the near future, and the Second Circuit’s decision in Rescuecom demonstrates that courts find the sale of trademarks as keywords to be a “use in commerce.” The pressing question going forward is whether these sales create a likelihood of confusion or result in initial interest confusion. It seems likely that the court’s analyses will necessarily turn on evidence regarding the sophistication of the consumers. However, such analysis requires significant consumer research that may prove difficult to obtain.

III. DOES GOOGLE INFRINGE?

The Second Circuit found trademarked keywords to be a “use in commerce,” but this is simply a threshold issue. This finding does not mean that Google automatically infringes Rescuecom’s trademarks. Courts must carefully protect trademark owners’ rights, while allowing legitimate competitive behavior between companies. “Trademark law strikes a careful balance to ensure that genuinely deceptive . . . uses of marks, which increase consumer search costs, are prohibited, while uses to critique or compare the mark owners’s [sic] products and thus enhance the flow of useful information to consumers are permitted.” The most pressing question remains: will Google be found liable for trademark infringement due to either likelihood of confusion, or initial interest confusion?

143. Id.
144. Rescuecom, 562 F.3d at 132.
145. Id.
146. Id. at 140–141.
A. LIKELIHOOD OF CONFUSION APPLIED TO RESCUECOM

While the likelihood of confusion test is by no means new, applying the model to keyword advertising proves challenging. Not all the Polaroid factors apply to trademarked keywords. The intention of the defendant, the proximity of the goods, the likeness of the advertising channels, and the sophistication of the consumers all still prove relevant. Courts must examine the likelihood of confusion factors on a case by case basis and must be wary of applying blanket policies to categories of cases such as keyword advertising. Ultimately in Internet cases, the analysis comes down to consumer sophistication. It seems likely that Google has a strong nominative fair use argument, but only if it can prove that its users are sophisticated enough to distinguish between Rescucom’s advertisements and competitors’ advertisements.

The first applicable factor calls for the court to look at the proximity of the goods. In this case, Google displays Rescuecom’s mark in the search results, and Rescuecom’s competitor’s mark in the sponsored links either at the top or to the right hand side of the results page. To determine the proximity of the goods, the court must necessarily examine the last factor: the sophistication of the consumer. Google displays sponsored links in separate, demarcated columns, but proximity depends solely on the consumer’s Internet prowess. Thus, the Second Circuit will need to examine consumer surveys regarding user sophistication, if it is possible to produce them.

Next, the court must examine evidence of actual confusion of the marks. Similarly to proximity of the marks, this must be done through consumer surveys. Rescuecom does not claim that Google’s sale of keywords have actually confused consumers. While the test does not require parties to prove actual confusion to find infringement under likelihood of confusion, such a “smoking gun” would be the most convincing evidence.

Finally, courts examine the sophistication of the consumers. However, this factor permeates the others. Courts use the “reasonably prudent” consumer as the test case, but it is difficult to determine who this is in an Internet context. Professor J. Thomas McCarthy explains:

148. See supra Section I.D.
150. While consumer sophistication is a separate factor in the Polaroid test, all the factors of likelihood of confusion as applied to keyword advertising seem to turn on consumer sophistication.
In determining trademark infringement and unfair competition, everything hinges upon whether there is a likelihood of confusion in the mind of an appreciable number of “reasonably prudent” buyers. But what kind of person is this “reasonable” buyer? Is he or she assumed to be cautious and careful in making purchases? Does he approach the marketplace assuming that every seller is out to confuse him by the use of similar trademarks? Or is he trusting and naive in thinking that products labeled about the same way must come from the same source? Does he make purchases quickly and on impulse guided by general impressions and vague recollections from advertising messages seen days before in another context? Or does he spend long hours carefully comparing products with similar trademarks, reading the small print with a magnifying glass?151

Who is the “reasonably prudent” Google user? This could be anyone from age five to eighty-five, with any sort of background, running any type of search. Is it the “reasonably prudent” Rescuecom searcher or consumer? This limits the consumer base, but means that courts must perform a fact-specific determination in each case. Consumer surveys seem to be the only reliable method for determining whether consumers face a likelihood of confusion when it comes to trademarked keywords.

Critics of Google’s practices argue that the entire purpose of selling trademarks as keywords to competitors is to confuse the consumer. They argue that Google acts in bad faith by selling trademarked terms and profiting greatly from doing so.152 They also argue that Google deceives the consumer by luring him towards a competitor’s advertisement.153 However, there is no evidence in the case law (including Rescuecom) that Google acts in bad faith to deceive consumers.

Rescuecom faces a challenge in proving that Google’s practices result in likelihood of confusion, as this doctrine does not project well onto Internet trademark issues. The purchase of a competitor’s trademark as a keyword is not necessarily meant to confuse consumers into purchasing a competitor’s product. Instead, the practice can be used to entice consumers to buy the competitor’s product, with the consumer knowing full well what he is purchasing. Consumers want choice and simple comparative advertising should be promoted. Furthermore, search engines such as Google are only able to provide their services for free because they sell advertising space. Courts should be wary of categorically finding all trademarked keywords

152. See, e.g., Eng, supra note 149, at 513.
153. Id.
likely to cause confusion. However, Google must be careful not to place advertisements that confuse Internet users about the source of a product. Whether Google’s practices actually lead to likelihood of confusion ultimately hinges on the nebulous idea of Internet user sophistication.

B. INITIAL INTEREST CONFUSION APPLIED TO RESCUECOM

Realizing the likelihood of confusion factors do not work well in the keyword advertising context, Rescuecom and other plaintiffs rely on the concept of initial interest confusion to claim that search engines violate the Lanham Act.

The Second Circuit should examine its own precedent in *Savin Corp. v. Savin Group* and find that initial interest confusion in the Internet context should require intent to deceive on the part of the defendant.154 Furthermore, the court should use consumer surveys, as it did in *Grotrian, Helfferich, Schultz, Th. Steinweg Nachf v. Steinway & Sons*, to judge consumer sophistication of Internet users.155 Initial interest confusion on the Internet is simply not the same as in the brick and mortar contexts. Internet users do not experience the same kind of inertia involved in brick and mortar situations because they have not invested the same amount of time or energy. They can back click, unless they find that the other product is closer to what they were looking for than their original search. Plaintiffs in keyword advertising cases prefer claiming initial interest confusion rather than likelihood of confusion because the likelihood of confusion factors work poorly in this context. However, courts should not expand initial interest confusion to cases that simply involve comparative advertising.

The Second Circuit should be wary of following the Ninth Circuit’s reasoning in *Brookfield*.156 Google’s sale of trademarked keywords differs significantly from the facts in *Brookfield*, and from the brick and mortar example. First, *Brookfield* dealt with meta tags that redirected the user, not keyword search results. Meta tags are perhaps more deceptive than keywords because they are internal and therefore users cannot tell why they are redirected to competitors’ sites.157 Second, Google marks its sponsored links so as to prevent against confusion with the organic search results. It delineates its advertisements in an attempt to avoid consumer confusion. Third, if the consumer is in fact confused, there is little cost associated with the mistake.

154. *See supra* Section I.D.
155. *See supra* Section I.D.
156. *See supra* Section I.F.2.
Unlike the brick and mortar example, the Internet user simply must click back to the previous page if he realizes he made a mistake. He does not invest the same amount of time or energy in the online context as he does in the brick and mortar situation. Fourth, Rescuecom faces a difficult proposition in claiming that Google intentionally deceives consumers with its advertising practices. Finally, comparative, non-deceptive advertising serves an important economic purpose, allowing consumers to make informed purchasing decisions. Nominative fair use allows for comparative advertising.

While the Second Circuit should not find initial interest confusion in Rescuecom, courts must perform a fact intensive, case-by-case analysis when determining trademark infringement. It is unwise for them to find that initial interest confusion could never exist in a case involving trademarked keywords. It is certainly conceivable that competitors may try to lure customers away from a popular brand by using that brand’s trademark in a confusing manner, and therefore taking advantage of the lack of consumer sophistication. At the same time, courts should be wary of allowing plaintiffs to liberally assert initial interest confusion claims since they are not grounded in the likelihood of confusion factors. Though the Second Circuit rightfully found that Google’s sale of Rescuecom’s trademark was a “use in commerce,” it should be careful in its application of the initial interest theory. Such a finding would encroach upon legitimate comparative advertising practices.

IV. CONCLUSION

Though the Second Circuit found Google’s sale of Rescuecom’s trademark to be a “use in commerce,” a number of pressing issues remain. First, it is unclear whether courts will find trademarked keyword advertising to cause likelihood of confusion under the Lanham Act. If they do, courts need to be wary of expanding the scope of initial interest confusion to cover legitimate comparative advertising practices. Essentially, this entire analysis must rest on whether consumers are sophisticated enough to tell the difference between the source of the advertisements. Second, if courts do find trademark infringement, the question of what happens to Google’s AdWords practice arises. Will Google need to revamp its lucrative business model? Finally, perhaps these issues are not appropriate for the courts. Perhaps they need to be addressed by Congress. Though unlikely, Congress could adopt Professor Eric Goldman’s suggestion of creating a safe harbor for search engines within the “use in commerce” definition in the Lanham Act. Or, Congress could adopt the Second Circuit’s suggestion by clarifying ambiguity in the “use in commerce” definition. Congress does not seem
poised to address the Lanham Act at this juncture. Therefore, courts must apply it as best they can.

Ultimately, courts must rely on the sophistication of the Internet users in determining trademark infringement. Online likelihood of confusion necessarily turns on whether users are confused in the setting. Further research is necessary to determine whether this confusion relates to the source of products. However, Google has a strong incentive to keep this issue out of court. Given the trend in out of court settlement in keyword cases, it is questionable whether courts will even address the issue of infringement in the near future. Google’s unwillingness to litigate the likelihood of confusion issue in court is all the more interesting given its global expansion of its trademark policy right after the Second Circuit decision. Though the Second Circuit may have addressed the “use in commerce,” trademark infringement in keyword advertising is an issue far from decided.
GRAND THEFT ARCHITECTURE: ARCHITECTURAL WORKS IN VIDEO GAMES AFTER E.S.S. ENTERTAINMENT V. ROCKSTAR GAMES

David K. Stark

INTRODUCTION

The video game industry has grown to become one of the, if not the, largest entertainment industries in the United States. 1 Part of this growth can be attributed to advances in the technology that powers the games industry, which allows games to become increasingly realistic and immersive. In the roughly three decades since the start of the mainstream games industry, the virtual worlds that users can explore and interact with have evolved from simple two-dimensional experiences to massive three-dimensional worlds.

This increased realism allows game developers to create immersive worlds that sometimes mirror their real life counterparts. 2 One of the ways that game developers can create a more engrossing world is to utilize representations of actual buildings to evoke the feel of the cities and environments represented in their games. 3 This technique, however, bears the risk of infringing a copyright or trademark of the real world counterpart. 4 The Ninth Circuit addressed this situation in E.S.S. Entertainment v. Rockstar Games 5 and concluded that the virtual building created by the game

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3. E.g., Musgrove, supra note 2 (“[T]he immediate visual of the Capitol and the Washington Monument and things like that, they tell a story immediately.”).


5. Id.
developers did not infringe the trademark of the real world counterpart.  

Rockstar Games dealt only with the issue of trademarks in buildings; however, protections for buildings exist under both trademark and copyright law.  

Uncertainty with whether a developer can use a building in a virtual world could cause them to avoid accurate representations of buildings in recognizable areas to avoid litigation. This tactic hurts both the game developer’s creative freedom and, as a result of decreased immersion, the user experience. This Note will argue that developers can utilize architectural works in games free from the risk of copyright or trademark infringement. It will start with an exploration of trademark and copyright law and cases dealing with protecting architectural works. The Note will then explore Rockstar Games and the impact that decision will have on game developers’ freedom to utilize easily recognizable architectural works in their games. The Ninth Circuit’s decision should allow game developers to freely utilize architecture without fear of resulting liability. The Note further argues that the test for trademark infringement should allow developers to use the actual trademarks of the businesses associated with the buildings in addition to the architecture. The legal protection of buildings must be explained completely to empower game developers to fully utilize recognizable locations, enhancing the immersion of their users, without fear of liability.

I. BACKGROUND

The use of buildings in virtual worlds implicates both copyright and trademark law. This Part will provide the relevant background to address the issue completely.

A. VIDEO GAMES

A video game consists of many distinct pieces that come together to create the overall user experience. Video games rely on a hardware component (either a computer or its equivalent) to run the software component, the actual game. The Ninth Circuit described the major components of a video game in Micro Star v. FormGen, Inc. involving the game Duke Nukem 3D. The court stated that

6. Id. at 1101. For more information about this case and the reasoning, see discussion infra Part II.
7. Id. at 1098.
8. See discussion infra Sections I.B–I.C.
9. And as the Rockstar Games case showed, non-exact reproduction is not always an exemption. See discussion infra Part II.
10. 154 F.3d 1107 (9th Cir. 1998).
[The game consists of three separate components: the game engine, the source art library and the [Duke Nukem game level layouts known as MAP] files. The game engine is the heart of the computer program; in some sense, it is the program. It tells the computer when to read data, save and load games, play sounds and project images onto the screen. In order to create the audiovisual display for a particular level, the game engine invokes the MAP file that corresponds to that level. Each MAP file contains a series of instructions that tell the game engine (and, through it, the computer) what to put where. . . . The MAP file describes the level in painstaking detail, but it does not actually contain any of the copyrighted art itself; everything that appears on the screen actually comes from the art library.

Although not all games share this architecture, this generally describes the different parts of a game. A video game may break a building into different parts that only come together when displayed on the screen. For example, these elements might include a map file (describing the layout of the world), a model for the building (describing the three-dimensional architecture of the building), and textures (essentially miniature pictures pasted on the model) that represent what the building looks like. When the game engine detects the building on the screen, it uses these aspects to recreate the building based on the user’s perspective. The game then projects a two-dimensional representation of this building on the screen. Rapid updates of this image simulate real-life interactions with a true, virtual world.

Sometimes, video games use buildings to help the player associate with the environment. A game may utilize architecture and buildings taken from a city to create a more immersive world for the player. Previous generation video games often utilized crude representations of architecture or previously

11. *Id.* at 1110 (emphasis in original).
13. *Id.*
14. *Id.*
17. *Cf.* E.S.S. Entertainment 2000, Inc. v. Rockstar Games, Inc., 547 F.3d 1095, 1100 (9th Cir. 2008) (stating that a way to develop a cartoon-style parody of East Los Angeles was to create a “critical mass” of Los Angeles buildings and business).
captured images to evoke this feel. Modern games, however, with more powerful hardware and larger storage mediums, can effectively recreate large parts of a city or full cities. Game developers often travel to the cities that they hope to represent in order to take test pictures and ensure that their virtual representation accurately emulates the real world. Although game developers might not reproduce entire cities due to time constraints or artistic choices, they may sufficiently recreate the architecture of a city to create a realistic feel.

B. TRADEMARK

Trademark protection for buildings and architectural works follows the traditional justifications for trademark law: protecting consumers from being mislead or purchasing false products. This Section will highlight the law and some relevant cases dealing with trademarks in architecture, focusing on how the consumer protective nature of trademark law applies to trademarks on buildings.

1. The Underpinnings of Trademark Law

Consumer protection is the basis of trademark law. Utilizing and protecting known consumer marks serves the dual purpose of safeguarding...
the consumer from inferior products and being misled into purchasing an item that they did not intend to purchase. The Ninth Circuit defines a trademark as “a word, phrase or symbol that is used to identify a manufacturer or sponsor of a good or the provider of a service.”

Trademark protection extends to both the physical mark a company uses to identify their goods and services and any recognizable aspects of the good consumers could associate with a specific company. The Ninth Circuit stated that the recognizable aspects—also known as trade dress—incorporate the “total image of a product” and could include “size, shape, color, color combinations, texture, or graphics.” Trade dress protection can only be found in tangible aspects of the product or business; it does not protect “[i]neffable and vague aspects such as a product’s marketing theme, the ‘aura’ of a product or the ‘cachet that ownership or display of it creates’ . . .” Further, functional aspects of the trade dress are unprotectable for two reasons: to ensure (1) that these types of protections remain in the domain of patent law, and (2) that competitors can copy aspects of the product that they will need to create competitive alternatives.

Trademark law, with its background in consumer protection, covers nearly anything capable of influencing a purchaser of goods and services. In addition to a “word, phrase or symbol,” trademark law protects buildings used as a designation of origin for goods and services. Protection is having the fruit of his labor misappropriated should not be disregarded.” (quoting Zippo Mfg. Co. v. Rogers Imports, Inc., 216 F. Supp. 670, 694 (S.D.N.Y. 1963)).

24. MCCARTHY ON TRADEMARKS § 2:4 (“[T]rademarks create an incentive to keep up a good reputation for a predictable quality of goods. An important purpose underlying trademark law is the protection of the trademark owner’s investment in the quality of the mark and the quality of the goods or services the mark identifies.”).

25. Mattel, Inc. v. MCA Records, Inc., 296 F.3d 894, 900 (9th Cir. 2002). See also MCCARTHY ON TRADEMARKS § 2:7 (“The emphasis and thrust of trademark protection and registration is in the direction of deciding whether an alleged symbol in fact functions to identify and distinguish the goods or services of one seller.”).

26. Vision Sports, Inc. v. Melville Corp., 888 F.2d 609, 613 (9th Cir. 1989) (internal quotation marks omitted); See also MCCARTHY ON TRADEMARKS § 8:4 (Modern trade dress “includes the total look of a product and its packaging and even includes the design and shape of the product itself. . . . [T]he Eleventh Circuit has stated that: ‘Trade dress involves the total image of a product and may include features such as size, shape, color or color combinations, texture, graphics, or even particular sales techniques.’” (quoting John H. Harland Co. v. Clarke Checks, Inc., 711 F.2d 966, 219 U.S.P.Q. 515 (11th Cir. 1983))).

27. MCCARTHY ON TRADEMARKS § 8:4 (citing Abercrombie & Fitch Stores, Inc. v. American Eagle Outfitters, Inc., 280 F.3d 619 (6th Cir. 2002)).

28. See id. § 7:63.

29. See id. § 3:1.

30. See TRADEMARK MANUAL OF EXAMINING PROCEDURE § 1301.02(c) (6th ed. rev. 1 2009), available at http://tess2.uspto.gov/tmdb/tmep/1300.htm#_T130102 (stating that “a
available for the recognizable use of the exterior or interior of a building.  

The defining characteristic is whether the building is used on goods and services. For example, using an image of the Sears Tower, a famous and easily recognizable building, on goods might not cause consumers to think that the Sears Corporation created or distributed them. However, the use of the Cinderella Castle, one of a few variants of the main castle at the center of many Disneyland theme parks, would be more likely to cause consumer confusion. A representation of the structure is used as the introduction to many Disney films and on other goods sold by the company. The use of the same or a similar structure would have a higher likelihood of consumer confusion than the use of the Sears Tower; trademark law would protect this use in order to prevent confusion.

Trademark protection in buildings hinges on the use of that building or architecture in relation to goods and services; ownership of the building used is not a prerequisite for protection. Confusingly, this allows a trademark to develop on a use of a building that the trademark owner does not own. As long as the building is used to identify their goods, trademark protection can be acquired. Although this type of use would normally apply to buildings where there is no valid copyright or trademark right, such as a public building or a building whose rights have already expired, the trademark protection only focuses on whether the building is associated with some goods or services. Historically, protection for trademark and trade dress in buildings three-dimensional configuration of a building is registrable as a service mark only if it is used in such a way that it is or could be perceived as a mark. Evidence of use might include menus or letterhead that show promotion of the building’s design, or configuration, as a mark.

31. MCCARTHY ON TRADEMARKS § 7:100.

32. In emphasizing the consumer protective nature of trademarks, the Sixth Circuit stated that “[i]t is well established that ‘[t]here is no such thing as property in a trademark except as a right appurtenant to an established business or trade in connection with which the mark is employed.’” The court further stated that when alleging infringement, “a plaintiff must show that it has actually used the designation at issue as a trademark, and that the defendant has also used the same or a similar designation as a trademark.” Rock and Roll Hall of Fame and Museum, Inc. v. Gentile Productions, 134 F.3d 749, 753 (6th Cir. 1998) (quoting United Drug Co. v. Theodore Rectanus Co., 248 U.S. 90, 97 (1918)) (emphasis in original).

33. MCCARTHY ON TRADEMARKS § 7:100 (“To possess valid trademark rights in a picture of a structure or building, it is not essential that the trademark owner own the actual real or personal property that is pictured.”).

34. Id. § 7:100 n.2 (citing Pebble Beach Co. v. Tour 18 I, Ltd., 942 F. Supp. 1513, 1541 (S.D. Tex. 1996), aff’d, 155 F.3d 526 (5th Cir. 1998) where a trademark owner used a lighthouse near their golf course for various corporate logos and promotional materials). McCarthy notes that possible examples would be use of the White House or Golden Gate Bridge as marks for bread and further that “[i]t is assumed that the owner of the physical
focused on consumer confusion caused by confusingly similar designs. Two recent cases have dealt with trademark protection for buildings when modern technology is considered: the Sixth Circuit dealt with the issue of reproduction of trademarked buildings in posters, and the Southern District of New York dealt with trademark aspects in film.

There are four major categories of trademarks: arbitrary/fanciful, suggestive, descriptive, and generic. Fanciful marks exist only for the purpose of being a mark. Arbitrary marks may have other meanings but are not normally associated with the goods bearing the mark. Suggestive marks require a logical leap to get to the goods that bear their marks. Descriptive marks simply describe the products that bear the mark. Generic marks are common terms that cannot acquire trademark protection. Generic marks also include previously fanciful terms that have become generic through common use and consumer association with a general class of products as opposed to a specific product or producer. Trademark protection requires that a protected mark, at a minimum, meet a low threshold of distinctiveness; the mark must be either arbitrary, fanciful, suggestive, or descriptive.

35. See id. § 7:100; see also infra Section I.B.2.
36. See Rock and Roll Hall of Fame and Museum, Inc. v. Gentile Productions, 134 F.3d 749 (6th Cir. 1998); see also discussion infra Section I.B.2.
38. See MCCARTHY ON TRADEMARKS § 11:1. Although arbitrary and fanciful marks are technically two separate categories, they are typically viewed as the same level or strength.
40. Examples of arbitrary marks: Omega watches, Sun computer, and Amazon online bookstore. Id. § 11:13.
41. “[A] mark which merely suggested some quality or ingredient of goods was labeled as ‘suggestive.’” Id. § 11:62. Examples of suggestive marks: Chicken of the Sea tuna, Coppertone sun tan oil, Q-Tips, and 7-Eleven. Id. § 11:72.
42. “A ‘descriptive’ term is one that directly and immediately conveys some knowledge of the characteristics of a product or service.” Id. § 11:16. Examples of descriptive marks: Philadelphia Card to describe a credit card depicting Philadelphia and targeting consumers in Philadelphia, Oatnut for bread. Id. Foreign words that describe the shop or items available at the shop can also be considered descriptive, i.e., Le Croissant Shop for a baked goods store. Id. For a larger list of descriptive marks, see id. § 11:24.
44. See, e.g., id. § 12:18 (noting Cellophane, Escalator, and Murphy Bed as examples).
45. “If a designation is not ‘distinctive,’ it is not a ‘mark.’ Without achieving distinctiveness, either inherently or through the acquisition of secondary meaning, then a
requirement also protects consumers by refusing to grant one producer control of a term that is, or has become, indistinct. 46 Arbitrary/fanciful and suggestive marks are considered inherently distinctive. 47 Descriptive marks, however, must show a secondary meaning, or a consumer association with the specified goods. 48 This requirement protects those marks that might not be unique enough to have consumer associations on their own but have built up a reputation through their use. 49

When a trademark holder believes that another has made an unauthorized use of their mark causing consumer confusion, trademark law allows them to bring an infringement action. 50 The federal test for infringement highlights the consumer-protective nature of trademark law: “whether the defendant’s use is ‘likely to cause confusion, or to cause mistake, or to deceive.’” 51 To prevail on a claim of trademark infringement, the plaintiff must show that the defendant used: “(1) a ‘reproduction, counterfeit, copy or colorable imitation’ of plaintiff’s mark; (2) without consent of the plaintiff; (3) in interstate commerce; (4) in connection with the ‘sale, offering for sale, distribution or advertising’ of goods or services; and (5) ‘where such use is likely to cause confusion.’” 52 In cases of trademarks in buildings and architecture, there must be a likelihood that a customer will be misled because of the use of the building in the product. 53 This analysis is done on a case-by-case basis. 54
In addition to the use of a mark on goods and services, nationally famous marks demand additional protections.\(^5\) To protect a famous mark’s national reputation, trademark law protects additional uses of the mark even when there is no intent to cause customer confusion: dilution by blurring and dilution by tarnishment.\(^5\) Dilution by blurring occurs when a famous mark is used on an unrelated good.\(^5\) In these cases, even though the defendant is not necessarily trying to feed off the goodwill of the famous mark, the use might cause harm to the famous mark’s distinctiveness.\(^5\) Some hypothetical examples of this type of dilution include, “Dupont shoes, Buick aspirin, Schlitz varnish, Kodak pianos and Bulova gowns.”\(^5\) Dilution by tarnishment causes harm to the reputation of a famous mark.\(^5\) The First Circuit described this type of dilution as an instance when “the goodwill and reputation of a plaintiff’s trademark is linked to products which are of shoddy quality or which conjure associations that clash with the associations generated by the owner’s lawful use of the mark.”\(^5\)

Use of another’s mark will not always lead to a finding of infringement. There are two categories of fair use available for users of another’s registered trademark: classic and nominative.\(^5\) The classic fair use scenario occurs when a mark that has a descriptive as well as trademarked meaning is used in the descriptive sense.\(^5\) This defense applies “only to marks that possess both a
primary meaning and a secondary meaning—and only when the mark is used in its primary descriptive sense rather than its secondary trademark sense.”

For classic fair use, the registered mark must not be used in a trademark sense and must be used in good faith and only to describe the goods. The Ninth Circuit does not allow classic fair use if there is a likelihood of confusion for the origin of a product.

The nominative fair use defense is available where the defendant has “used the plaintiff’s mark to describe the plaintiff’s product, even if the defendant’s ultimate goal is to describe his own product.” The main purpose of nominative fair use is for the “purposes of comparison, criticism [or] point of reference.” A defendant seeking to prove nominative fair use must satisfy three requirements:

1. the plaintiff’s product or service in question must be one not readily identifiable without use of the trademark;
2. only so much of the mark or marks may be used as is reasonably necessary to identify the plaintiff’s product or service; and
3. the user must do nothing that would, in conjunction with the mark, suggest sponsorship or endorsement by the trademark holder.

In addition to the fair use defenses, the First Amendment permits unauthorized trademark use where there is an artistic element to the use and the likelihood of consumer confusion is very low. This principle allows anyone to use a famous mark to “make fun of or to criticize the products or policies of the mark owner.” This exception prevents a corporate trademark owner from silencing any non-commercial, negative, or offensive use of the mark. The dominant First Amendment trademark test is from Rogers v.

64. Brothers Records, Inc. v. Jardine, 318 F.3d 900, 905 (9th Cir. 2003).
65. MCCARTHY ON TRADEMARKS § 11:45. McCarthy describes a hypothetical scenario where the use of a trademarked credit card called “Adventure” in a slogan “Go on an adventure, with [competitor’s credit card]” would probably be considered classic fair use.
67. Cairns, 292 F.3d at 1151 (emphasis in original).
68. Walking Mountain, 353 F.3d at 809 (quoting New Kids on the Block v. News Am. Publ’g, Inc., 971 F.2d 302, 305 (9th Cir. 1992)).
69. Rock Star Videos, 444 F. Supp. 2d at 1029 (quoting Walking Mountain, 353 F.3d at 809) (internal quotation marks omitted).
70. For more information on the First Amendment as a defense, see infra Part II.
71. MCCARTHY ON TRADEMARKS § 24:90.
72. Id. The Second Circuit commented that “[free speech uses] risk some dilution of the identifying or selling power of the mark, but that risk is generally tolerated in the interest
Grimaldi,\footnote{875 F.2d 994 (2d Cir. 1989). For more on the Rogers test, see infra Section II.B.} which allows the use of a mark if the use has some artistic relevance to the work and there is a low likelihood of consumer confusion.

2. The Evolution of Trademark Case Law Addressing Architectural Works

As mentioned in the previous Section, trademark protection for architecture is rooted in consumer protection. An early California case,\footnote{109 Cal. 529 (1895).} \textit{Weinstock, Lubin \& Co. v. Marks,}\footnote{109 Cal. at 534 (1894).} dealt with protecting consumer associations in architecture. The plaintiff owned a dry goods store in Sacramento with a distinct architecture involving alcoves and arches.\footnote{Weinstock, 109 Cal. at 537.} The plaintiff sued a competitor who built a store nearby with a confusingly similar architecture and business name.\footnote{Weinstock, 109 Cal. at 539.} The court enjoined the defendant and stated that the defendant was “defrauding [the] plaintiff of its business [and] stealing its goodwill.”

The theme of consumer protection is consistently emphasized in cases involving trademarks in buildings\footnote{See MCCARTHY ON TRADEMARKS § 7:100 listing cases involving trade dress in buildings. Some noteworthy cases include: Fuddruckers, Inc. v. Doc’s B.R. Others, Inc., 826 F.2d 837, 841 (9th Cir. 1987) (stating that trade dress protection could be acquired in the “restaurant’s décor, menu, layout and style of service.”); Freddy Fuddruckers Inc. v. Ridgeline, Inc., 589 F. Supp. 72, 74 (N.D. Tex. 1984) (finding trade dress in combination including “an exposed glassed-in butcher shop for meat preparation, . . . a bakery showcase for the bakery products; a fresh vegetable condiment island with stacked vegetables, . . . dark brown and white checkerboard asbestos tile flooring; and interior green bands of neon lights and neon beer signs”). Courts have also found protection in distinctive color combinations for buildings. See Pure Oil Co. v. Ruthsatz, 27 F. Supp. 688 (D. Mich. 1939); see also Charles S. Cash, Inc. v.} and trade dress involving architecture.\footnote{77. Weinstock, 109 Cal. at 539.}
Building designers, however, must be careful that the court does not find their trade dress as functional or they risk losing protection. Also, if a trade dress is shared by many similar businesses, the court might find that there is no chance of consumer confusion because there is nothing distinctive in the building design.

Even a somewhat loose standard of trade dress protection was found to be valid by the Supreme Court. The Court found protection for a chain of Mexican-style restaurants in Texas. Taco Cabana, which opened its first restaurant in 1978, sued Two Pesos, a competing restaurant, which opened in 1985. The Court described the building as “a festive eating atmosphere having interior dining and patio areas decorated with artifacts, bright colors, paintings and murals.” The Supreme Court upheld the holding of the Fifth Circuit and found that Taco Cabana’s trade dress was entitled to protection.

The Sixth Circuit found that uniformity in the mark at issue was a key factor for establishing a trademark in architecture in a case involving the Rock and Roll Hall of Fame and Museum (the Museum), which had registered its name and unique building design as trademarks. Professional photographer Charles Gentile took a sunset picture of the building and created a poster using the picture and the name “Rock N’ Roll Hall of Fame.” The Museum filed a complaint alleging that it had used the name and building design as trademarks and Gentile’s poster infringed, diluted, and unfairly competed with these marks. A district court found that the museum had shown a likelihood of success in proving the trademark claims

Steinbook, 247 N.Y. 531 (1928) (finding trademark protection in color combination of blue and orange); McCARTHY ON TRADEMARKS § 7:48 (discussing color combinations as trademarks).

80. Prufrock, Ltd. v. Lasater, 781 F.2d 129 (8th Cir. 1986) (finding design of “down home country cooking” restaurant which included exposed kitchen area, antique decorations, and small print wallpaper were functional). See also Prints Plus, Inc. v. Classic Graphics, Inc., 225 U.S.P.Q. 679, 680 (N.D. Cal. 1985) (finding interior design elements were functional for selling prints including display racks, neutral color carpeting, high ceilings, removed work areas, and vertical storage bins).


83. Id. at 765.

84. Id.


86. Id.

87. Id.
and granted a preliminary injunction. The Sixth Circuit reversed this finding, stating that it was not convinced that the Museum had used the building as a trademark. The court also found that the characterization of the Museum building as a fanciful mark (which the plaintiff argued and the district court found) did not work with the concept of a building. A fanciful mark has no purpose other than to be a trademark; using the museum as a building conflicted with characterizing it as fanciful. The court also found that the Museum used various representations of the building taken from different angles as a mark instead of one, uniform image. This hurt their trademark argument because it is tougher for consumers to gain an association when the mark in question is constantly changing. The court made this clear by stating,

In reviewing the Museum’s disparate uses of several different perspectives of its building design, we cannot conclude that they create a consistent and distinct commercial impression as an indicator of a single source of origin or sponsorship. . . . Consistent

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89. Rock and Roll Hall of Fame, 134 F.3d at 754. The court also stated that they did not view the protection of the photographed building as the type of protection that trademarks are meant to grant:

That is to say that, when we view the photograph in Gentile’s poster, we do not readily recognize the design of the Museum’s building as an indicator of source or sponsorship. What we see, rather, is a photograph of an accessible, well-known, public landmark. Stated somewhat differently, in Gentile’s poster, the Museum’s building strikes us not as a separate and distinct mark on the good, but, rather, as the good itself.

Id.

90. The court noted,

Although the plaintiffs ‘invented’ the Museum, the Museum’s existence as a landmark in downtown Cleveland undermines its ‘fancifulness’ as a trademark. . . . [A fanciful mark, such as a made up word] is distinctive as a mark because it readily appears to a consumer to have no other purpose. In contrast, a picture of the Museum on a product might be more readily perceived as ornamentation than as an identifier of source.

Id. at 754–55.
91. Id. at 755.
92. Id.
93. Id. The court compared this to earlier cases where certain images had been used for celebrity marks. In those cases, the owners of the rights to the celebrities had tried to use the association with one specific image to claim trademark protection of all images of the celebrity. The courts in these cases rejected those arguments. Id. (citing Pirone v. MacMillan, Inc., 894 F.2d 579, 583 (2d Cir.1990) (dealing with photographs of Babe Ruth) and Estate of Presley v. Russen, 513 F. Supp. 1339, 1363–64 (D.N.J.1981) (dealing with photographs of Elvis Presley)).
and repetitive use of a designation as an indicator of source is the hallmark of a trademark.94

The court also stated that it was unsure whether the use of “Rock N’ Roll Hall of Fame” would be an infringement of the registered mark or a description of the building pictured.95

Adapting trademarks in architecture to the digital age leads to a new set of challenges. The Second Circuit upheld the non-infringement of the digital alteration of advertisements on famous buildings.96 The film Spider-Man digitally altered advertisements placed on Times Square buildings and replaced them with other sponsorship.97 The owners of the Times Square buildings sued Sony alleging trademark and trade dress infringement.98 These plaintiffs alleged that by altering the advertisements that were already there, Sony had infringed the trademarks and trade dress of the buildings and had caused consumer confusion as to the building’s association with the substituted advertisements. In a two-page opinion, the district court dismissed the claims, stating that there was no consumer confusion as the alteration did not affect purchasing decisions.99 The district court also dismissed the trade dress infringement by stating that the advertising dress of the buildings changes constantly.100 The Second Circuit affirmed the decision and stated that the plaintiffs had failed to assert what exactly constituted the trade dress infringed.101 This case is a good example of courts reiterating that trademark protection for buildings is rooted in consumer protection. Since there were no purchasing decisions affected by the alteration of the advertisements and no uniform trademark usage, the court found no infringement.

94. Id.
95. Id. at 756.
96. Sherwood 48 Associates v. Sony Corp. of America, 76 F. App’x 389 (2d Cir. 2003).
97. Sherwood 48 Associates v. Sony Corp. of America, 213 F. Supp. 2d 376, 377 n.2 (S.D.N.Y. 2002) (stating that Sony substituted a “USA Today” ad for the “Samsung” ad that was in the original shot).
98. The owners also alleged a baseless trespass claim which was also dismissed. Id. at 377.
99. Id. at 377 (citing Lang v. Retirement Living Publ’g Co., Inc., 949 F.2d 576 (2d Cir.1991)).
100. Id. at 377.
C. COPYRIGHT

Congress added copyright protection for buildings and other architectural works in 1990. This protection carried with it an important limitation due to the public nature of these works. This Section will explore the law and cases around copyrights in buildings.

1. The Underpinnings of Copyright Law as to Architectural Works

Unlike trademark law, copyright law protects artistic expression. Copyright law traditionally protects books, photographs, motion pictures, paintings, musical compilations, and other works containing artistic elements. Unlike trademark law, copyright protection, like patent law, draws its support from the Constitution. Patent law is meant to protect useful articles whereas copyright law is meant to protect those elements of artistic works that can be separated from the useful aspects.

Congress granted buildings and architectural works copyright protection on December 1, 1990 with the Architectural Works Copyright Protection Act (AWCPA). Before 1990, plans for buildings could be protected as graphical works but the buildings themselves could not. Buildings were originally considered uncopyrightable because they were seen as functional and thus “useful articles” outside the realm of copyright protection. However, to conform to the Berne Convention, Congress passed the AWCPA, which added architectural works to the list of protectable expression. Congress defined an architectural work as “the design of a building as embodied in any

104. See WILLIAM F. PATRY, PATRY ON COPYRIGHT § 3:1 (database ed. 2009) [hereinafter PATRY ON COPYRIGHT] (“Congress shall have the Power . . . To Promote the Progress of Science and useful Arts, by securing, for limited Times, to Authors and inventors, the exclusive Right to their respective Writings and Discoveries.” (quoting U.S. CONST. art. I, § 8)).
105. See, e.g., Mazer v. Stein 347 U.S. 201 (1954) (finding protection of an ornamental lamp base as a statue by separating the expressive aspects of the lamp base from the lamp itself). This idea is known as separability and will be discussed in infra Section I.C.2.
107. JULIE E. COHEN ET AL., COPYRIGHT IN A GLOBAL INFORMATION ECONOMY 268 (2d ed. 2006).
108. Id.
109. PATRY ON COPYRIGHT § 3:107. The Berne Convention is an agreement between member countries, originally signed by ten countries in 1886, to guarantee certain minimum substantive standards for created works. Several areas of American copyright law had to be changed in order to conform to the minimum requirements that this agreement calls for. See COHEN, supra note 107.
tangible medium of expression, including a building, architectural plans, or drawings.” 110 By having protection available as soon as the work is fixed, Congress intended to protect the original designer of the building. 111 This intent is further emphasized by the fact that the fixation requirement for architectural works does not require the construction of the building before protection is acquired. Although completion of the building will meet this requirement, protection is available for “plans, drawings, blueprints and computer disks.” 112 Congress did not choose to protect all three-dimensional structures when they enacted the AWCPA; Congress made a policy decision to include only those structures that were human inhabitable as architectural works and to exclude “interstate highway bridges, cloverleafs, canals, dams and pedestrian walkways” because their protection was not required by the Berne Convention. 113

The functional view of buildings persists even after the adoption of the AWCPA. The legislative history of the AWCPA shows that Congress envisioned a two-step analysis for determining copyrightability involving separation of the original design elements of the building and then judging whether these elements are functional. 114 Although buildings that lack

110. 17 U.S.C. § 101 defines “architectural works” as “the design of a building as embodied in any tangible medium of expression, including a building, architectural plans, or drawings. The work includes the overall form as well as the arrangement and composition of spaces and elements in the design, but does not include individual standard features.” Not protecting standard features is a common trend in copyright, which seeks to protect only what is original about the work.

111. PATRY ON COPYRIGHT § 3:108.

112. Id. § 3:108. The inclusion of computer disks is meant to protect plans in computer programs such as AutoCAD. Patry later mentions that Congress added protection for the schematics of a building because of a fear that “if an architectural work could be fixed only in a building, there would be no liability if an infringer ‘scooped’ the architect by constructing the building first.” Id.

113. Id. Patry later gives examples of protected buildings: “houses, apartments, office buildings, churches . . . [also] structures that are used by humans but not inhabited, such as belvederes, pergolas, gazebos, and garden pavilions.” Id. Patry also describes the definitions of a building from the copyright office:

The term building means humanly habitable structures that are intended to be both permanent and stationary, such as houses and office buildings, and other permanent and stationary structures designed for human occupancy, including but not limited to churches, museums, gazebos, and garden pavilions. [This definition excludes] structures other than buildings, such as bridges, cloverleafs, dams, walkways, tents, recreational vehicles, mobile homes, and boats.

Id.

114. COHEN, supra note 107, at 276 (quoting H.R. Rep. No. 101-735, 101st Cong., 2d Sess. 20–21 (1990)).
originality (such as a generic office building composed of standard features) are generally not protectable, an original combination of standard features would still be.\textsuperscript{115}

Congress added a “photographic exception” in § 120(a) to limit the protection granted to items classified as architectural works, stating that the exclusive rights do not include the “right to prevent the making, distributing, or public display of pictures, paintings, photographs, or other pictorial representations of the work, if the building in which the work is embodied is located in or ordinarily visible from a public place.”\textsuperscript{116} Further, the legislative history of the Act implies that monuments, originally given full copyright protection as sculptures, were reclassified as architectural works with all the limitations that classification carries.\textsuperscript{117} Case law also implies that works of art that are essential to or exist as part of a building can be classified as, and subject to the limitations of, architectural works.\textsuperscript{118}

This exception is especially useful to the gaming industry because it allows the use of publicly viewable buildings to create a realistic game environment without opening the companies up to liability from the building architects. William Patry states this exact idea when talking about the photographic exception:

The limitation to two-dimensional reproductions is also important, since the exemption does not cover three-dimensional reproductions. By three dimensional is meant a physical three-dimensional object, and not a two-dimensional that is designed to appear three-dimensional. For example, no depiction of a work on a computer, whether in conjunction with a Computer Aided Design or CAD program on a virtual world such as second life

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\textsuperscript{115} Patry on Copyright § 3:108.
\textsuperscript{116} 17 U.S.C. § 120(a) (2006).
\textsuperscript{117} Cohen, infra note 107, at 278 (“Monumental, nonfunctional works of architecture are currently protected under § 102(a)(5) of title 17 as sculptural works. These works are, nevertheless, architectural works, and as such, will not be protected exclusively under section 102(a)(8).” (quoting H.R. Rep. No. 101-735, 101st Cong., 2d Sess. 20 n.43 (1990))).
\textsuperscript{118} See Leicester v. Warner Brothers, 232 F.3d 1212 (9th Cir. 2000) (holding a statue erected as part of a building to be an architectural work, allowing Warner Brothers to film it without seeking the artist’s permission).
It is important to note that the CAD program mentioned by Patry is the screen representation of a CAD design. As was previously mentioned, the fixation requirement is met when an architectural plan is fixed within a computer disk. However, the fixed design as rendered and displayed on a computer screen is not protected as an architectural work. When displayed on a screen, the design is viewable for the world to see.

The photographic exception for virtual worlds makes sense when we look at the reasons behind architectural copyright protection. Congress decided to protect plans because of the fear that someone would “scoop” the building, for example building the structure and obtaining copyright protection before the original architect. Congress wanted to guarantee that the designer of the building would be the one to build it. Once the building is complete, the copyright ensures that no one else will create another identical physical building. By allowing an exception for two-dimensional representations, Congress protects the physical building while recognizing its public nature. A three-dimensional representation within a virtual world would not infringe the physical building since there is still only one physical copy of it. The architect’s design is still protected and embodied in the physical building. Further, a three-dimensional virtual reproduction is still a two-dimensional representation and within the photographic exception. Although the design might appear to be three-dimensional, the projection on the screen is a two-dimensional image drawn to appear three-dimensional.

The protection of architectural works would reach too broadly if a copyright holder was allowed to assert protection against virtual world representations of publicly visible buildings. This important realization also comes with a limitation for game developers because of how Congress decided to protect architectural works. Creators of virtual representations of buildings must be careful with their source material and ensure that reproductions only utilize pictures taken from publicly viewable vantage points. Virtual representations of real world buildings will fall within the photographic exception only if they are created from publicly accessible pictures; recreation from a building’s plans or schematics will not fall within the exception. Though the eventual representation would still be the same, a copyright violation would occur if a virtual representation of a building was

119. PATRY ON COPYRIGHT § 3:111.10 (emphasis in original).
120. See supra note 112.
121. PATRY ON COPYRIGHT § 3:108.
created from architectural plans as opposed to pictures taken from a public space.

2. Leicester v. Warner Bros. and Architectural-Sculptural Merger

The Ninth Circuit in *Leicester v. Warner Bros.* extended the protection afforded in the photographic exception to other copyrightable works incorporated into a building. The case dealt with the filming of a building used in the movie *Batman Forever*. A scene in the film contained both the actual building and a sculptural work built as a part of it. Warner Brothers also made a miniature reproduction of the sculpture for the filming. The court in *Leicester* held that the photographic exception included sculptural works that are seen as part of the building as a whole. The sculptor tried a separability argument and stated that his work was “conceptually separate” from the building it was built for. If the court had accepted this analysis, it could have held that the photographic exception only applied to the actual building and not to the sculpture on top of it. This type of a holding would make little sense given the rationale behind the photographic exception, that the building was clearly in public view and thus pictures of it should not be considered copyright infringement.

The *Leicester* court rejected the sculptor’s separability analysis. In doing so, the court applied the photographic exception to a completely separate

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122. 232 F.3d 1212 (9th Cir. 2000).
123. Id. at 1215.
124. Id. at 1217. The appeals court, reviewing the district court findings, found that [g]ainst this backdrop, the district court found that the lantern towers and the smoke towers, including the decorative elements at the top, are part of the 801 Tower as a whole. As it explained, each tower appears to be an integrated concept which includes both architectural and artistic portions. The court rejected Leicester’s assumption that the decorative portion should be looked at alone as conceptually separate, artistic embellishments of the whole; rather, it found, the artistic and architectural impression is one created by the towers as a whole, complementing the pilasters and continuing the theme of the third floor lanterns of the building. Thus, it concluded, the four towers are part of the design plan of the building.

125. Id. at 1215.
126. Id. at 1219: Leicester further maintains that the streetwall towers are a sculptural work which is “conceptually separate” from the building and thus independently entitled to copyright protection. Again, the district court found otherwise and we cannot say its finding lacks support. The streetwall towers were designed to extend the building visually, which they do along both Figueroa and Eighth. The Eighth Street smoke towers are
work of copyright. The court recognized that the practical purposes of the photographic exception outweigh independently copyrightable items of expression closely tied to the architecture in question. The court treated these independent copyrightable works as a part of the building, demonstrating how powerful the photographic exception can be for the reproduction of buildings within a virtual world.

II. E.S.S. ENTERTAINMENT V. ROCKSTAR GAMES

A recent Ninth Circuit case attempted to synthesize the trademark aspects of architecture in video games and, in the process, adopted the Rogers test for uses that were not in the title of a work. This Part addresses the background of the case, the district court opinion, and the appellate opinion.

A. BACKGROUND

E.S.S. Entertainment operates the Play Pen strip club in eastern Los Angeles. The logo of this establishment consists of the words “the Play Pen” and the words “Totally Nude” written in a publicly available font with a silhouette of a nude female dancer inside the stem of the first “P”. The mark was an unregistered mark.

Rockstar Games is the developer of many games, including the Grand Theft Auto (GTA) series. Rockstar is not a stranger to litigation; many equally integrated and serve the same purpose on Eighth as the Figueroa Street smoke towers do on Figueroa.

127. The court expounds on this when it states that “[g]iven the important public purpose served by these uses and the lack of harm to the copyright owner’s market, the Committee chose to provide an exemption, rather than rely on the doctrine of fair use, which requires ad hoc determinations.” Id. at 1217.

128. Id. at 1219–20:

Whether or not Leicester may have some other claim for a different infringement of his copyright in the Zanja Madre towers as a sculptural work, we believe he has none for a pictorial representation of the 801 Tower and its streetwall embodying a protected architectural work. Otherwise, § 120(a)’s exemption for pictorial representations of buildings would make no sense. When copyright owners in architectural works were given protection for the first time in 1990, the right was limited by § 120(a) so that publicly visible buildings could freely be photographed. See H.R. Rep. 101-735, at 1112, 21–22. This reflected a shift from the prior regime of relying on “ad hoc determinations” of fair use. Id. at 21–22. Having done this, it would be counterintuitive to suppose that Congress meant to restrict pictorial copying to some, but not all of, a unitary architectural work.


130. Id. at 1027 n.95.
lawsuits have been filed against the company, a majority of them involving the GTA series. The GTA series was launched in 1997 and Rockstar has released new games under that brand every few years since. Each game takes place in a fictitious city that is based on a real world counterpart. Grand Theft Auto: San Andreas features three virtual cities, “Los Santos,” “San Fierro,” and “Las Venturas,” which are based on Los Angeles, San Francisco, and Las Vegas, respectively. The neighborhoods are fictionalized versions of their real world counterparts. The “Pig Pen” is a virtual strip club located within the Eastern portion of Los Santos. Though the artists used images taken from East Los Angeles when creating the Los Santos section of the game, including images of the Play Pen, they testified that they were not trying to recreate the establishment.

The two structures are very different. The court noted that the Pig Pen is “a totally different size, color, shape, and structure than the Play Pen. . . . [It] does not have a stone façade, a valet stand, large plants and gold columns around the entrance, or a six foot black iron fence surrounding the parking lot.” The color schemes of the pole signs of the two places are different and the Pig Pen’s sign does not feature a trio of nude silhouettes nor does it have a “totally nude” sign below it.

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134. Id.

135. Id. at 1017: The neighborhoods [of Los Santos, the fictionalized Los Angeles,] are populated with cartoon-style liquor stores, ammunition dealers, casinos, pawn shops, tattoo parlors, bars, and strip clubs, among other things. The brand names, business names, and other aspects of the locations have been changed to fit the overall “Los Santos” theme and the [Grand Theft Auto series’] irreverent tone.

136. Id. at 1017–18.

137. Id. at 1018–19.

138. Id. at 1019.

139. Id. at 1019–20.
B. **DISTRICT COURT OPINION**

E.S.S. Entertainment filed suit against Rockstar Games in the Central District of California. It claimed that Rockstar had used the Play Pen's distinctive logo and trade dress in *Grand Theft Auto: San Andreas* without authorization and created a likelihood of confusion among consumers as to whether E.S.S. Entertainment had endorsed, or was associated with, the game. Rockstar Games moved for summary judgment on all the claims asserting nominative fair use and First Amendment protection as defenses.

The district court dismissed the nominative fair use defense because it requires the defendant to use the mark to “clearly identify[] and intentionally refer[] to the plaintiff’s product or service.” Rockstar’s artists and employees testified that they used the trade dress and mark to create a fictionalized strip club within Los Santos and not to refer to the actual Play Pen establishment. The court, thus, denied summary judgment for nominative fair use.

For the First Amendment analysis, the district court stated that trademark protection does not allow the owner of the mark to “quash an unauthorized use of the mark by another who is communicating ideas or expressing points of view.” The court further used the *Rogers* test, which the Ninth Circuit adopted for previous trademark uses within the title of a work. The *Rogers* test allows trademark protection to apply to artistic works where the public interest in avoiding consumer confusion outweighs the public interest in free expression. Rockstar’s use of this defense was novel because the Ninth Circuit had not ruled on whether uses that did not involve the title of the work fell within it. In a previous case the Ninth Circuit had contemplated the use of the *Rogers* test in this context but chose not to apply it because other defenses applied. In that case, the Ninth Circuit specifically mentioned that if nominative fair use had not been applicable, the
court probably would have used the Rogers test. The district court looked to other circuits that applied the Rogers test to all expressive uses of a trademark or trade dress in artistic works, whether titular or not, and found that the Rogers test should be used for Grand Theft Auto.

Under the Rogers test, the district court first had to determine whether the Pig Pen had artistic relevance to the game. E.S.S. argued that Rockstar’s use of the Pig Pen was improper because the establishment had not reached the status of a landmark and was not relevant to creating a realistic depiction of the city. The court, however, found that the mark did have artistic relevance to the game’s depiction of Los Angeles. The court found that the decision to borrow aspects of the Play Pen’s design was closely connected to the artistic design of the fictional East Los Angeles city. This satisfied the first prong of the Rogers test because the borrowed elements had some artistic relevance to the underlying work. The court further found that

[the] defendants incorporated distinctive elements of the Play Pen name, logo, and trade dress . . . to create a locale that players would readily recognize as the Game’s version of East Los Angeles. Because defendants’ artistic objective was . . . [not to] produce an exact replica of East Los Angeles, it was unnecessary for defendants to copy everything about the Play Pen, including the architectural style of its buildings.

The second requirement of the Rogers test requires “that the use of the mark [does] not explicitly mislead as to the source or content of the work.” Because the Pig Pen was not featured in any advertisements and the player did not even need to visit the establishment to finish the game, the court found that there was no chance of content confusion.

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149. Id. at 1038 (citing Mattel, Inc. v. Walking Mountain Productions, 353 F.3d 729, 809 n.17 (9th Cir. 2003)) (“Were the nominative fair use test not available and so attractive to this claim, we very well m[ight] have had to apply Rogers.”).
150. Id. (citing cases and treatises including a Second Circuit and Sixth Circuit case applying the Rogers test).
151. Id. at 1040.
152. Id.
153. Id. at 1041.
154. Id.
155. Id. at 1043.
156. Id. at 1043–44.
157. Id. at 1044.
158. Id.
the Play Pen’s owners. The court further found that a small chance of association between the mark owner and the artistic work is not enough to defeat a First Amendment defense under the Rogers test. Since Rockstar’s use of the trademark passed both aspects of the Rogers test, the district court granted the motion for summary judgment. The court further found that because the analysis for E.S.S.’s other state law claims was substantially the same as for the Lanham Act claim, summary judgment was appropriate.

C. NINTH CIRCUIT OPINION

On appeal, the Ninth Circuit affirmed the district court decision. As a result, the court adopted the Rogers test for any use of a trademark in an artistic work and found that Rockstar Games’s use of the Play Pen passed the test. The Ninth Circuit held that the requirement for artistic relevance was a very low threshold. The Ninth Circuit analysis focused on the artistic purpose of including Los Angeles architecture. In finding artistic relevance, the court found that a reasonable way to create a cartoon-style parody of East Los Angeles was “to recreate a critical mass of the businesses and buildings that constitute it.” The Ninth Circuit further found that there was a low likelihood of misleading consumers based on the use of the mark.

159. Id. at 1045.
160. Id. (“While the similar font and common use of nude silhouettes might suggest an association between the Play Pen and [Grand Theft Auto: San Andreas] to some consumers, this is not enough to defeat First Amendment protection under Rogers.”).
161. Id. at 1048.
162. Id. at 1049.
163. E.S.S. Entertainment 2000, Inc. v. Rockstar Games, Inc., 547 F.3d 1095, 1101 (9th Cir. 2008).
164. The Ninth Circuit stated that an artistic work’s use of a trademark is not actionable “unless the [use of the mark] has no artistic relevance to the underlying work whatsoever, or, if it has some artistic relevance, unless [it] explicitly misleads as to the source or the content of the work.” The Ninth Circuit further said that “[a]lthough the test traditionally applies to uses of a trademark in the title of an artistic work, there is no principled reason why it ought not also apply to the use of a trademark in the body of the work.” Id. at 1099.
165. Id. at 1100 (“In other words, the level of relevance merely must be above zero.”).
166. Id.
167. Id.
168. Id. (“Both San Andreas and the Play Pen offer a form of low-brow entertainment; besides this general similarity, they have nothing in common. . . . Nothing indicates that the
III. VIDEO GAMES WILL RARELY INFRINGE LEGAL PROTECTIONS IN ARCHITECTURE

The adoption of the *Rogers* test, along with previous case law, leads to the conclusion that the First Amendment will usually allow the inclusion of architectural works in virtual worlds. This Part combines the protections from the *Rogers* test for trademark infringement with the exceptions to copyright to argue that video games will rarely infringe legal protections in architecture.

A. ARCHITECTURAL TRADEMARKS AFTER *E.S.S. v. ROCKSTAR GAMES*

For a game to infringe trademarks in architecture under the *Rogers* test, its use must lack artistic value to the game and explicitly mislead consumers. This Section will go through each of these prongs and conclude that such infringement will rarely, if ever, occur.

1. Artistic Intent

The Ninth Circuit specifically stated that the recreation of public buildings is a sufficient artistic purpose for a First Amendment defense and that a developer could evoke the feel of Los Angeles by creating a critical mass of buildings.\(^{169}\)

The Ninth Circuit stated that the artistic relevance of a work has to be “above zero.”\(^{170}\) This low threshold gives game developers a lot of freedom when incorporating trademarks into their own works. The court allowed a game developer to utilize the trade dress and potentially trademarked architecture of a “critical mass” of Los Angeles buildings for the artistic goal of a cartoon-style parody of the city.\(^{171}\) The same principle should hold true for creating a realistic representation of a city. In sum, any translation of the real world to a game representation should pass the artistic bar.

\(^{169}\) Id. (stating that “Rockstar’s artistic goal . . . is to develop a cartoon-style parody of East Los Angeles. Possibly the only way, and certainly a reasonable way, to do that is to recreate a critical mass of the businesses and buildings that constitute it.”).

\(^{170}\) Id.

\(^{171}\) Although the Ninth Circuit does not specifically tell developers to use the trademarked architecture, by stating that the easiest way to evoke the city is to create a critical mass of buildings that will be recognizable, it is not inconceivable that a large portion of these will be trademarked buildings. To assume that the Ninth Circuit is saying to copy only those buildings that do not have a trademark on them would not make sense, especially given the impracticalities of such an assumption.
A recent Central District of California case applied the Rogers test to a video game with a realistic artistic intent. The case involved a football simulation game with the artistic intent of accurately modeling the sport. Even with the goal of realism, the court, citing to Ninth Circuit precedent, stated that “[i]t is well established that ‘video games are a form of expression protected by the First Amendment.” The court then found the use of a famous running back in the game furthered the artistic intent of creating a realistic representation of football and that there was no risk of consumer confusion. The reasoning of that case along with the court’s use of the Rogers test for a realistic video game supports the idea that using actual buildings in a realistic representation of a city would pass the artistic intent prong.

The language of the Ninth Circuit and recent district court precedent shows that to meet the artistic goal of evoking a real world city, game developers can logically use real representations of buildings within that area. This proposition not only authorizes developers to make copies of individual buildings to further the artistic purpose of the game, it also allows trademark use on a massive scale to qualify as free speech. In terms of a video game and virtual world, this type of reasoning makes sense. A game developer will need to recreate a large portion of a city and many key buildings in order to evoke the feel of that city. A single copied building would not be enough for the player to recognize the modeled area.

2. Likelihood to Mislead the Consumer

The Ninth Circuit quickly dismissed any notion that including the Pig Pen in Grand Theft Auto: San Andreas would explicitly mislead a consumer into believing that E.S.S. was involved in the game. This dismissal was based on

173. Id. at *5 (citing to Video Software Dealers Ass’n v. Schwarzenegger, 556 F.3d 950, 958 (9th Cir. 2009)).
174. Id. at *9.
175. Rockstar Games, 547 F.3d at 1100 (“Possibly the only way, and certainly a reasonable way, to [create a cartoon-style parody of East Los Angeles] is to recreate a critical mass of businesses and buildings that constitute it. In this context we conclude that to include a strip club that is similar in look and feel to the Play Pen does indeed have at least ‘some artistic relevance.’”).
176. While many players might recognize the Staples center and associate it with downtown Los Angeles, it is unlikely that the game would evoke the feel of downtown Los Angeles if that one building was present. Further, it would probably look out of place and might break the feel of the game if one recognizable building existed in a sea of generic ones.
177. “Nothing indicates that the buying public would plausibly believe that ESS produced the video game or, for that matter, that Rockstar operated a strip club. . . . It also
the fact that the game was not based around operating a strip club and that the club did not play a prominent role in the advertisements of the game. Under this logic, there are few instances where an in-game trademarked building could mislead the consumer.

It is possible that the building’s use in a parody of Los Angeles influenced the Ninth Circuit’s dismissal of the likelihood to mislead. The court mentions the GTA series’ parody aspects in the description of the game but not in the analysis of consumer confusion. Even though the opinion might have implicitly considered this aspect, the opinion does not analyze the trademark use in this way. The Ninth Circuit opinion fully analyzed the mark as referring to the strip club and concluded that there would be no consumer confusion. Although it would have been easier to state that there was little possibility of confusion between an obvious parody of the Play Pen mark and building and the in-game use, the Ninth Circuit’s analysis includes statements that identify E.S.S. without mentioning the cartoon-style aspects of the use. These statements reaffirm the difficulty of infringing architectural trademarks in video games; whether the use is an obvious parody or a complete architectural reproduction, the reasoning supporting a low likelihood to mislead will be the same.

However, the growth in traditional advertising uses within games could lead to more restrictions on the use of architecture based on the consumer confusion prong. More companies recognize the growing popularity of games and are increasing their advertising efforts in that area. Burger King, M&Ms, Doritos, 7-UP, and others have all sponsored the creation of games based on their brands. Additionally, many games prominently feature advertisements within the virtual world that promote various products, and seems far-fetched that someone playing San Andreas would think ESS had provided whatever expertise, support, or unique strip-club knowledge it possesses to the production of the game.” Rockstar Games, 547 F.3d at 1100.

178. The court does state, however, that the strip club is generic and the district court opinion goes into detail about the differences so it is possible that the court decided it was not worth addressing.

179. Rockstar Games, 547 F.3d at 1100–01 (“Nothing indicates that the buying public would reasonably have believed that ESS produced the video game . . . . A reasonable consumer would not think a company that owns one strip club in East Los Angeles . . . also produces a technologically sophisticated video game like San Andreas.”).


182. The most interesting one being the Obama campaign’s use of advertisements in various Electronic Arts games in the time leading up to the election. See Posting of Ross Miller to Joystiq, http://www.joystiq.com/2008/10/14/obama-takes-campaign-to-
various companies have sponsored downloadable additions to games.\textsuperscript{183} The fundamental difference between these types of uses and the use that occurred in Rockstar Games and other cases of trademarked architecture is the use of the trademark in a traditional advertising context. Traditional forms of sponsorship, including advertising billboards, prominent product placement, and overt splash screens and messages, would lead a consumer to conclude that a game is supported and endorsed by the trademark owner. This type of use approaches the level of explicitly misleading the consumer. Without these types of traditional sponsorship associations, the likelihood of explicitly misleading consumer would be low.

Though Rockstar used aspects of the Play Pen’s architecture and some of the trade dress for the logo, it was still used as a public building in a way that the average consumer would not traditionally associate with sponsorship. There was little risk that a consumer would think that a location with little relevance to the overall story and not placed on any promotional screenshots, videos, or box art was somehow associated with the development or promotion of the game. This is the nature of architectural works in video games. The game developer’s use of architecture will rarely lead to consumer confusion over the sponsorship of the game. Even if the architecture and trade dress are prominently displayed, the amount of time the player spends around or within the building will most likely be similar to that in Rockstar Games. Unless the developer decides to create the “McDonald’s home base” or other similar locale that contains a prominent mission or repeated interactions, the use would not approach that of sponsorship. Essentially, a developer would need to actively attempt to evoke a sponsorship with the architectural work for it to lead to consumer confusion. Even the prominent placement of potentially trademarked architecture can lead to no consumer confusion and a mutually beneficial relationship.\textsuperscript{184}

When games reproduce billboards and other traditional forms of advertisements, the result of this prong of the test is harder to predict. Even though the architecture of a billboard on its own is unlikely to raise any trademark liability due to its functional nature, the use of the trademarked

\textsuperscript{183} Downloadable add-ons have been sponsored by Fanta, Monster Energy Drink, Sprint, Coca-Cola, and the Discovery Channel to name a few. \textit{See}, e.g., Posting of Dustin Burg to Joystiq, http://xbox.joystiq.com/2007/01/08/new-gow-maps-coming-thursday/ (Jan. 8, 2007, 00:30) (detailing new maps for a game sponsored by the Discovery Channel).

\textsuperscript{184} \textit{See infra} Part IV.B.
advertisement might. Because these uses are more in-line with traditional advertising, the likelihood of consumer confusion could be greater. The reasoning of the Ninth Circuit, however, seems to miss the mark when applied to traditional advertisements. The Ninth Circuit focused on the likelihood of the mark to confuse the consumer as to the game’s origin, but in cases of small advertisements within a large world, unless the same advertisement was reproduced throughout the city, it is unlikely that a single advertisement would cause the consumer to think that the game was developed or produced by the company holding that trademark. Consumers might think that the company sponsored or endorsed the use of the mark in game, but it is unlikely that this could cause consumers to believe that the company was responsible for making the game or lending their expertise. The trademark’s use in traditional advertising is very different from having the logo appear on a splash screen or other prominent placement.

The question of whether a trademark holder endorsed a game is more difficult. Considering that many games use in-game advertisements to generate revenue, the likelihood that an in-game product advertisement for a famous trademark would lead to a consumer thinking the trademark owner had specifically endorsed it is high. It is still questionable whether endorsement would actually mislead the customer in the traditional trademark sense. The Ninth Circuit analysis hinged on source confusion; even with an advertisement, it would still be clear that the advertising mark holder did not create the game or lend their expertise. Although this type of

185. Such as having every billboard say, “Enjoy Coca-Cola.”

186. This leads to the question whether consumer perception that a game is endorsed by a trademark holder would itself lead to consumer confusion. If the trademarks were not prominently featured on the game art or in advertisements, there would be little fear of initial interest confusion.

187. Cf. Sega Enterprises Ltd. v. Accolade, Inc., 977 F.2d 1510 (9th Cir. 1992). Sega filed a trademark infringement action for Accolade’s inclusion of code which caused Sega’s trademarked logo to appear during the start of the Accolade game. Id. at 1528. The Ninth Circuit, however, determined that Sega required the inclusion of the code for a game on their console to work properly, making the trademark functional. Id. at 1532. Had Accolade included the code for purposes other than getting the game start on a Sega console, however, the court could have come out differently.


189. Trademark dilution was discussed in supra Section I.B.1.
use would more closely approach an explicitly misleading endorsement by the trademark holder, the Rogers test might still allow it. The district court focused their analysis on misleading the consumer as to whether the mark holder had lent their specific expertise to development of the game. Real world advertisements could contribute to the realistic artistic purpose of a city and should be allowed as long as they are neither prominently placed nor explicitly suggest sponsorship. If the usage does not mislead consumers as to the game’s origin, the usage should be allowed under the Rogers test.

It is unlikely that developers would bother to try to incorporate trademarked advertisements in their games without permission. Because of the relative simplicity of replacing actual advertisements on architecture with fake or approved advertisements, most game companies would avoid any liability altogether. Additionally, the ability of game developers to make substantial revenue from sponsored advertisements would likely prompt them to use ads that trademark owners endorse. The developer that chooses to use authentic ads and forgo potential additional revenue would likely do this to further the player’s sense of realism and immersion in the virtual world. When a developer makes this choice, the only factor considered should be the lost ad revenue; the law recognizes video games as protected artistic works and the fear of litigation should not be a motivator. The developer that chooses additional artistic immersion should not face litigation because of this choice.

B. COMBINING THE NINTH CIRCUIT’S TRADEMARK TREATMENT WITH COPYRIGHT LAW

The Ninth Circuit’s treatment of the trademark usage of publicly viewable buildings in Rockstar Games complements the defenses for public architectural works built into the Copyright Act. The photographic exception provides strong protection for game developers seeking to utilize copyrighted architecture in their virtual worlds, and this protection has only become stronger through case law. Leicester held that the photographic exception applies to traditional artistic works incorporated into a building

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191. The developer would simply need to replace the image used for the advertisement with a non-infringing version or substitute advertisement.

192. See, e.g., Matthew Yi, Advertisers pay for video games, S.F. CHRON., July 25, 2005, at E1 (estimating that in-game advertisements could increase game maker’s profits by 16 to 40 percent).

193. See supra Section I.C.
because of their contribution to the building as a whole. Indeed, this type of analysis is increasingly important for game developers seeking to use the exception for copyrighted architectural works containing other copyrighted expression.

It is possible that the result of Leicester was motivated by the fact that the city of Los Angeles required buildings to include their own separate artistic requirements, causing the work in question to be viewed more easily as a part of the whole. However, this aspect of the case did not enter the appellate court’s analysis. Rather, the analysis from the case focused on the similarity of the architectural work with the building. Although some of this similarity might be attributed to the requirement of the city, the analysis holds up regardless of the city requirements.

There is an argument that games can more easily handle the removal of independently copyrightable elements of a building. Unlike the film crew in Leicester, who could not relocate the independently copyrighted statue, it is less burdensome for a game developer to substitute or remove these independently copyrightable elements. This requirement, however, would work against the artistic purpose of using actual buildings to give an authentic feel for the player. Copyright protections provide exceptions for two-dimensional reproduction of public buildings and trademark law provides an artistic exception if the use is artistic and does not cause consumer confusion. Both of these uses are well suited for games. Combining these two should allow game developers to create accurate, realistic, and immersive worlds for their games without fear of liability from the use of buildings and architecture.

However, this is not enough. The conclusion of the Ninth Circuit in Rockstar Games should allow the free speech exemption to extend to other aspects of the building, including the logo. As long as there is a low likelihood of explicit consumer confusion, the law should allow the developer to use the associated logo. The Ninth Circuit’s analysis (use of the trademark in an artistic work and a low likelihood of consumer confusion) should allow the use of traditional marks in video games. If the building is recognizable enough to acquire trademark protection, the addition of the logo associated with the architectural work should not change the result of the Rogers test. The Rogers test is flexible enough to allow the use of trademarked logos on their associated buildings, and copyright law would

194. Supra Section I.C.2.
195. Refer to the separability analysis from Leicester, discussed in, supra, Section I.C.2.
196. Leicester v. Warner Bros., 232 F.3d 1212, 1219 (9th Cir. 2000).
197. See discussion supra Sections I.B–I.C.
exempt their use under the photographic exception. These uses would contribute to the artistic intent of the developers and could further the immersive aspect of their virtual worlds.

IV. EXAMPLES FROM MODERN GAMES

A. USE OF BUILDINGS FOR IMMERSION

Even though the use of fake or altered versions of trademarked, easily recognizable buildings could work against the artistic relevance of a game, developers typically sacrifice some realism for reduced liability. The law already shields developers from liability and any changes made only hurt the game-playing audience.

In *Rainbow Six: Vegas*, a game set in the city of Las Vegas during a terrorist incident, players are transported to a virtual recreation of the city. The game used representations of Las Vegas hotels and casinos freely during the opening scenes. The Vegas scenario starts with a helicopter flying over the city. The use of Las Vegas landmarks is quickly apparent as the player surveys the city below and this use contributes to the sense of immersion. However, as soon as the player lands, the recognizable locales are only visible in the background. The areas where the player engages in combat with enemies are all fictional locations within the city. Later, there is a scene where the player witnesses from an adjacent building the destruction of the top floor of a tower. Although the scene is an important plot point, the player having no association with the destroyed building lessens the impact of its destruction and the player's sense of immersion.

Contrast this scene with *Call of Duty: Modern Warfare 2*, in which the player must explore a war-torn Washington, D.C. As the player explores the level, they witness destroyed versions of the Washington monument, the White House, and the Capitol building. Although the idea is similar, the destruction of U.S. buildings as major plot points in a game, the fact that the player sees recognizable landmarks contributes to the immersive aspect of

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198. Spoiler Alert: the following Section talks about aspects of two games and reveals certain plot elements. Readers who do not wish to know about Rainbow Six: Vegas and Call of Duty Modern Warfare 2 are advised to skip to the next Section.


200. *See id.* (“Models of the city’s most-famous landmarks such as the MGM Grand, Bellagio and the Fremont Street Experience, were included, but all the action takes place in fictional casinos such as the underwater-themed Calypso and the Stratosphere-inspired Vertigo.”).
the scene and the impact it has on the player. The destroyed buildings do not have trademark protection, and thus no risk of liability to the developer. Even so, from the player’s perspective, the scene in Modern Warfare 2—seeing a destroyed Washington monument—has more impact than seeing an unnamed building destroyed in the distance.

Although the destruction of video game representations of trademarked architecture has not been addressed by the courts, weighing the artistic relevance versus the likelihood to mislead the customer should allow the use and destruction of the trademarked building. This type of use might invoke trademark dilution by tarnishment or blurring. The First Amendment protections built into trademark law, however, should overcome these types of problems. Although most developers would probably rather take the Rainbow Six: Vegas approach and create fictional locations, the artistic loss from this practice hurts the players’ experience and the game’s atmosphere. The Rogers test should allow these types of uses and game developers should not be afraid to exploit these rights for their artistic works. The developers of Call of Duty: Modern Warfare 2 were able to use these buildings because neither trademark nor copyright protect them—a decision which greatly helped the artistic goal of the game. Developers should not be forced to sacrifice artistic relevance because of fears of trademark and copyright liability. Since the law already encourages uses that further artistic pursuits, the destruction of trademarked buildings should be no different from a traditional use.

The same artistic protections under the First Amendment should overcome a dilution by tarnishment for questionable subject matter argument. Trademark owners, while protective of their mark, should not have the power to control its use in artistic works. Given the very low artistic bar of the Rogers test, a court will likely find that the use of a mark associated with a building will contribute to the artistic purpose of a game. Though the trademark owner might not want to associate with a video game in general or

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201. See, e.g., Musgrove, supra note 2.
202. Another example of realistic buildings and architecture helping immersion comes from a recent game-related podcast where one of the hosts talks about Assassin’s Creed II, a game set in Renaissance Italy. The host was looking for a specific building in Florence and found it using Google Maps to map where it was in relation to his current location. Podcast: 4 Guys 1UP: 11/20/2009 at 1:43:00, available at http://podcast.the1upnetwork.com/flat/1UPYours/4G1U112009.mp3. Cf. Podcast: Joystiq Podcast Episode 119, 12/04/2009 at 22:00, available at http://podcasts.aolcdn.com/joystiq/podcasts/12-04-09-joystiqpodcast-e119.mp3, where a listener complained that a building known as the Baptistery was absent from Assassin’s Creed II. The listener said that when he was playing the game, he noticed that something was missing and remembered from studying Renaissance Italy that a building was removed.
the specific content of a certain game, if the mark passes the *Rogers* test, then
the owner should not be able to restrict its use.

B. **THE CHURCH OF ENGLAND**

Even the unauthorized use of architecture in a video game can have a
mutually beneficial relationship for the building owner. The game *Resistance: Fall of Man* included a scene inside Manchester Cathedral. The game
recreates the interior of the cathedral and involves a firefight between the
player and the alien enemies of the game. The scene contains the architecture
and many of the interior artistic aspects of the cathedral, including stained
glass windows and statues.

This reproduction caused controversy with the leaders of the Church of
England. The Church claimed the depiction to be desecration and copyright
infringement, stating that it was inappropriate of Sony to allow players to
shoot guns in a city with a gun problem. A good amount of back and forth
between Sony and the Church ensued. Sony issued an unreserved apology
but refused to change the game or issue a donation as the Church
demanded.

In the end it appears that the use has resulted in a mutually beneficial
effect. *Resistance: Fall of Man* went on to sell over a million copies
worldwide. During the controversy, its United Kingdom sales rank went
from 40th to 22nd, and it remained in the top forty for two additional
weeks. The controversy also indirectly benefited Manchester Cathedral,
which saw a significant increase in visitors after the controversy broke. Although it would be tough to equate increased tourism with possible
desecration of a religious building, the direct impact of the game’s scene on

204. Id.
205. See e.g., Ruth Gledhill, *Manchester Cathedral says Sony apology not enough and issues new digital rules*, TIMES ONLINE (July 6, 2007), http://www.timesonline.co.uk/tol/comment/faith/article2036423.ece.
tourist numbers is highlighted by David Marshall, director of communications for the Diocese of Manchester: “Teachers tell us that teenagers in particular are interested to see a building which they thought was fictional.” The cathedral did eventually forgive Sony for using the architecture in their game, but stated that the controversy was important to ensure that game developers have respect for the subjects of their games.

Even though the law protecting the cathedral in this case is different from what U.S. law protects, it is important to note that copyright and trademark law would likely not have protected Sony’s use of the building. The reproduced section was the inside of the building and the photographic exception is only valid for parts of a building that are visible from publicly accessible areas. Although there is a question of whether or not the inside of a church is publicly accessible, it would most likely not fall within this exception. Additionally, the developer reproduced many artistic aspects of the cathedral, including stained glass windows and sculptures. Even though some of these would likely have been absorbed into the Leicester definition of a building, some artistic aspects within the reproduction would probably retain their separate copyright status. Even so, the result from the case shows that the use of protected buildings can serve dual purposes. It helps the artistic intent of the work in question, and, in this case, it increased the awareness of the protected building within a new audience.

V. CONCLUSION

The video game industry as a whole has become gun shy regarding the use of trademarks in video games. When the goal of the game is to recreate or evoke the feeling of a realistic city, the only people that are hurt by the lack of relevant architecture are the game-buying public. Architectural recreations in video games are exempt from copyright infringement by statute. Trademark protection for architectural works focuses on a different harm. Although some developers will still choose to alter their in-game architecture and buildings to avoid the risk of litigation, this attitude harms the artistic aspects of the work and the players in general. The courts should encourage game developers to utilize trademarked and copyrighted architecture for the artistic purpose of creating virtual worlds. The courts

210. Id.
212. 17 U.S.C. § 120(a) (2006) (stating no copyright protection against photographs “if the building in which the work is embodied is located in or ordinarily visible from a public place”).
should further prevent trademark and copyright holders of buildings from subsequently burdening these developers with lawsuits. Although Congress has already addressed these issues with the photographic exception, the protection for game developers from trademark infringement will most likely need to come from the courts. The Rogers test is a case-by-case analysis, similar to fair use in copyright law. What the courts can, and should, do is establish a strong precedent of dismissing these cases at the summary judgment phase to discourage frivolous claims. This practice would minimize the financial burden of using protected buildings and further the purpose of the Rogers test: encouraging minimal harm artistic uses of trademarks.

Although game developers have architectural works protections available, if the result of placing buildings in a game world is an expensive lawsuit, developers will most likely change buildings and architectural works at a cost of user immersion. Protections against infringement are available for both copyright and trademark claims, and developers should be able to rely on these to ensure that they can realize their artistic vision for an immersive world without fear of costly litigation.

Game on.
Since the inception of the Internet, speculators have sought to monetize web pages, often by selling space to advertisers. Monetized domain parking has emerged as a multi-million-dollar business over the last several years, evolving from simple cybersquatting to a sophisticated and mostly automated method of delivering pay-per-click advertising on thousands of domains. Similar to the game of Whac-A-Mole, whenever the state introduces new legal tools to curb domain speculation abuse, domain name speculators alter their business models to survive. Although federal trademark law has a part to play in the battle against domain name speculation, some academics are concerned about expanding the law for this purpose. Additionally, the legal tools currently used most frequently to battle domain name speculation, the Uniform Domain-Name Dispute-Resolution Policy (UDRP) and the Anticybersquatting Consumer Protection Act (ACPA), have been in use for ten years, yet the problem persists.

This Note examines the evolution of the domain name speculation business model and the tools used to fight it, outlines the scope of the problem and the barriers to solutions, and concludes that due to the difficulties of policing domain name speculation using trademark law, a combination of policy changes, technological solutions, and social engineering will more likely achieve lasting success against domain name speculation.
Part I of this Note defines the technology and ideas behind the domain speculation business model and identifies the players. Part II charts the evolution of domain name speculation and the legal remedies dedicated to preventing its harms. Part III describes monetized domain parking, the current iteration of the domain name speculation business model. Part IV outlines the challenges inherent in using trademark law against domain name speculation and addresses why those who might be able to curb domain name speculation choose not to do so. Part V suggests other, non-legal tools that may be effective against domain name speculators and why those methods may prove to be more effective in the long term than further legal remedies.

I. STRUCTURE AND DEFINITIONS REQUIRED FOR AN UNDERSTANDING OF THE DOMAIN NAME SPECULATION BUSINESS MODEL

This Part will outline the basic architecture of the Internet and define the terms necessary to understand the business model of domain name speculators. Further, it will explain how advertising works to monetize the Internet so it is clear how the domain name speculators have taken advantage of each stage of the development of the hodge-podge of laws governing the Internet.

A. THE ARCHITECTURE AND LANGUAGE OF THE INTERNET

The Internet is a distributed and interconnected system of computers originally developed by the U.S. government that now forms the backbone of an international communications network. The World Wide Web is the information existing within the structure of the Internet. Traffic across the Internet is sent and received using internet protocol (IP) addresses. IP addresses are a string of numbers separated by a period, e.g., 192.168.0.2. These numbers are like street addresses or telephone numbers in that they signal to the computer where to look for the information being requested. Because internet users found it difficult to remember these numerical

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sequences, domain names developed. Domain names are words or phrases that substitute for and corresponded to IP addresses.

A typical website address, or uniform resource locator (URL), has consistent components. The domain name is the part that follows the “http://www.” or “http://” part of the URL. For example, in the URL that will land a user on CNN’s website, http://www.cnn.com, “com” is the top-level domain (TLD) and stands for “commercial.” Generic TLDs are the part of the URL that ends in .com, .net, .gov, .org, etc. There are also country-specific TLDs, such as .uk (United Kingdom) and .au (Australia). Originally, TLDs were intended to reflect the kind of information that was offered, e.g., .com was supposed to be for commercial purposes, .org for non-profit groups. However, in September 1995, the domain registrars stopped enforcing these restrictions, and more recently, Internet Corporation for Assigned Names and Numbers (ICANN) has proposed the implementation of even more TLDs. Second-level domains (SLDs) are the part of the URL that precedes the TLD, “cnn” in our example. Many companies include their trademark in the SLD. TLDs are the battlefield upon which the domain name speculation wars have been fought and SLDs are the spoils of that war. All of these domain names must be translated back into IP addresses before an internet user is correctly directed to the web page he seeks.

Domain Name System (DNS) servers do the work of “resolving” a domain name—either entered by a user into the browser bar or by clicking a link—into an IP address understandable by the internet infrastructure. Used in this context, “resolving” simply means the process by which the domain names are matched to an IP address within DNS servers. DNS servers maintain the lists that match domain names to IP numbers. The fact that registering a domain name is on a first-come, first-served basis and is a fairly straightforward two-step process may have set in motion the first domain

10. Id. at 319.
11. Id.
15. Id.
17. See Springer, supra note 9, at 319.
name speculators. First, an interested purchaser visits one of the domain name registrars certified by ICANN to handle the transaction (such as GoDaddy.com). Second, the purchaser inputs his contact information, pays a small fee (usually between $10 and $35), and then has the right to use the domain name for the duration of the term purchased (usually one year with the option to renew).

Users arrive at an internet destination by clicking links on a web site, by using a search engine and clicking a link in the results, or by type-in traffic. Type-in traffic, also known as direct navigation, occurs when internet users type in the URL directly into a browser's URL bar. For example, instead of using a search engine to search for websites related to the term “wealth,” a user may type “wealth” into the URL bar. When this happens, DNS servers, rather than returning an error page or a search engine results page, attempt to resolve it to a web address incorporating the user’s term, with varying amounts of success. Type-in traffic is important because it is why many internet users land on pages created by domain name speculators for the purposes of receiving advertising revenue instead of reaching a page that more closely matches their desired destination. Without an understanding of the process that leads internet users to the web pages they are seeking, one cannot understand the ways in which others try to take advantage of this system.

**B. CYBERPIRACY**

Cyberpiracy encompasses many forms of deceptive internet practices with the intent to profit from online users. Cybersquatting and typosquatting are both encompassed in cyberpiracy. Cybersquatting entails purchasing domain names that include a trademark in the hope that the trademark owner will purchase the domain from the squatter for a value over the amount that

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18. Id. at 320–21.
20. Id.
the squatter paid.\textsuperscript{24} Indeed, “many Fortune 500 companies . . . paid as much as $15,000 to purchase their brand domain names.”\textsuperscript{25} Anytime a new TLD launches, a “land grab” occurs where domain name speculators register thousands of names hoping to receive a substantially larger sum of money from the trademark owner than what they paid.\textsuperscript{26} Cybersquatting was the first form of domain name speculation and began in the 1990s when the Internet first became commercialized.\textsuperscript{27}

Typosquatting is even more speculative and was developed shortly after cybersquatting. Typosquatters register domain names that are “intentional misspellings of distinctive or famous names”\textsuperscript{28} with the hope that the domains will generate traffic when an internet user makes a typographical error when typing a URL directly into the browser’s URL bar. Typosquatting can be accomplished several ways. A typosquatter might register a common misspelling of a trademarked word, a foreign spelling, a common typographical error (“berizon.com” instead of “verizon.com”), different formations of a word (the trademarked word with the addition of an –s or –ed), or a different TLD version of the trademarked word (“.org” instead of “.com”).\textsuperscript{29} Some typosquatters have even purchased domain names with the period after “www” removed, e.g. “wwwcnn.com.”\textsuperscript{30} Particularly insidious are typosquatting websites that “mousetrap” the user in an endless loop of pop-up browser windows\textsuperscript{31} and those that direct traffic—especially mistyped children’s website URLs—to pornographic websites.\textsuperscript{32}

Another popular method to profit from typosquatted domain names is “phishing.” Phishing is when an internet user mistakenly arrives at a webpage that mimics his desired destination, yet is a cybersquatted or typosquatted domain. For example, one may reach what appears to be a bank’s website.

\begin{itemize}
\item \textsuperscript{24} See Christopher G. Clark, The Truth in Domain Names Act of 2003 and a Preventative Measure to Combat Typosquatting, 89 CORNELL L. REV. 1476, 1487 (2009).
\item \textsuperscript{26} Steve DelBianco & Braden Cox, ICANN Internet Governance: Is It Working?, 21 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 27, 35 (2008).
\item \textsuperscript{27} Id.
\item \textsuperscript{28} Shields v. Zuccarini, 254 F.3d 476, 483 (3d Cir. 2001).
\item \textsuperscript{31} Id. at 275.
\end{itemize}
When the user attempts to login, his username and password are stored by the website and either directly used in a fraudulent manner by the owners of the website, or the list of usernames and passwords generated through this activity may be sold to someone else.33

Domain parking is a broad term that encompasses several specific practices. The simplest form of domain parking occurs when someone purchases a domain and does very little with it. For instance, if the domain contained no content, the DNS would resolve to a “404” error page.34 Rather than have this error page display, the domain owner uploads a simple page stating that the page is “under construction” or “coming soon.” A second type of domain parking is when the registrar or the domain owner instead uploads a page that contains many pay-per-click advertising links in the hope that the user will “click-through” and provide income to the registrar or domain owner through an advertising agreement.36 This is the type of domain parking that the rest of this Note will refer to as “domain parking.” It is the second generation of the domain name speculation business model. Parked domain pages often look similar to a search engine site to confuse internet users. The owner of the domain name often uses a middleman service specializing in placing advertising on web pages. These services often take a large percentage of the advertising revenue generated. Those who practice this business model have attempted to re-brand themselves as “domainers.”37

Domain tasting and domain kiting have encouraged the practice of domain parking. Domain tasting resulted from ICANN’s policy allowing registrars a five-day grace period to return domains at no charge.38 This policy was intended to help registrars who mistakenly registered a domain or domains. During the grace period, domain parkers analyzed the website for traffic to see if purchasing the domain for use as a monetized parked domain

would be profitable. Domain kiting is the process of repeatedly registering and canceling within the five-day grace period. The domain kiter captures short-term advertising revenue from the domain name without actually ever paying or intending to pay for the right to use it. ICANN changed their policy in June 2008, no longer allowing unlimited free returns during the grace period. They recently announced that this change resulted in a dramatic drop in domain tasting. This change also, by definition, eliminates domain kiting altogether since there are now financial consequences for registering and dropping domain names.

C. THE DEVELOPMENT OF INTERNET ADVERTISING AND HOW INTERNET ADVERTISING FUNCTIONS TO PROVIDE MONETARY COMPENSATION FOR DOMAIN NAME OWNERS

The way advertising works on the Internet enables parked domains to earn money. Early advertising on the Internet consisted of banner advertising—banners displaying graphics and text on the top or bottom of a page that users could click to be redirected to the advertised site. Similar to hard copy advertising, advertisers paid a fee for their banner ad to be displayed. By keeping track of how many times that particular ad was displayed through website counters, an advertiser could estimate how many “impressions” his ad had. Then, advertisers started paying a rate based on how many “click-throughs” they received from the advertising on a particular webpage. A click-through is when a user actually clicks upon the link embedded within the advertisement, resulting in a visit to the advertiser’s site.

39. Id.
42. Internet Corp. for Assigned Names and Nos., supra note 38.
43. Id.
Google revolutionized online advertising by offering unobtrusive text advertising links instead of banner ads. In October 2000, Google introduced its “self-serve” AdWords program, but it was not very successful. In 2002, Google introduced a new version that adopted a pay-per-click auction model, auctioning off search terms to bidders, and also incorporated an ad’s relevance by measuring its click-through rate. For example, Rolex might buy the key word “watch.” When an internet user searches for “watch” using these search engines, the search engine returns results that its internal algorithms determine to be most relevant. Along with these “organic” search results, search engines display advertising links along the side of the page, at the top of the page, or both. The search engines label these links with an indication that these search engine results are “sponsored” by an advertiser as was suggested by the Federal Trade Commission.

Google does not disclose how much they share per click with the website displaying the advertising. Domainers claim that the rate could vary between $0.02 and $15.00 per click depending on the advertiser, product being advertised, conversion rate—the number of people who click the ad compared to the number of times the ad is displayed—and various other factors. The advertiser pays Google when the ad is clicked. Google then splits the proceeds with the owner of the page that generated the click-through. Again, Google has not released specific numbers, but discussions on forums dedicated to discussing domainer issues claim that Google may...

47. Id.
49. Karp, supra note 46.
51. Open a web browser that does not have ad blocking enabled. Navigate to Google.com. In the search bar, enter “figure skating.” Note that the results that appear to the right of the main body of search results are “sponsored links.”
55. Wirken, supra note 53.
pay out between thirty and fifty percent of the revenue produced by the click-through. Most academics and consultants who study online advertising, however, estimate that ten to fifteen percent of ad clicks are a result of fraud, representing roughly one billion dollars in annual billings. “Google has defined click fraud as the intentional clicking of an online advertisement for a reason ‘other than to view the underlying content.’”

II. THE EVOLUTION OF THE DOMAIN NAME SPECULATION BUSINESS MODEL

This Part will chronologically describe the back-and-forth between the domain name speculators and those that battled to reign in the abuse. First, this Part describes how Federal Courts applied existing trademark law to internet domain name disputes. Second, this Part outlines how policy changes by national and international governing bodies altered the internet domain name playing field, requiring internet domain name speculators to modify their businesses.

A. ROUND ONE: CYBERSQUATTERS VERSUS THE FEDERAL COURTS

The business of domain name speculation began by profiting on domain names comprised of trademarks. The arrival of the World Wide Web spawned “gold-rush” style acquisitions of domain names. In many cases, traditional brick-and-mortar trademark owners were slow to realize the value of their trademarks on the Internet. Instead, domain speculators recognized that value, swooped in and, in some cases, bought hundreds or thousands of domains, including those domain names that invoked an existing trademark. Early cybersquatters were often unsophisticated, blatantly extorting trademark owners for use of the trademarked domain name. With the

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59. Gilwit, supra note 30, at 268.
61. See, e.g., Panavision Int'l v. Toeppen, 141 F.3d 1316, 1325 (9th Cir. 1998) (demonstrating early cybersquatting against big companies not quick enough to register the domain names they used as trademarks).
63. See id.
“wild-west” feel of the Internet, and little established law concerning domain names and trademarks, trademark owners often purchased these domain names at inflated prices.64

As with any emerging technology, the legal framework lagged behind,65 requiring the courts to interpret statutes written before the advent of the Internet. Using then current trademark and anti-dilution laws, the federal courts in the 1990s tried to fashion some fences to restrain domain name abuse. In Panavision v. Toeppen,66 the Ninth Circuit held that the defendant Dennis Toeppen’s registration of the Panavision.com domain name was a “commercial use”67 and his offer to sell it to Panavision violated the Federal Trademark Dilution Act.68 The court rejected Toeppen’s argument that a domain name was simply an address.69 The court stated that a “significant purpose of a domain name is to identify the entity that owns the web site.”70 The court further noted that a domain name is one of the primary ways customers can find a company on the Internet, and it is a valuable corporate asset because it can facilitate customer communication.71 In addition, the company’s customers may become frustrated or angry when trying to search for the company’s website.72 When they are unable to find it, the customer may be less likely to seek out that company in the future.73 This opinion was a firm response to the business of speculative buying of domain names containing trademarks and offering them for sale to the trademark owner. The federal courts fashioned a mallet out of existing law, the Federal Trademark Dilution Act, to whack the first mole that popped up in the domain speculation business.

B. ROUND TWO: CYBERSQUATTERS AND TYPOSQUATTERS VERSUS POLICY AND LEGISLATIVE CHANGES

As the full scope of the problems of combating domain name speculation using existing trademark law became clear, two new tools for


66. Panavision, 141 F.3d at 1325.

67. Id.


69. Id. at 1324–25.

70. Id. at 1327.

71. Id.

72. Id.

73. Id.
trademark owners arrived on the scene. In 1998, the World Intellectual Property Organization (WIPO) attempted to bring some order to the chaos and developed the Uniform Domain-Name Dispute-Resolution Policy (UDRP) to adjudicate trademark disputes between all member nations. Shortly after, in 1999, the U.S. Congress also dipped its toes into the internet waters, and passed the Anticybersquatting Consumer Protection Act that allows for civil relief to trademark owners when their mark has been infringed through the use of domain names.74

1. WIPO Fashions Another Mallet

The international community developed dispute resolution procedures that would provide trademark owners limited forms of relief against domain name speculators. At the request of the United States, WIPO75 conducted a consultative study on the domain-name trademark issue.76 WIPO delivered its report to ICANN in April 1999, recommending a uniform dispute resolution policy by all registrars.77 The UDRP was then adopted by ICANN who had the power to compel domain name registrants to agree to the resolution's terms.

ICANN manages the assignment of domain names and other activities related to the basic functioning of the Internet.78 In 1997, the Clinton Administration called for the privatization of the Internet Domain Name System.79 In response, ICANN formed as a non-profit corporation a year later,80 and the U.S. government then “ceded” control of the domain name

77. Id.
80. ICANN, supra note 76.
process that up until then had been controlled by the National Science Foundation through the Internet Assigned Numbers Authority. The Internet community actually relies on ICANN to manage the DNS to achieve two key qualities—availability and integrity. ICANN certifies domain name registrars who then sell the domain names to the public, and requires that all of its certified registrars include in their agreements that the registrant agrees to submit to the UDRP. Thus, after WIPO recommended the adoption of a uniform policy for dispute resolutions concerning domain names, ICANN adopted one and registrars are bound by contract to enforce it.

The UDRP outlines a procedure by which trademark owners can dispute the ownership of a domain they believe infringes their trademark. There are five stages to a WIPO domain dispute: (1) a complaint, (2) a response, (3)
appointment of an administrative panel that will decide the dispute, (4) the issuance and notification of the decision, and (5) implementation of the decision through the domain name registrars, e.g. the cancellation or transfer of the domain name. Normally, the process takes sixty days from receipt of the complaint. This process is a simple and relatively cheap alternative to bringing a lawsuit against alleged infringers. Currently, the fees for this process range from $1500 to $5000 depending on the number of domain names in dispute and the number of panelists requested to decide the dispute. The decision of the panelists can be appealed by filing a lawsuit in certain courts. Trademark owners using the WIPO process, however, are not entitled to any relief other than the cancellation or transfer of the domain. For other remedies, trademark owners must turn to another forum.

2. The United States Congress Gives Trademark Owners Another Mallet

In 1999, the U.S. Congress amended the Lanham Act, the federal trademark law statute originally passed in 1946, by enacting the Anticybersquatting Consumer Protection Act (ACPA). ACPA provides civil remedies against domain owners found to be guilty of cybersquatting. According to the Senate Report accompanying the Act, “[t]rademark owners are facing a new form of piracy on the Internet caused by acts of ‘cybersquatting,’” which the Senate Report defined as “the deliberate, bad-faith, and abusive registration of Internet domain names in violation of the rights of trademark owners.” One key provision within the ACPA allows lawsuits to be brought in rem against domain names as if they were real property, instead of requiring the suit to be brought against the registrant.
ACPA provides for civil liability for registering, trafficking in, or using a domain name in bad faith if the domain name is a registered trademark, is identical or confusingly similar to a distinctive mark, or is identical, confusingly similar, or dilutive of a famous mark. To determine bad faith intent, the statute outlines several non-exhaustive factors to examine. Bad faith will not be found if a court determines that a person had a reasonable belief that the use of the mark was fair use or otherwise lawful.

In a case of first impression interpreting the newly passed ACPA, the Third Circuit in Shields v. Zuccarini held that Zuccarini violated the ACPA and awarded Shields statutory damages and attorney’s fees. Zuccarini argued that the ACPA did not apply to his practice of typosquatting but only to cybersquatting. The court disagreed, reasoning that “[t]his argument ignores the plain language of the statute and its stated purpose as discussed in the legislative history.”

3. The Federal Trade Commission Wields a Mallet Against Fraudulent Domain Name Practices

Being sued in federal court after passage of the ACPA was not enough to shut Zuccarini down. He continued to purchase domain names that were confusingly similar to trademarked names and eventually was sued by the Federal Trade Commission. The Truth in Domains Act of 2003 criminalized some of Zuccarini’s activities, such as “mousetrapping” users and directing domain names confusingly similar to trademarked children’s

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99. Bad faith factors to consider: 1) the trademark or other IP rights in the domain name; 2) whether the domain name is the person’s name or nickname; 3) the person’s prior use of the domain name in offering goods or services for sale; 4) noncommercial or fair use of the domain name; 5) intent to divert customers away from the mark owner’s online location that could harm the goodwill associated with the mark, either for commercial gain or with the intent to tarnish the mark, by creating confusion about the actual source or sponsorship of the site; 6) the person’s offer to sell or transfer the domain name to the mark owner without having used the domain name itself to offer goods or services or the person’s prior pattern of conduct of doing so; 7) providing false contact information when registering the domain name or a past pattern of doing so; 8) the person’s acquisition of multiple forms of the domain name that are confusingly similar to marks of others or a pattern of doing so; and 9) the extent to which the mark is or is not distinctive or famous. 15 U.S.C. § 1125(d)(1)(B)(i).
102. Id. at 483.
103. Id.
websites to websites containing pornography.\textsuperscript{105} Zuccarini was arrested in 2003 for violating the Act and in 2004 was sentenced to two and a half years in prison.\textsuperscript{106}

III. MONETIZED DOMAIN NAME PARKING: THE LATEST ITERATION OF THE DOMAIN NAME SPECULATION BUSINESS MODEL

Domain name speculators have persevered through these legal attempts to shut down domain name speculation. Their business model has evolved from simple trafficking in domain names to a pay-per-click advertising-based business model called monetized domain parking. “[T]oday advertising-based ‘domain-parking’ sites are the fastest growing cybersquatting problem.”\textsuperscript{107} Legal domain parking occurs when a non-trademarked or generic term is purchased with the hope that internet users will simply type the term into their browser’s URL bar instead of searching for the term in a search engine.\textsuperscript{108} Examples of these are terms so generic they cannot be trademarked, such as business, pets, or wealth. Generic domain names can generate millions of dollars when sold. For example, business.com was sold for $7.5 million, sex.com was sold for $14 million,\textsuperscript{109} and Toys.com was sold to Toys R Us for $5.1 million in March 2009.\textsuperscript{110} Illegal domain parking is a form of cybersquatting or typosquatting that occurs when a trademark or typographical error of a trademark name is registered and generates revenue through the use of pay-per-click advertising.\textsuperscript{111} Thus the domain owner profits from the trademark without the consent of the trademark owner.

\begin{itemize}
\item \textsuperscript{105} Truth in Domains Act, 18 U.S.C. § 2252B (2006).
\item \textsuperscript{107} Mitchell, supra note 6.
\item \textsuperscript{108} ACPA only prohibits the use of trademarked terms, or those so similar that they are likely to cause consumer confusion.
\item \textsuperscript{111} These are the domain names discussed infra Section II.B.2.
\end{itemize}
A. Domain Parking Generates Millions of Dollars for Domain Name Speculators

Domainers purchase many domains and “park” advertising-laden pages at the domain site.\(^{112}\) They hope to get a few visitors per day from type-in traffic rather than search engine traffic. For example, if an internet user types a generic term into most popular browsers’ URL address bar window (not the search bar window), the browser will be unable to resolve the term into a usable domain name that can be looked up in the DNS servers. Instead, the browser will resolve to a page of search results generated by the default search engine specified for that particular browser. However, if the user types in “[genericterm].com,” the browser will look up the domain name on the DNS server and resolve the address to what is often a website featuring advertising links to other retail sites.\(^{113}\) These sites generate income through advertising click-throughs.\(^{114}\) In addition, formerly registered domain names that are allowed to expire and have pre-existing traffic are often scooped up the moment they expire.\(^{115}\) “A Google AdSense ad tends to generate between $2 and $3 [per thousand visitors] on average.”\(^{116}\) When a domainer owns thousands or even hundreds of thousands of domains, however, this small amount of money can add up to very large sums of money.\(^{117}\) Domain parkers do not have to create their own parked pages but instead contract with a service with which they split the advertising proceeds. For example, companies like Sedo allow domain purchasers to register with them and then Sedo generates pages with advertising in exchange for a partial share of the advertising revenue.\(^{118}\)

Overall, monetized domain parking generates hundreds of millions of dollars per year for domainers.\(^{119}\) There is even a resale market for domainers
to sell domains to other parked domain speculators.\textsuperscript{120} However, click-through fraud has been alleged where the “type in” traffic is not legitimate but instead utilizes “bots”\textsuperscript{121} to comb through a domainer’s websites. These bots, using unique IP addresses so as to not raise red flags by their activities, generate small amounts of click-through revenue every day on each owned domain.\textsuperscript{122}

B. \textbf{DOMAIN NAME SPECULATION EVOLVES AGAIN TO BATTLE POLICY AND TECHNOLOGICAL INNOVATIONS}

Simple monetized domain parking became less profitable because of the change in ICANN policy removing the ability to “taste” domains\textsuperscript{123} and various technological changes.\textsuperscript{124} With the success of these tools against this form of domain name speculation, the speculators have changed their business model once again. The latest incarnation of the domain name speculation business attempts to provide actual content, albeit just enough to achieve a legitimate business ranking.\textsuperscript{125} This new domain parking system utilizes pages resembling “wikipedia lite.”\textsuperscript{126} Although there is some actual information on these pages, the intent is still to get a visitor to click through on one of their advertising links.\textsuperscript{127} Since these pages appear to be actual web pages, consumers may be more likely to be confused into thinking they have arrived at a website with actual content, and so they may be more likely to click on a link that will generate click-through revenue.

\begin{flushleft}
\textsuperscript{120} James Charles, \textit{How to Profit from Domain Names}, TIMESONLINE.COM, Sep. 18, 2008, http://www.timesonline.co.uk/tol/money/article4781681.ece.
\textsuperscript{123} Internet Corp. for Assigned Names and Nos., supra note 38.
\textsuperscript{124} See infra Section V.A.3.
\textsuperscript{126} See http://stopdomainparking.com/ for an ironic example (last visited Feb. 22, 2010).
\end{flushleft}
IV. CHALLENGES IN USING LEGAL REMEDIES TO FIGHT DOMAIN NAME SPECULATORS

As noted above, domain name speculation has evolved to side-step the legal and technological remedies deployed against it.128 This Part will discuss how trademark law differs from other intellectual property and how that creates challenges for the legal system, those injured by domain name speculation, and why those who might be able to provide lasting solutions fail to do so.

A. TRADEMARKS ARE NOT LIKE OTHER INTELLECTUAL PROPERTY

Trademark owners have now had ten years to use the WIPO dispute resolution process or to sue in court using the ACPA. These tools have not stopped typosquatters and the issue is still alive and changing today. In fact, the New York Times reported that in 2008, the sales of domain names containing a trademark rose eighteen percent.129 Using trademark law to fight domain name speculation has been problematic from the start. Trademark law is different than other forms of intellectual property like copyright and patents.130 Instead of being a right derived from the Constitution, trademark doctrine developed out of unfair competition common law.131 Trademark doctrine has dual goals.132 First, trademark doctrine seeks to protect the consumer from deception and confusion over trade symbols.133 Second, trademark doctrine seeks to protect the trademark owner.134 “[T]he Lanham Act . . . gives a producer a cause of action for the use . . . of ‘any word, term, name, symbol, or device, or any combination thereof . . . which . . . is likely to cause confusion . . . as to the origin, sponsorship, or approval of his or her goods . . . ‘”135 Historically, trademarks have not been viewed by the courts as property.136 However, the application of trademark law to the Internet and domain names appears to be stretching existing law to give trademark law quasi-property status. And domain names themselves are arguably recognized

128. See infra Part III.
130. Dogan & Lemley, supra note 3, at 801.
131. See ROBERT P. MERGES, PETER S. MENELL, & MARK A. LEMLEY, INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 635 (4th Ed. 2007).
133. Id.
134. Id.
136. Dogan & Lemley, supra note 3, at 788.
as property. For instance, the ACPA grants the ability to conduct in rem suits against domain names, a right traditionally granted against property.\(^\text{137}\)

When evaluating the success of the remedies currently used against domain speculators, one might question just how successful we want them to be. Although ICANN made assurances that the UDRP would be used only in egregious cases evidencing “bad faith” the use of the UDRP has been expanded to rule against even un-trademarked famous names.\(^\text{138}\) A common complaint against the UDRP is that it is biased towards trademark owners, finding in their favor over 80 percent of the time.\(^\text{139}\) Domainers’ due process rights may be violated through the use of privatized arbitration procedures established by WIPO and adopted by ICANN.\(^\text{140}\) Furthermore, if the purpose of trademark law is to promote economic efficiency by providing consumers with information,\(^\text{141}\) then the use of trademark law through ACPA against some domain names that contain a trademark term defeats this purpose. Finally, critics contend that, “too many [courts] have rushed to find a trademark use without proper consideration of the long-established limitations on trademark owners’ rights under the Lanham Act . . . .”\(^\text{142}\)

B. WHO ARE THE VICTIMS OF DOMAIN NAME SPECULATION?

Domain parking, whether trademark infringing or not, injures consumers, intermediaries like ISPs, and trademark holders. Trademark owners are injured by the loss of value in their trademark and in some cases are financially harmed directly. For example, Land’s End was directly harmed when it paid out affiliate-referral dollars to a domain owner who owned several typographical misspellings of Land’s End.\(^\text{143}\) The typosquatting websites resolved domain names with landsend.com misspellings through an unseen process that directed internet users invisibly through the typosquatter’s own website to Land’s End to gain affiliate revenue.\(^\text{144}\) Thus, the trademark owner had to pay for a referral from a typosquatted domain when users who arrived there via a typographical error were automatically routed through to the trademark owner’s site. The automatic and invisible


\(^{139}\) Patrick D. Kelley, Emerging Patterns in Arbitration Under the Uniform Domain-Name Dispute Resolution Policy, 17 BERKELEY TECH. L.J. 181, 182–83 (2002).

\(^{140}\) See generally id.

\(^{141}\) McCarthy, supra note 132, at § 2:3.


\(^{143}\) Land’s End, Inc. v. Remy, 447 F.Supp. 2d 941, 945 (W.D. Wis. 2006).

\(^{144}\) Id. at 946.
“click-through” resulted in a fee paid to the affiliate from the aggrieved trademark owner.

Additionally, trademark owners are injured when a domainer, by acquiring thousands of domains, intentionally or unintentionally infringe upon trademarks to generate ad-click revenues. Trademark owners have no choice but to attempt to enforce their mark or they risk the cancellation of their mark.145 Moreover, consumers may be confused or annoyed by the typosquatter’s domain and blame the inconvenience on the trademark owner.146 Trademark owners’ costs increase whenever ICANN decides to implement new TLDs because they must then purchase additional domain names to guard against cybersquatters.147 ICANN recently announced that the next time it introduces new TLDs, it will implement new rules to protect trademark owners.148 The sheer amount of typosquatted domains can overwhelm even large companies. Some companies have to prioritize which domains to pursue (usually those serving pornography ads) and simply leave the others alone to profit.149

Consumers are injured, both by trademark infringing domain parking and non-trademark infringing domain parking. An internet user typing a word or internet address into the browser’s URL bar loses time when arriving at a parked domain. In addition, some parked domains have caused harm to consumers through phishing.150 Consumers may also be injured if they desire to become domain name owners. For instance, the “land grab” that has already occurred by cybersquatters and domainers151 results in few attractive options for ordinary consumers. Prospective registrants are often unable to find any domain names in the most common TLDs that are not nonsense arrangements of letters and numbers.152 Trademark holders must police their trademarks,153 and can spend thousands of dollars a year in fees to WIPO for

146. See Panavision Int’l v. Toeppen, 141 F.3d 1316, 1327 (9th Cir. 1998).
147. See infra Section V.A.2.
149. Mitchell, supra note 6.
150. See Lynch, supra note 33, at 267.
151. See supra Section I.B.
UDRP proceedings—possibly more if the trademark owner sues in federal court to enforce their trademark rights. Consumers must also bear increased costs that result in the excess and unwanted bandwidth generated by accidental visits to parked domain pages. All these costs are passed on to the consumer through the products and services they purchase. Accordingly, domain parking profits off unrealized externalities. If domain parkers had to pay for the unwanted internet traffic they generate, domain parking might cease to be profitable.

C. LEGAL SYSTEM LARGELY INEFFECTIVE AGAINST PARKED DOMAINS, WHO CAN HELP?

Since legal solutions have so far proven ineffective in ending domain name speculation, especially the most recent iteration of monetized domain parking, consumers may find relief elsewhere. Google could effectively solve the problem if they stopped serving their ads to parked domain pages. Not only does Google serve ads to middleman services that host parked domain pages, but also expanded their AdSense program specifically for domains. When Google acquired Doubleclick in 2008, it doubled its market share over search engine advertising and now controls almost seventy percent of the market.

Google has little incentive to end parking as it is generating millions of dollars in revenue. Google’s use of AdSense advertising on parked domain pages could be seen as hedging position. Google now offers its own parking service, in effect cutting out the middleman domain parking services like Sedo. Historically, Google made money if its search engine was used to find a website when the user clicked a sponsored link. Google now also makes money when users type directly into a browser and are redirected to Google’s monetized parked domain.

ICANN significantly diminished parking by altering its policy of a five-day grace period for domain name registration. ICANN could further curb...
domain speculation if it decertified its domain registrars for failing to abide by its policies. Further, ICANN or the registrars could institute a trademark check during the registration process. Some registrars already offer, for an additional fee, a service to monitor the registration of domain names including a trademark. Some registrars contribute to the problem by themselves being major domainers. Sarah Deutsche, vice president and associate general counsel at Verizon Communications Inc., says that “all of the companies Verizon has sued for cybersquatting are domain-name registrars that have been accredited by the ICANN . . . ” Registrars often park ad-laden domain pages as soon as a domain name is registered without the registrant’s knowledge. When the domain owner uploads his own content, this ad page is removed.

Additionally, many registrars are in the business of “expiration extortion,” a common practice of forcing a domain owner to pay an exorbitant fee to reinstate a name that has been allowed to expire. A leading registrar, for example, charges $80 to reinstate a domain name that costs only $8 to initially register. Expiration extortion also describes the speculative game of snatching expiring domain names for resale to their former owner—or to the highest bidder. Registrars are also accused of running up the prices of expired domain names during auctions. “The gatekeepers ultimately must be those that are responsible for domain names, legitimate or otherwise, reaching the internet—domain name registrars.”

Consumers, arguably the real victim of domain name speculation, cannot themselves find relief. Public choice theory, which applies economic principles to explain political actions, suggests why not. Consumer interest

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166. Mitchell, supra note 6.
167. Id.
168. Id.
169. Mitchell, supra note 163.
171. Id.
172. Id.

174. Springer, supra note 9, at 360.
groups form only when their constituents believe that the costs of doing so will result in a beneficial action or legislation. Legislation is a public good, however, and will benefit all citizens, even those who did not input any resources in trying to get the legislation passed. If citizens are rational, none will try to influence the political process to pass legislation because any benefit to them will be very small; instead the benefit accrues more to the public at large.

V. SOLUTIONS

Legal barriers to trademark-infringing parked domains have not successfully stopped domain name speculation. Instead, the business of domain name speculation has evolved to find new models each time the legal system blocks the existing one. If coming up with new legal tools to solve the current en vogue model, monetized domain parking, is likely to result in yet a new “mole to whack,” and the players that might solve the problem through policy changes are unlikely to because of economic incentives, what other tools might be available to solve the problem once and for all? The changing marketplace may discover new tools to fight domain name speculation or domain names may become obsolete altogether.

A. CURRENT SOLUTIONS

This Section will examine several methods to combat domain name speculation, many of which are already in practice to some extent. Each has some usefulness in combating the problem, but each also has limits.

1. Private Entity Policy Changes

The most effective policy change to date has resulted in a drastic drop in the amount of domains registered. An August 2009 announcement by ICANN sheds light on whether further efforts are necessary or if domain parking is a dwindling threat to internet consumers and trademark owners alike. In June 2008, ICANN changed the policy that allowed domain tasting and instead began charging registrars for returning large amounts of domains within the five-day grace period. The policy change resulted in a 99.7% drop in domains purchased and dropped within the grace period.

175. WILLIAM N. ESKRIDGE, JR., PHILIP P. FRICKEY, & ELIZABETH GARRETT, LEGISLATION AND STATUTORY INTERPRETATION 88 (2d ed. 2006).
176. Id. at 89.
177. Id.
178. Internet Corp. for Assigned Names and Nos., supra note 38.
179. Id.
Whether due to this policy change, or the economy in general, domain parking business has dropped, and recently one of the largest parking businesses acquired two smaller businesses.\(^\text{180}\)

2. **Self-help**

One of the first methods of curbing domain name speculation as far back as the 1990s was defensive domain name purchasing.\(^\text{181}\) Trademark owners purchase hundreds of domain incorporating their trademark or its common misspellings.\(^\text{182}\) Though an individual domain name is inexpensive at about ten dollars, in aggregate the amount of domain names purchased by each mark owner combined with the sheer number of trademark owners seeking defensive domains represent a large number of defensive purchases.\(^\text{183}\) Second, some trademark owners purchase services that monitor domain name registration and alert them when a domain name identical to or confusingly similar to a trademark in their portfolio is registered.\(^\text{184}\) Some of these services are even provided by the registrars themselves.\(^\text{185}\) Mark Monitor is a popular but expensive service used by large companies.\(^\text{186}\)

3. **Technological Solutions**

It may be useful to analogize domaining to spam emailing. Both are a problem because of the shared resources they consume.\(^\text{187}\) Some varieties of spam emailing, like non-trademark infringing domaining, are legal. ISPs, Information Technology (IT) departments, and consumers all share the cost of spam email: ISPs in the form of increased traffic across their network resulting in increasing bandwidths needs, while IT departments in businesses spend a significant amount of both time (setting up programs) and money (buying filtering software) finding ways to ensure that spam emails do not reach their employees.\(^\text{188}\) Some of these technological solutions are already

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\(^{181}\) Mitchell, supra note 6.

\(^{182}\) Id.

\(^{183}\) See id.

\(^{184}\) Id.

\(^{185}\) See EnCirca, supra note 165.

\(^{186}\) Mitchell, supra note 6.


available and in use, for instance, those utilizing blacklisting and whitelisting.\textsuperscript{189}

Blacklisting is a list of persons or organizations that are considered to be untrustworthy.\textsuperscript{190} Whitelisting is the opposite of blacklisting—a list of contacts that the user deems acceptable.\textsuperscript{191} Email spam filters use blacklists and whitelists to provide spam filtering services to ISPs and businesses. A plug-in application\textsuperscript{192} is available through the Firefox add-ons page that uses a list generated by the Parked Domain Project to block browsers from resolving to a page known to be a parked domain.\textsuperscript{193} User comments, however, complain that the plug-in is very slow.\textsuperscript{194}

4. DNS Redirection Tools

Microsoft has developed a similar tool. Microsoft’s Strider URL Tracer program includes a Typo-Patrol feature that “generates and scans sites that capitalize on inadvertent URL misspellings, a process known as typo-squatting. The tool also enables parents to block typo-squatting domains that serve adult ads on typos of children’s Web sites.”\textsuperscript{195} In addition, OpenDNS is a provider of services intended to combat a myriad of cyberpiracy attacks, including typographical misspellings that land a user on a parked domain page.\textsuperscript{196} It provides free ad-based service for individuals and subscription services for enterprise users.\textsuperscript{197} Google’s browser, Chrome, eliminates the URL address bar and has one box for entering search terms or website addresses.\textsuperscript{198} This should eliminate the problem of DNS servers resolving mistyped domain name addresses to a parked domain page because the user

\begin{itemize}
  \item[194.] Add-Ons for Firefox, supra note 192.
  \item[197.] Id.
\end{itemize}
will instead receive a search engine result page and will be able to choose the desired link.

A common problem with these technological solutions, however, is that they require internet users to choose to implement them. Additionally, the users must be technologically savvy enough to know there is a solution to their annoyance and to install and use each of these third-party solutions. None of these third-party applications are well-known or advertised.

B. **Other Solutions**

1. **User Retraining**

   The simplest way to prevent arriving at an unwanted parked domain is to train users to always use a search engine. For example, typing whitehouse.com into the URL bar of either Internet Explorer or Firefox results in being directed to a monetized parked domain. If the user instead types in whitehouse.com into either Bing (the default search engine in Internet Explorer) or Google (the default search engine for Firefox), they get directed to a page containing search results where the user can select the official whitehouse.gov link in the first few results. If users never see a parked domain page, they will not click on it and the parked domain will fail to generate ad-click revenue.

2. **Death of the Trademarked Domain Name**

   Perhaps the most striking solution to preventing trademark-infringing domain parking is the choice not to use trademarked terms as domain names. This is being done in many countries, though not to fight parked domain advertising. In countries without Latin alphabets, trademarks are often not translatable to the Latin alphabet-style keyboard and therefore domain names often are not recognizable to their local consumers. In Japan, advertising does not include a standard website URL. Instead, a search engine box is pictured with a suggested search term or terms already entered into the box.\(^{199}\) Mobile phone browsing is bringing this trend into the United States. “Text-weary thumbs” are making it possible for “QR” codes, considered by some to be URL killers, to gain acceptance in the U.S.\(^{200}\) QR codes are 2D bar codes containing small bits of data that can be read by applications on

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mobile devices when a user takes a picture of the code.\footnote{Id.} The device then launches the appropriate application, including a browser with the correct address pre-loaded.\footnote{Id.} Only recently, with increased smart phone use, has the use of QR codes begun to catch on in Europe and the United States.\footnote{Id.} The Trademark Blog remarked that the current domain name system is damaged and training users to use search engine terms rather than URLs is a step in finding a way around that damaged system.\footnote{Id.}

VI. CONCLUSION

After examining how the domain name speculation business model has, for ten years, found ways around the legal tools created to fight it, it is time to consider other methods. It is certain ICANN will introduce more TLDs to meet the growing domain for virtual addresses on the Internet. Due to the difficulties of policing domain name speculation using trademark law, a combination of policy changes, technological solutions, and social engineering will more likely achieve lasting success against domain name speculation. By making domain speculation more difficult, less profitable, or even obsolete, the legal system and trademark owners can cease playing Whac-A-Mole with speculators, leaving more resources for them to conduct their intended activities.

\footnote{Id.} Id.  
\footnote{Id.} Id.  
\footnote{Id.} Id.  
ADDITIONAL DEVELOPMENTS—
TRADEMARK LAW

BADEN SPORTS INC. V. MOLTEN USA INC.
556 F.3d 1300 (Fed. Cir. 2009)

The United States Court of Appeals for the Federal Circuit held that Baden Sports Inc.’s (Baden) claim of false advertising directed toward the use of the word “innovative” by Molten USA Inc. (Molten) must be rejected under Section 43(a)(1)(A) and Section 43(a)(1)(B) of the Lanham Act, which contains the federal trademark law. Specifically, Section 43(a)(1)(A) relates to the origin of the goods and Section 43(a)(1)(B) which relates to the nature, characteristics, or qualities of the goods. The court held that the term “innovative” does not relate to qualities listed under either section but rather to the authorship of an idea.

Baden and Molten both manufacture and sell high-quality basketballs. Baden was, however, first to develop and receive a patent for dual-cushion technology. Thus, it filed a complaint alleging that Molten should be held responsible for patent infringement and false advertising under Section 43(a) of the Lanham Act because Molten undertook advertising that falsely implied that Molten invented dual-cushion technology.

The district court ruled on Baden’s motion for summary judgement for patent infringement in Baden’s favour, finding that Molten infringed the dual-cushion claim patented by Baden. In a separate opinion, the district court granted in part Baden’s false-advertising claims against Molten’s use of the term “innovative,” which Baden claimed falsely implied that the dual cushion technology was Molten’s innovation. The court awarded Baden $8 million in damages for Molten’s intentional false advertising.

Molten then filed an appeal on Baden’s false-advertising claims, arguing that the Supreme Court’s holding Dastar Corp. v. Twentieth Century Fox Film Corp. provides that Section 43(a) has limited application as a remedy for unfair trade practices. Specifically, the Section’s use of the term “origin of the goods” does not refer to the author of an idea.

The Court held that Section 43(a)(1)(A) cannot serve as a basis for Molten’s liability because Molten’s claims do not cause confusion as to the origin of the basketballs. Applying the reasoning of the Dastar case, the Court found that Section 43(a)(1)(A) does not permit Baden to claim false advertising because the contested claim does not refer to “the producer of the tangible goods” but to “the author of” the idea.
Next, the Court held that claims based on false designation of authorship are not actionable under Section 43(a)(1)(B). The Court noted that allowing Baden to proceed with a false advertising claim that is fundamentally about the origin of an idea, would be contrary to the Ninth Circuit interpretation of 43(a)(1)(B) in the case *Sybersound Records, Inc. v. UAV Corp.*, 1144, and could create an overlap between the Lanham and the Copyright Acts. In *Sybersound*, the court noted that in order “to avoid overlap between the Lanham and Copyright Acts, the nature, characteristics, and qualities of karaoke recordings under the Lanham Act are more properly construed to mean characteristics of the good itself.” Consequently the Court reversed the district’s court denial of judgement as matter of law and vacated the damages award based on Baden’s claims.

**LA RUSSA V. TWITTER INC.**

*Complaint, No. 02487393 (Cal. Super. Ct. May 6, 2009)*

On May 6, 2009, in the San Francisco Superior Court of California, St. Louis Cardinals Manager Tony La Russa filed a complaint against the social media site Twitter for trademark infringement, false designation of origin, trademark dilution, cybersquatting, misappropriation of name, misappropriation of likeness, invasion of privacy, and intentional misrepresentation. This lawsuit was the first complaint regarding impersonation that had been filed against Twitter, raising an interesting issue about trademark infringement. Although the Anti-Cybersquatting Consumer Protection Act of 1999 gave trademark owners the right to sue cybersquatters, it is unclear how the law should apply to false Twitter accounts.

The complaint stemmed from an unknown Twitter user who opened an account under the name, “Tony La Russa.” The Twitter page consisted of unauthorized photo and written statements which included, "lost 2 out of 3, but we made it out of Chicago without one drunk driving incident or dead pitcher." Upon La Russa’s filing, Twitter removed the account in question.

The majority of La Russa’s claims were problematic under Section 230 of the Communications Decency Act of 1996, which shields websites like Twitter from liability on obscene, lewd, lascivious, filthy, excessively violent, harassing, or otherwise objectionable materials posted by users regardless of whether the material would be constitutionally protected. The Act 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.” In an attempt to circumvent the Act, La Russa’s attorneys filed a trademark infringement claim.
The trademark infringement claim focuses on statements that appeared on the Twitter site that were generated by Twitter itself such as, “Tony La Russa is using Twitter” and “Join today to start receiving Tony La Russa's updates.” La Russa's attorney argued that these statements infringed on La Russa’s trademark, his name, because they were misleading and likely to confuse users by leading them to believe that the Twitter account was endorsed and authored by La Russa.

On June 5, 2009, Twitter filed to remove the case to the United States District Court for the Northern District of California. Soon after, La Russa was quoted as saying that he and Twitter had reached a settlement. The next day, Twitter co-founder, Biz Stone, blogged on the site that Twitter did not settle and had no intention of settling. Stone also stated that Twitter took impersonation seriously, but that Mr. La Russa’s lawsuit bordered on “frivolous.” He noted, however, that Twitter would now begin a system of verifying accounts to prevent impersonation; this service would first be open to public officials, public agencies, famous artists, athletes, and other well known individuals.

On June 26, 2009, La Russa withdrew his lawsuit by filing a notice of dismissal, prompting speculation of a settlement, although neither parties have given official word.

**MARY KAY, INC. V. WEBER**

*601 F. Supp. 2d 839 (N.D. Tex. 2009)*

The District Court for the Northern District of Texas held that defendant Amy Weber’s use of the “Mary Kay” trademark online to describe secondhand cosmetics may qualify as nominative fair use only if the advertisements did not suggest a connection with or endorsement by plaintiff Mary Kay, Inc. (Mary Kay).

Defendants are resellers of Mary Kay cosmetic products and had previously been beauty consultants for the cosmetic brand in the past. After terminating their contracts with Mary Kay, they opened an online business in which they bought the manufacturer's products from other independent beauty consultants and resold those products to consumers. Defendants also paid for 75 search engine terms containing the plaintiff’s trade name that would direct potential customers to the defendants’ website instead.

In May of 2008, Mary Kay filed a complaint asserting eight causes of action including trademark infringement under the Lanham Act. The plaintiff argued that the defendants used the Mary Kay mark to do more than identify the products it sold. The defendants argued that they have used only as much of the Mary Kay mark as necessary to make clear to their customers that their
products were manufactured by Mary Kay; they emphasized that they did not use any registered logos or any distinctive script or pictures, and that they did not mimic the look or feel of the Mary Kay website. The plaintiff further argued that “a defendant may not avail itself of the nominative fair use defense where, as here, it uses the plaintiff’s marks as Internet keywords.”

The court noted, however, that the use of advertising through search terms alone does not make the fair use defense inapplicable and that holding otherwise would prevent all defendants who advertise via search engines from asserting the fair use defense. Applying the reasoning of the Tiffany (NJ) Inc. v. eBay, Inc., the court held that “the fair use doctrine allows second hand sellers to inform customers that it sells a mark holder’s product so long as it conveys the information . . . in a way that uses no more of the mark than necessary to identify the product, and does not suggest affiliation or sponsorship.”

The court also held that defendant’s ad, which read “Mary Kay Sale 50% off: Free Shipping on Orders over $100 Get up to 50% Off” could suggest affiliation or sponsorship with the plaintiff. With respect to other references to Mary Kay on the defendant’s website, the court observed that six out of the seven factors for likelihood of confusion under Scott Fetzer Company v. House of Vacuums, Inc. weighed in favor of confusion. Thus, the court held that there was at least a genuine issue of material fact as to whether the defendant’s website suggested affiliation with or endorsement by Mary Kay and denied defendant’s motion for summary judgment.

**VOYAGEURS DU MONDE, TERRES D’AVENTURE v. GOOGLE**
*Tribunal de grande Instance [T.G.I.] Paris, Jan. 7, 2009*

On January 7, 2009, the Tribunal de Grande Instance of Paris held Google liable for business torts and deceptive advertising for selling the names and trademarks of two French travel agencies to their direct competitors as part of its AdWords service.

Voyageurs du Monde is a tour operator and travel agency and owns several trademarks, including “Voyageurs du Monde” and domain names using this term. Terres d’Aventure is a tour operator and traveling agency specializing in adventure trips; it owns the trademarks “Terres d’Aventure,” “Terдав,” and related domain names.

In 2004, Voyageurs du Monde and Terres d’Aventure learned that Google had suggested the trademarks “Voyageurs du Monde”, “Terres d’Aventure,” and “Terдав” to competitors as keywords to be purchased on its AdWords service. Consequently, when the terms “voyageurs du monde” and “terres d’aventure” were entered into Google’s search engine, the user
would see ads of, and links to, the websites of plaintiffs’ direct competitors on the Google search results page.

On May 12, 2004, the two companies asked Google to stop infringing their trademarks. Google responded that it would stop displaying the commercial links related to the disputed keywords associated with the trademarks, but did not do so. Consequently on October 20, 2006, the two companies filed suit against Google, alleging trademark infringement, deceptive advertising, and unfair competition.

In its ruling, the Tribunal de Grande Instance of Paris rejected the trademark infringement claims, but held that Google violated the French duty of loyalty and good faith under Article 1382 of the Civil Code by failing to monitor whether the competitors had obtained authorization from Voyageurs du Monde or Terres d’Aventure for use of the companies’ trademarks as keywords. In addition, the court held Google liable under Article 20 of the Loi pour la Confiance dans l’Economie Numérique (June 21, 2004) for deceptive advertising and misleading consumers as to the nature of the sponsored links; the court concluded that the commercial links were not distinctive enough to be identified as advertisements because they were displayed in the same font and color as the search results. The court awarded 200,000 € to Voyageurs du Monde and 150,000 € to Terres d’Aventure in damages and interest. Google filed an appeal to the Court of Appeals of Paris on February 2, 2009.
INTERNET SAFETY SURVEY: WHO WILL PROTECT THE CHILDREN?

Charlotte Chang

I. INTRODUCTION

The expansion of the Internet and its accompanying technologies has brought both increased efficiency and new methods of communication. However, the Internet also makes it easier for bad actors to harass and offend others. One form of online harassment is cyberbullying. Cyberbullying has become increasingly visible in the media, and concerns over online safety have prompted many state legislatures to take action. This Note will examine recent legislative attempts to make the Internet safer and explore the legal ramifications of implementing them.

Children and teenagers constitute a large portion of Internet users and are the focus of many recent statutory attempts to enhance online safety. According to an April 2009 study conducted by Pew-Internet & American Project, 74% of adults use the Internet. A recent study found roughly 93% of Americans between the ages of twelve to seventeen use the Internet, and youth Internet use is expected to increase. A 2009 study by Nielsen Research found an 18% increase in Internet use for children between the ages of two and eleven. Indeed, children are exposed to the Internet at the very young ages of two, three, and four as they sit on their parents’ lap. The increasing number of pre-teens who are online emphasizes the need to educate children about how to navigate the online world in a safe and moral manner. This Note construes “moral” and “ethical” Internet practices as not sending

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offensive or harassing messages through the Internet and not abusing social networking sites.\(^5\)

The Internet can be an exciting place for children and teenagers because they are able to adopt different identities and interact away from adult supervision.\(^6\) Yet this same autonomy also makes the Internet dangerous. Just as teenagers can create personas that are different from their real world identity, so too can sexual predators\(^7\) and cyberbullies.\(^8\) High profile cases involving Internet safety, such as the Megan Meier suicide\(^9\) and the television show “To Catch a Predator,”\(^10\) have sparked legislative action.\(^11\) Several states have proposed or enacted statutes designed to address internet safety.

Part II of this Note will discuss recent state legislative attempts to regulate social networking sites from sex offenders. Part III will examine state statutes addressing cyberbullying. Part IV will evaluate proposed solutions to online safety issues. Finally, Part V advocates that

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5. For purposes of this Note Internet use considered not “moral” or “ethical” would include pretending to be someone else online, creating false personas to harass others, and posting and spreading false information using social networking capabilities.


7. Research has shown that the likelihood that a sexual predator will contact a child and exploit the child offline is very low. On the other hand, the likelihood of exposure to cyberbullying through social networking sites is much more likely and should be addressed. See SAMEER HINDUJA & JUSTIN W. PATCHIN, BULLYING BEYOND THE SCHOOLYARD: PREVENTING AND RESPONDING TO CYBERBULLYING 90 (2009).

8. Cyberbullying is difficult to define because it encompasses different communication technologies and involves different methods of bullying. At its core, cyberbullying involves “bullying through the use of technology such as the Internet and cellular phones.” KOWALSKI, LIMBER & AGATSTON, supra note 6, at 43.

9. Megan Meier was a thirteen-year-old girl from Missouri who committed suicide after she was cyberbullied by a classmate’s mother, Lori Drew. Drew created a MySpace account for the fictitious “Josh Evans” and used it to flirt with Meier to try and get information about Meier. Drew wanted retribution against Meier for perceived slights against her daughter. While pretending to be “Josh Evans” Drew allegedly told Meier that the “world would be a better place” without her. Meier committed suicide in her home. See Christopher Maag, A Hoax Turned Fatal Draws Anger But No Charges, N.Y. TIMES, Nov. 28, 2007, at A23.

10. “To Catch a Predator” is an American reality television show that focuses on identifying would-be pedophiles through hidden camera investigations. The pedophiles make plans via internet chat to enter into sexual relations with a “minor,” who is actually a decoy. See To Catch a Predator Home Page, http://www.msnbc.msn.com/id/10912603/ns/to_catch_a_predator/.

comprehensive education is the best solution at this time to social networking safety and cyberbullying.\textsuperscript{12}

II. \textbf{SOCIAL NETWORKING SITES AND SEX OFFENDERS}

This Part will first give a brief background of self-regulatory attempts by social networking sites. Next, this Part will analyze legislative attempts by Illinois, Georgia, Utah, and New Jersey to address social networking safety issues. Finally, this Part will examine studies about the actual threat of online predators.

A. \textbf{BACKGROUND AND SELF-REGULATION}

In recent years, social networking sites have grown in popularity and become the source of many online safety concerns. A social networking site is a “[w]eb site that provides a virtual community for people interested in a particular subject or just to ‘hang out’ together.”\textsuperscript{13} Social networking sites allow users to share their interests within online communities, meet new people, and interact with their real-life friends in the virtual world.\textsuperscript{14} For example, users can share their pictures with their friends and express themselves through online status updates.\textsuperscript{15} Users can also meet new friends through shared interests or mutual friends.

The anonymity of the Internet enables bad actors to create false identities on social networking sites and potentially harm other users. This danger is applicable to users of all ages, but this Note will focus on efforts that lawmakers have taken to protect children from bad actors, such as sexual predators. Social networking sites have taken steps to regulate sex offenders on social networking sites. In January 2008, the attorneys general from forty-

\begin{itemize}
  \item \textsuperscript{12} This Note is a survey of recent legislation and proposed solutions to address online safety. Therefore, the scope of the legislation that this Note will address is limited to the period directly before this piece was written in late 2009. The Note is not meant to be an exhaustive exploration of the topics of social networking or cyberbullying. Rather, the Note examines some of the latest efforts to address online safety issues for children.
  \item \textsuperscript{13} Definition of Social Networking, PC Magazine Encyclopedia, http://www.pcmag.com/encyclopedia_term/0,2542,e=social+networking&i=55316,00.asp (last visited Oct. 25, 2009).
  \item \textsuperscript{14} \textsc{Hinduja & Patchin}, \textit{infra} note 7, at 188.
  \item \textsuperscript{15} A user on Facebook, for example, can update their “status,” which is then distributed to all the user’s virtual friends. If the user entered “I had a rough day” as his status, his friends who log onto Facebook would be able to view that message.
\end{itemize}
nine states reached an agreement with the social networking site MySpace to protect children who used its platform. This agreement included age-protecting certain areas of MySpace and preventing users from changing their age to shift between the age-restricted areas. Therefore, a user would not be able to switch between the adult area and an area intended for children.

The agreement was significant because cooperation between MySpace and governing bodies had once been tenuous. MySpace previously refused to give the names of users who were sex offenders to the attorneys general for fear of violating privacy rights, as well as the Electronic Communications Privacy Act of 1986, which technically prohibits private information from disclosure without a subpoena. However, MySpace later agreed to share with the attorneys general information that it retrieved from Sentinel Safe, a database that contains data aggregated from state sex offender registries. MySpace also agreed to work within each state’s specific process and requirements to ensure that the Sentinel Safe data was shared.

Facebook, which has supplanted MySpace as the dominant social networking site, has also taken steps to stop sex offenders from lurking on its network. In May 2008, Facebook reached a similar agreement with the attorneys general from forty-nine states. The agreement addressed automatic warnings when underage users are in danger of giving out personal information.

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17. Id.


21. Id.


information and restricting the ability of users to change their age to under eighteen.\textsuperscript{24} During the period between May 1, 2008 and January 31, 2009, Facebook removed more than 5,500 convicted sex offenders from its social networking website.\textsuperscript{25} MySpace reported that over a two-year period it had removed 90,000 convicted sex offenders from its social networking site.\textsuperscript{26}

There have also been legislative efforts in addition to these self-regulating deals. Many of the legislative efforts present constitutional concerns and could be found void for vagueness. “Void for vagueness” is a legal concept that states that a given statute is void and unenforceable if it is too vague for the average citizen to understand and does not provide fair warning.\textsuperscript{27} It would be unjust to punish a person without providing clear notice about what conduct is prohibited.\textsuperscript{28} Also, if the contours and minimum guidelines of the laws are not objective, enforcement of the law may be uneven and prone to “personal predilections.”\textsuperscript{29} Legislative efforts could run afoul of the Constitution if the statutory language is not clearly defined and a reasonable citizen would not know what conduct was permitted and what conduct was prohibited.\textsuperscript{30} The next Sections will discuss recent legislative efforts by Illinois, Georgia, Utah and New Jersey.

B. ILLINOIS

In August 2009, Illinois Gov. Pat Quinn signed a bill that banned sex offenders from social networking sites.\textsuperscript{31} House Bill 1314 made it a felony for
a sex offender to access a social networking site for any purpose. The purpose of the law was to make it more difficult for sex offenders to meet new potential victims. This law is one of the latest actions by states to deal with the issue of sex offenders using social networking sites to interact with children and seek new victims.

The bill may be too broad to be workable. The bill fails to specify which social networks are covered and instead broadly defines “social networking website” as

an Internet website containing profile web pages of the members of the website that include the names or nicknames of such members, photographs placed on the profile web pages by such members, or any other personal or personally identifying information about such members and links to other profile web pages on social networking websites of friends or associates of such members that can be accessed by other members or visitors to the website. A social networking website provides members of or visitors to such website the ability to leave messages or comments on the profile web page that are visible to all or some visitors to the profile web page and may also include a form of electronic mail for members of the social networking website.

This definition is broad and may extend too far. For instance, professional networking sites such as LinkedIn would qualify under this definition. Thus, a sex offender conviction could take away one’s ability to post a resume in an attempt to secure employment—a result that seems unreasonable.

Forbidding sex offenders from using professional social networking sites would stunt their progress as they try to reintegrate into society. Thus, a careful balance must be struck between protecting potential sex offender

34. State attorneys general have previously created partnerships with two of the major social networking sites, MySpace and Facebook, to stop convicted sex offenders from using the social networking sites. See Richard M. Guo, Note, Stranger Danger and the Online Social Network, 23 BERKELEY TECH. L.J. 617, 638 (2008).
35. In November 2009, an attempt by the United Kingdom government to keep sex offenders from social networking sites was halted because “such a move would breach human rights laws.” There were also concerns that the plan would be incompatible with the right to privacy. Jamie Doward, Bid to Block Pedophiles from Facebook Fails, THE OBSERVER, Nov. 8, 2009, http://www.guardian.co.uk/technology/2009/nov/08/facebook-sex-offenders-law.
victims and not overly restraining offenders so that they are unable to find employment or reintegrate into society.

Furthermore, there are many different types of crimes for which one will be labeled a sex offender, ranging from the serious sexual offenses to non-dangerous crimes. As long as the crime is of a sexual nature or contains a sexual element, the conviction will result in the label of sex offender. One example of a non-dangerous sexual offense is consensual sex between two teens whose ages are on different sides of the statutory rape line. If one of the teenagers is eighteen, the other is seventeen, and the age of consent in that state is eighteen, then the eighteen-year-old would be guilty of statutory rape. However, the sexual interaction was consensual and it is only because one of them was eighteen and legally of age and the other was technically still a minor that the sex constitutes a crime. The eighteen-year-old is then labeled as a “sex offender” and will have all the corresponding restrictions and stigma placed upon him or her.

Under the Illinois statute, a child or teenager convicted of a sex crime will not be able to access LinkedIn and other professional networking sites in his adult life. Though his crime was significantly less serious than other sex offenders, the online handicaps remain the same. The broad range of what constitutes a sex offender is hard to reconcile with the sweeping prohibition of accessing social networking sites. In an increasingly interconnected world,

38. For example, crimes such as sexually abusing children and rape would qualify as serious sex offenses.
40. Another example is sexting. Sexting involves sexually explicit messages or photos that are electronically transmitted, most often through cell phones. Ofentimes the sexting involves teenagers taking nude pictures of themselves and sending the images via text message to their partner. The transmission of nude pictures over cell phones could constitute possession of child pornography, but the perpetrators are children themselves. The crime in this case is not the traditional sexual pervert who downloads child pornography, but is the transmission of one’s own image to one’s significant other. But, the treatment of both is the same—they are sex offenders if they are convicted. See “Sexting Shockingly Common Among Teens, CBSEWS.COM, Jan. 15, 2009, http://www.ebsnews.com/stories/2009/01/15/national/main4723161.shtml (last visited Oct 25, 2009); See generally Elizabeth C. Eraker, Stemming Sexting: Sensible Legal Approaches to Teenagers’ Exchange of Self-Produced Pornography, 25 BERKELEY TECH. L.J. (forthcoming 2010) for more information about sexting.
41. Statutory rape is a term used to describe sexual relations that occur when one participant is below the age required to legally consent to the behavior. It usually refers to adults engaging in sex with minors under the age at which individuals are considered competent to give consent to sexual conduct. Kay L. Levine, The External Evolution of Criminal Law, 45 AM. CRIM. L. REV. 1039, 1058 (2008).
the role of social networks is growing at a rapid pace. To make it illegal for some sex offenders to participate is more punishment than is necessary.

Another important issue is the enforceability of banning sex offenders on social networking sites. The ability to create pseudonyms and varied email addresses that contain no identifying information means that just about anyone can create a social networking profile. It would be costly and time-consuming for the government to attempt to ensure compliance by every sex offender.

C. GEORGIA AND UTAH

Georgia recently revised its sex offender statute to increase the requirements for sex offender registration. In addition to the traditional home residence information, sex offenders must also register their email addresses and passwords. The registration of email addresses is not novel; several states previously adopted provisions requiring sex offenders to provide email addresses. However, only Utah had previously required disclosure of all Internet passwords.

1. Utah

The Utah sex offender registry statute required that sex offenders provide the Department of Corrections all Internet identifiers and the addresses the offender used for routing or self-identification in Internet communications or postings. The sex offender also had to turn over the name and Internet addresses of the websites where he registered with an online identifier, as well as the passwords and user names associated with those websites. A related statute required sex offenders to give the Department of Corrections the password to an “online identifier,” which was defined as “any electronic mail, chat, instant messenger, social networking, or similar name used for Internet communication.” The provisions in the Utah statute essentially meant that a majority of interactive Internet use by a sex offender would have to be disclosed, although the online identifier and password themselves would not be disclosed to the public.

42. GA. CODE ANN. § 42-1-12 (2009).
44. Id.
46. Id.
47. UTAH CODE ANN. § 77-27-21.5(2)(c).
In *Doe v. Shurtleff*, a man affected by the legislation challenged the Utah law on constitutional grounds. Doe argued his First Amendment right to anonymous free speech was violated when he was required to hand over his passwords to the Utah Department of Corrections (UDOC). The District Court judge found that the Utah statute violated plaintiff’s right to free speech and that if “Doe provide[d] the UDOC with his Internet information and [knew] that there [were] no statutory limits on how that information [could] be used by the UDOC, or others, he [would be] less likely to engage in protected anonymous speech.” On May 12, 2009, amendments were made to the statute and the requirement to provide Internet passwords was removed. The scope of discretion was also limited so that the information could only be used to investigate sex-related crimes or to make disclosures permitted by Utah’s Government Records Access Management Act (GRAMA).

Doe also argued the Utah statute resulted in unlawful and unreasonable search and seizure under the Fourth Amendment. To establish a violation of the Fourth Amendment, a plaintiff had to show that he has a reasonable expectation of privacy. The court held that because Doe presumably accessed the Internet through an IP address linked to his subscriber information, and thus his identity, Doe would have no reasonable expectation of privacy in those user names.

2. **Georgia**

The Georgia statute adds “[e]-mail addresses, usernames, and user passwords” to the list of required registration information. The Georgia statute defines “user password” to pertain to “e-mail messages and interactive online forums.” The Utah statute was very similar to Georgia’s,

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48. Doe v. Shurtleff, No. 1:08-CV-64, 2008 WL 4427594 (D. Utah Sep. 25, 2008), rev’d, 2009 WL 2601458 (D. Utah Aug. 20, 2009). The government defendant moved for, and was granted, a Rule 60(b) vacating order after the law was amended.


52. *Id.* at *2; GRAMA is a statute that allows the public to obtain copies of government records. UTAH CODE ANN. § 63G-2-101, et seq.


54. *Id.*


56. *Id.*
but it also required disclosure of passwords for email, chat, social networking sites and other means of Internet communication. Given the similarity between the two laws, it is likely that the same or similar First and Fourth Amendment claims will be made in at least one pending challenge to the Georgia statute. The results in Utah foreshadow the pending challenge to the Georgia statute. Accordingly, a court will possibly strike down the Georgia law.

Also, much like the Illinois statute, authorities will have difficulty monitoring offenders under the Georgia law. Sex offenders have a strong incentive to lie or disclose incomplete email and password information, and it would not be the best use of resources to attempt to track down every username and password owned by every sex offender. Even if a sex offender were to hand over all her passwords, the barrier to create a new username and password is very low—the sex offender could easily create a new name that the government would not have in its records.

D. NEW JERSEY

New Jersey Assembly Bill 3757, proposed in February 2009, also targeted social networking sites. This bill introduced the “Social Networking Safety Act,” which was “intended to deter cyber-bullying and the misuse of social networking Web sites.” The first piece would prohibit the use of social networks to transmit “sexually offensive communication” to minors in New Jersey. The second piece proposes to make it illegal for a person to transmit a “harassing communication” through a social networking site to or about a person located in New Jersey. “Sexually offensive communication” is defined as

any communication which a reasonable person would believe is intended to solicit or request a person to engage in sexual activity, and any communication depicting or describing nudity, sexual conduct or sexual excitement when it: (1) predominantly appeals to a prurient interest in sex; (2) is patently offensive to prevailing

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60. Id.
standards in the adult community as a whole with respect to what is suitable material or conduct for minors; and (3) taken as a whole, is without serious literary, artist, political or scientific value for minors.61

One who violates this statute and sends out a sexually offensive communication would be liable to the social networking operator as well as the recipient of the “sexually offensive communication.” The transmitter of the communication would be liable to the social networking site operator in a civil action for $1,000 plus reasonable attorney fees for each violation.62 The transmitter would be liable to the recipient of the communication for damages of $5,000 plus attorney fees, or actual damages, whichever is greater.63

The definition of “sexually offensive communication” relies on standards that are not particularly clear. To determine what content is “suitable for minors,” the statute looks to “prevailing standards in the adult community.” Every transmitter of a message will likely have a different definition of what that is appropriate. If the statute is too vague or unclear, it could be found void for vagueness.65

The second piece of the statute appears to address cyberbullying. It prohibits the transmission of a “harassing communication,” which is defined as “any communication which is directed at a specific person, serves no legitimate purpose, and a reasonable person would believe is intended to threaten, intimidate or harass another person.”66 No definition of “harass” or “threaten” is given, which could prove problematic in attempts to develop clear and objective boundaries for enforcement. Additionally, the phrase “serves no legitimate purpose” is indefinite as what is reasonably “legitimate” to one person may not be “legitimate” to another person. Further still, there are potential First Amendment issues, as this statute potentially infringes on the First Amendment right to speak one’s mind in an abrasive and harassing way. Courts have carved out exceptions to free speech laws in situations when there were threats of imminent unlawful violence, but it is very likely

61. Id.
62. Id.
63. Id.
64. Id.
65. See supra Part II.A for more on “void for vagueness.”
that the First Amendment would protect harassing speech not accompanied by threats of imminent unlawful violence.67

The statute also requires that a social networking website remove the “sexually offensive communication” or “harassing communication” without unreasonable delay.68 If social networking sites do not comply, they would violate the New Jersey Consumer Fraud Act69 and can be sued.70 However, the statute provides a safe harbor for social networking sites that display buttons to report violations, conduct reviews in an expedient fashion of any report of violations, block violators when appropriate, and contact the police when appropriate.71

The Social Networking Safety Act was written to avoid conflict with Section 230 of the Communications Decency Act (“Section 230”).72 Section 230 grants protection for online intermediaries and states that “[n]o 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.”73 Section 230 has been interpreted broadly and has granted immunity to Internet Service Providers (ISPs) even when the ISP had notice that the content was tortious.74 The proposed statute states that the bill should not be “construed to permit a civil action against an interactive computer service that is inconsistent with the provisions of [Section 230].”75

This attempt to avoid preemption by the federal statute renders the New Jersey bill relatively toothless. Section 230 would probably apply to most, if

67. See Brandenburg v. Ohio, 395 U.S. 444 (1969) (holding that the government could not punish inflammatory speech unless it is likely to incite imminent lawless action); see also Davis, supra note 58.


74. See Zeran v. America Online, Inc., 129 F.3d 327, 332 (4th Cir. 1997) (holding that even notice of the content cannot serve as a basis for liability). Courts have found Section 230 to protect social networking sites from tortious actions. See Doe v. MySpace, Inc., 528 F.3d 413 (5th Cir. 2008) (finding that a social networking site was under Section 230 and not liable for tortious actions based on user-generated content). See generally Shahrzad Radbod, Craigslist – A Case for Criminal Liability for Online Service Providers?, 25 BERKELEY TECH. L.J. ___ (forthcoming 2010).

75. N.J. A.B. 3757.
not all, civil suits brought under the statute thereby preempting the New Jersey bill.

The proposed New Jersey statute also puts a burden on a specific technology and type of website: the social networking site. Email providers, blogs, or wikis do not have the same burden.\textsuperscript{76} The success and popularity that social networks have attained with youths in recent years has generated additional scrutiny.\textsuperscript{77} These requirements represent an added cost and a higher barrier to entry for new social networking sites. If there are too many regulatory burdens on the social networking sites, then there may be fewer new social networking sites. This would result in a net loss to society as there would be fewer choices and less incentive for social networking sites to be innovative if there is little competition. A lack of innovative network development would hinder the hallmarks of social networking: individual expression and community building online.\textsuperscript{78}

The statutes of Illinois, Georgia, and New Jersey are problematic and unlikely to be effective. Notwithstanding the constitutional concerns, the success of the Illinois and Georgia statutes hinges on the sex offenders providing accurate and truthful information as well as voluntarily abstaining from creating further accounts. This is unlikely to occur. The New Jersey statute that addresses “sexually offensive communication” also may falter because of its vague standards. These statutes are unlikely to be effective against sexual predators. However, some evidence suggests that the sexual predator problem is not as big as the media portrays.

E. \textbf{Statistics and Solutions}

The Crimes Against Children Research Center (CACRC) conducted a Youth Internet Safety Survey, which showed that the percentages of youth who received sexual solicitations declined from 19\% in 2000 to 13\% in 2006.\textsuperscript{79} This decrease in reported sexual solicitations is significant given the increase of time young people spend on the Internet.\textsuperscript{80} This decrease also

\textsuperscript{76} Barber, supra note 70.
\textsuperscript{77} See supra Part II.A.
\textsuperscript{80} \textit{NANCY E. WILLARD, CYBERBULLYING AND CYBERTHREATS} 67 (2007).
suggests young people are “gaining greater skills in avoiding the online places where such contacts are being made.”

Most of the recipients of sexual solicitation (81%) were between the ages of fourteen and seventeen. Other adolescents and young adults between eighteen and twenty-one, not older adults, were the source of most of the solicitations. Furthermore, not all solicitations came from strangers; one detailed study found that about 14% came from offline friends or acquaintances. More importantly, very few of the solicitations resulted in offline contact. Also, teenagers seem to shrug off the solicitations without experiencing distress. These statistics suggest that publicity about online predators preying on innocent children exaggerates the actual harm. The lack of actual offline contact and the decreasing number of solicitations suggests that the likelihood of youths encountering online sexual predators is quite low. Online predator arrests comprise only 1% of arrests for sex crimes against minors. However, any online contact achieved by a sexual predator is a serious threat and children should be warned of the dangers that can result from offline contact. None of the state statutes previously discussed were proactive attempts to halt sexual solicitation by predators online.

A better solution is to educate children on safe Internet practices and on the realities of sexual predators. Teaching children about safe Internet practices and cautioning them against sharing too much information online will have lasting effects. Just as children learn to not take candy from

81. Id.
82. Janis Wolak, Kimberly Mitchell & David Finkelhor, National Center for Missing and Exploited Children, Online Victimization of Youth: Five Years Later 17 (2006), available at http://www.unh.edu/ccrc/pdf/CV138.pdf. The Berkman report further detailed a study that found that younger age groups were not as likely to have experienced sexual solicitation. Two percent of fourth through six graders were asked about their bodies, compared with 11% of seventh through ninth graders and 23% of tenth through twelfth graders. In this study, 3% of the two older groups admitted to asking others for sexual content. Berkman Center, supra note 79.
83. BERKMAN CENTER, supra note 79.
84. Id.
85. Id.
86. Id.
89. Id.
strangers, they can also learn to not share personal information and about the wrongs of internet harassment. If children learn about ethical internet practices, it may become second nature to them and instances of severe cyberbullying may decrease.

III. CYBERBULLYING AND CYBERSTALKING

A. CYBERBULLYING STATISTICS

Statistics suggest that cyberbullying will impact a greater percentage of youth than sexual predators will in the United States. A recent report by the Internet Safety Technical Task Force concluded that bullying and harassment by peers “are the more frequent threats that minors face, both online and offline.” Nine studies done in 2006 found that the percentage of children who were cyberbullied ranged from 9% to as high as 53%. The vast majority of these studies found that greater than 17% of children had been cyberbullied. A 2006 nationwide survey conducted by the Opinion Research Corporation for Fight Crime found that cyberbullying occurs frequently. The study found that “31% of 12–14-year-olds and 40% of 15–17-year-olds reported that in the last year ‘mean, threatening or embarrassing [things were] said about [them] through email, instant messages, websites such as MySpace, Friendster, etc., chat rooms or text messages.” Most scholars agree that approximately 15–20% of students are regular victims of bullying behavior while about 10% of American children are subject to extreme victimization by bullying. The aggregate numbers from the various

90. Cyberbullying statistics, like all research, must be evaluated in the correct context. Some cyberbullying statistics are gathered through online surveys and the online nature of the surveys might skew the results because those most likely to fill out the surveys are those who are already frequent Internet users. This caveat is not intended to diminish the studies’ results. As with all research, the context in which the data was gathered should be considered. See KOWALSKI, LIMBER & AGATSTON, supra note 6, at 69.

91. “The Internet Safety Technical Task Force (ISTTF) is a group of Internet businesses, non-profit organizations, academics, and technology companies that have joined together to identify effective tools and technologies to create a safer environment on the Internet for youth.” BERKMAN CENTER, supra note 82, at 4.

92. Id.

93. KOWALSKI, LIMBER & AGATSTON, supra note 6, at 71.

94. Id.


studies conducted in 2006 fall within this range, with some studies indicating much higher numbers for cyberbullying.  

Hinduja and Patchin attribute the range of cyberbullying statistics to factors such as the varying ages of the respondents, the reporting periods of the different surveys, and the definition used for “cyberbullying.” Hinduja and Patchin also point out that different methodologies might yield different results. For instance, the respondents could be questioned in-class, over the phone, or through the Internet. The Internet-based samples tend to report higher numbers of aggressors and victims because those respondents are more likely to use the Internet regularly and are most likely to experience cyberbullying. An accurate evaluation of cyberbullying statistics will consider these factors. Regardless of the specific cyberbullying numbers, the effects of bullying on children are well documented.

1. **Effect on Children**

Bullying can have lasting psychological effects on children. For instance, bullied children are more likely to be anxious and to think about committing suicide. Unfortunately, the problems are not only psychological and emotional; the effects can extend into the physical realm as well. In a study of Dutch schoolchildren aged nine to twelve, researchers found that bullied children were “approximately three times as likely to experience headaches, feel listless and wet their beds.” Studies have shown that the effects last into adulthood. One study found that male young adults who were bullied in junior high were likely to suffer from low self-esteem and depression a decade after the physical bullying had ended.

Bullying is damaging enough in its traditional schoolyard form, and the Internet only magnifies the effects. The breadth and reach of the Internet allows one’s humiliation at the hands of a bully to reverberate across cyberspace. Whereas only a handful of local students might witness a traditional bullying incident, YouTube and digital cameras make the spread of humiliation available to a much wider audience. Recent legislative efforts to address cyberbullying are discussed in Sections III.B and III.C.

97. [Kowalski, Limber & Agatston, supra note 6, at 71.]
98. [Hinduja & Patchin, supra note 7, at 49.]
99. [Id.]
100. [Kowalski, Limber & Agatston, supra note 6, at 26.]
101. [Id.]
102. [Id. at 27.]
B. **TELEPHONE HARASSMENT LAWS**

In February 2009, Idaho H.B. 82 proposed to amend telephone harassment laws to apply to Internet communications. The amendment would impose a misdemeanor on “every person who, with intent to annoy, terrify, threaten, intimidate, harass or offend, telephones or emails or sends a text message or posts on the internet to another” and with “obscene, lewd or profane language.” The proposed statute defined “internet posts” as “use of internet sites including, but not limited to, social networking sites and personal blogs.” The statute did not provide definitions of “annoy” and “terrify.”

The amendment of an existing telephone harassment law is not unprecedented. In January 2006, the federal government amended the Federal Telephone Harassment Statute in an attempt to address the growing cyberstalking problem. The pre-amendment statute outlawed anonymously and knowingly making a telephone call or using a “telecommunications device” to “annoy, abuse, threaten or harass” a person. The phrase “telecommunications device” was amended to include “any device or software that can be used to originate telecommunications or other types of communications that are transmitted, in whole or part, by the Internet.”

The lack of definition for “annoy” was problematic. Words such as “annoy” are very difficult to define and use as a standard for enforcement. In *United States v. Bowker*, the Sixth Circuit examined the federal statute and found that the word “annoy” was constitutional because it upheld Congressional intent to protect individuals from fear, and the term did not chill political or free speech. The *Bowker* analysis preceded the amendment to “telecommunications device,” but the analysis for the newly amended statute might be the same. Naomi Harlin Goodno posits that “read in context, ‘annoy,’ like ‘threaten’ and ‘harass,’ is not unconstitutional because its purpose is to prohibit messages aimed at instilling fear, whether the

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104. Id.
105. Id.
109. Id. (adding this language to 47 U.S.C. § 223(h)(1)(C)).
message is sent via the telephone or the Internet.” The analysis in Bowker could apply to Idaho H.B. 82 and other similar legislative proposals. If these legislative efforts pass into law courts could find “annoy” or other similarly ambiguous words constitutional.

Ultimately, Idaho H.B. 82 was held in session and did not pass into law. However, the above analysis could hold true for future legislative attempts to amend telephone harassments laws to fit Internet harassment.

C. TEXAS

Texas H.B. 2003 amended the penal code to create the crime of online harassment. Unlike the Idaho bill, Texas H.B. 2003 went into effect September 1, 2009 and there has already been at least one arrest of a teenager under the new law.

The bill prohibits a social network user from using the name or persona of another to create a Web page or post comments within a social networking site without consent. The social network user must not have the intent to “harass, embarrass, intimidate or threaten” another on a “commercial social networking site.” The statute defines “commercial social networking site” as

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\text{[a]ny business, organization, or other similar entity operating a website that permits persons to become registered users for the purpose of establishing personal relationships with other users through direct or real-time communication with other users or the creation of web pages or profiles available to the public or to other users. The term does not include an electronic mail program or a message board program.}
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The exclusion of email and message boards creates a dual system wherein one could harass through Facebook messages, which are delivered to users

111. Goodno, supra note 107, at 150.
115. Id.
116. Id. (emphasis added).
via email, and could possibly be convicted of a felony, but send the same messages through email and not violate this law. In both cases, the recipient of the harassing message received and viewed the message through email, but the legal treatment would be different. The only difference is one is routed through a social networking site first, whereas the other is directly sent via email.117

H.B. 2003 also raises First Amendment issues. Similar to the First Amendment concerns with Idaho H.B. 82, the right to be annoying or to make unpopular comments online is protected by the First Amendment. Supporters of the statute say that it is narrow enough to avoid infringing free speech, while detractors point out that “harm” could be broadly interpreted and juvenile pranks or jokes could fall under the statute.118 Furthermore, opponents of the law suggest that current laws adequately protect against cyberstalking and impersonation.119 Opponents claim that identity theft laws could be used to prosecute those who impersonate and steal someone’s online identity and the current stalking laws could serve to protect against online stalking.120

Another harassment law, Section 42.07(a)(7) of the Texas Penal Code was recently ruled unconstitutionally vague by the Texas Court of Criminal Appeals.121 Section 42.07(a)(7) read:

(a) A person commits an offense if, with intent to harass, annoy, alarm, abuse, torment, or embarrass another, he: . . . (7) sends repeated electronic communications in a manner reasonably likely to harass, annoy, alarm, abuse, torment, embarrass, or offend another.122

117. Some scholars have found the focus on social networks untenable. When discussing Texas H.B. 2003, Professor Eric Goldman said, “The whole social networking exceptionalism is ridiculous” and that “[t]here’s no way to distinguish social networking sites from other sites.” Texas Passes Bill on Online Impersonation, NACS Online, June 10, 2009 http://www.nacsonline.com/NACS/News/Daily/Pages/ND0610099.aspx (quoting Prof. Goldman).


119. Id.

120. Id.


122. TEX. PENAL CODE ANN. § 42.07(a)(7) (Vernon 2003).
The court held that Section 42.07(a)(7) had First Amendment implications and if First Amendment freedoms are implicated “the law must be sufficiently definite to avoid chilling protected expression.”\textsuperscript{123} The court found the words “annoy,” “alarm” and “embarrass” unconstitutionally vague; the statute did not establish an objective standard to measure the level of prohibited annoying or alarming behavior.\textsuperscript{124} The lack of a clear standard for whose sensibilities must be offended and what level of annoyance was illegal did not afford a person of ordinary intelligence a “reasonable opportunity to know what was prohibited.”\textsuperscript{125} Given that the Federal Telephone Harassment Statute\textsuperscript{126} makes it a crime to use a telecommunications device to “annoy, abuse, threaten or harass” and uses “or” as a connector, it could be argued that the federal statute is also unconstitutional under the same analysis.\textsuperscript{127} Texas H.B. 2003 is more definite than Section 42.07(a)(7) and is better equipped to withstand a constitutional challenge for vagueness, although the court may view the words “harm” or “intimidate” in a similar light as they are undefined in the statute.

Idaho H.B. 82 had fewer constitutional concerns than the Texas statute. The existing state statute that Idaho amended mirrors a federal statute, which was found constitutional. The Texas law, on the other hand, is closely related to another harassment statute that was previously found to be unconstitutional by the Texas state courts. Both proposals attempt to provide some legal recourse for those who have been cyberbullied or harassed online.

However, even if the statutes did not have potential constitutional issues, the statutes would not address the root of the cyberbullying problem. A more lasting solution would be to educate children on moral and ethical Internet use. With proper education, cyberbullying would be addressed before it escalates to the point where legal action is needed.

\textbf{IV. PROPOSED SOLUTIONS}

This Part will discuss various proposed solutions to the cyberbullying problem. Section IV.A will examine a proposed solution to decrease the immunity that intermediaries enjoy and increase their role in policing harassing internet speech. Section IV.B will discuss a proposal to reduce

\textsuperscript{123} Scott, 298 S.W.3d at 268.
\textsuperscript{124} Id. at 270.
\textsuperscript{125} Id. at 268.
\textsuperscript{126} 47 U.S.C. 223(a)(1)(c) (2006); see supra Part III.B.
\textsuperscript{127} Susan Brenner, Texas Online Harassment Statute Held Unconstitutional, CYB3RCRIM3, May 6, 2008, 15:37 EST, http://cyb3rcrim3.blogspot.com/2008/05/texas-online-harassment-statute-held.html. But see Booker, supra note 110.
anonymity on the Internet. Section IV.C will then evaluate a proposed Federal statutory solution. Lastly, Section IV.D will discuss educating children on internet practices as a way to improve online safety and address cyberbullying.

A. **REDUCE IMMUNITY AND INCREASE THE ROLE OF ISPS**

One solution to the cyberbullying problem is to reduce the immunity from tort liability that intermediaries, such as Internet Service Providers (ISPs), enjoy under Section 230 of the CDA. The intermediaries bear no responsibility for the harassment that their users’ experience at the hands of third-party actors and have no obligation to remove offensive materials from websites.

Bradley Areheart proposes that ISP immunity should be lessened and stripped for certain cyberwrongs. Areheart suggests a “notice and takedown” scheme similar to the one for copyright infringement under the Digital Millennium Copyright Act (DMCA). Under Areheart’s proposal, where an ISP has received notice of tortious cyberbullying from a victim, the ISP must remove the content or risk loss of immunity under the CDA. If the ISP refuses to remove the bullying material after receiving notice, then the intermediary could be held liable under tort law.

However, given the nature of cyberbullying, a takedown regime might prove difficult. Cyberbullying usually involves repeated acts or prolonged harassment and to prove that there were instances of cyberbullying the intermediaries would have to sift through a large amount of data to determine if there was a pattern of cyberbullying. This might make it more difficult for an intermediary to decide whether to take down information that allegedly constitutes cyberbullying. Areheart acknowledges that his proposal could “require companies to make decisions about torts that are

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128. Internet service providers (ISPs), such as AT&T or Comcast, provide access to the Internet. See generally Sara D. Sunderland, *Domain Name Speculation: Are We Playing Whac-A-Mole?,* 25 BERKELEY TECH. L.J. ___ (2010) for more information on how the Internet works.

129. See supra Part II.D for a discussion of Section 230 of the CDA.


132. Areheart, supra note 130.


notoriously ambiguous, such as negligence and intentional infliction of emotional distress.\footnote{135} The intermediaries might then be inclined to take down all content that was complained about to avoid exerting the resources to determine which instances were truly tortious cyberbullying, and to avoid legal liability. Such an action would remove constitutionally protected speech along with potentially harassing speech.

By essentially deputizing the intermediary firms, Areheart’s proposal shifts regulation from the government to private firms whose interests may not be aligned with what is best for the public. Private firms will want to minimize their legal liability and satisfy their legal obligations at a low cost, which may end up limiting constitutionally protected speech. The possible infringement of protected speech by the takedown method makes Areheart’s proposal less attractive. The tradeoff to get better response to cyberbullying may not be worth the removal of legitimate speech.

B. REDUCING ANONYMITY

The easiest way to identify users over the Internet is by tracing the Internet Protocol (IP)\footnote{136} address through the ISP. But for the victim of sexual solicitation or cyberbullying to confront the harasser through the legal system they must have the cooperation of relevant ISPs or other intermediaries. The ISPs and other intermediaries possess identifying data, such as IP addresses, that would help identify harassers; Section 230 immunity, however, provides little motivation for the ISPs to voluntarily cooperate. In this manner, the broad protection under Section 230 serves to hinder individuals in their efforts to identify their online attackers.

Joan Lukey\footnote{137} proposes a system that would require an Internet intermediary, such as an ISP, to remove cyberbullying or cyberstalking material upon notice by a plaintiff, but only after an actual lawsuit has been filed.\footnote{138} Currently, an enforcement agency can only look for the IP address of

\footnote{135. Areheart, supra note 130, at 44.}  
\footnote{136. An Internet Protocol (IP) address is a numerical label assigned to devices participating in a computer network utilizing the Internet Protocol for communication between its nodes. An IP address serves two principal functions in networking: host identification and location addressing. An IP address is unique to a computer and can be used to trace from where Internet comments were made. Definition of Internet Protocol Address, PC Magazine Encyclopedia, \url{http://www.pcmag.com/encyclopedia_term/0,2542,t=IP+address&i=45349,00.asp}. See generally Sunderland, supra note 128.}  
\footnote{137. Joan Lukey is a partner at Ropes & Gray LLP. Joan Lukey Biography, Ropes and Gray LLP, \url{http://www.ropesgray.com/joanlukey} (last visited Jan. 24, 2010).}  
an offender if there is a criminal complaint. Lukey’s proposal would allow the enforcement agency to search for the IP address even without a criminal complaint, as long as a judge found reasonable cause that there were libelous or defamatory postings. Immunity would still be offered for third-party posted content, but if there is a court order at the outset of a criminal case, then the ISPs and search engines would be obligated to turn over whatever identifying information they have, “particularly the metadata necessary to track the IP address of the computer.”

The Lukey proposal would only require action on the part of the ISP when it has been informed of some wrongdoing. This proposal expands the means to get IP addresses to include some civil actions. Lukey’s proposal is less drastic than Areheart’s and appears to be a reasonable attempt to open up more avenues for cyberbullying victims to identify their harasser. To fully evaluate the process and its effects, more details of this legislation are needed.

C. FEDERAL STATUTE CRIMINALIZING CYBERBULLYING

Another proposed solution would make cyberbullying a federal crime. In May 2008, Rep. Linda Sanchez (D-CA) introduced the “Megan Meier Cyberbullying Prevention Act” which would render cyberbullying a federal felony. The proposed legislation reads:

Whoever transmits in interstate or foreign commerce any communication, with the intent to coerce, intimidate, harass, or cause substantial emotional distress to a person, using electronic means to support severe, repeated, and hostile behavior, shall be fined under this title or imprisoned not more than two years, or both.

The proposed bill would create a dual system where one could bully another on the playground and be free from federal repercussions, but not through the Internet. Sanchez wrote “Congress has no interest in censoring speech and it will not do so if it passes this bill. Put simply, this legislation would be

139. Id.
140. Id.
141. For instance, if there is a court order at the outset of a libel case, the intermediaries would be required to provide whatever identifying information they can about the poster. Baxter, supra note 138.
142. Szoka, supra note 134.
used as a tool for a judge and jury to determine whether there is significant
evidence to prove that a person ‘cyberbullied’ another.”

Despite Rep. Sanchez’s assurances that the bill will only be used for
cyberbullying, there is no way to know how the bill will be interpreted. Professor Eugene Volokh has said that the proposed law is clearly “facially
overbroad (and probably unconstitutionally vague), and would thus be struck
down on its face under the First Amendment.” The proposed act is well
meaning but is simply too vague as the standard for “severe, repeated,
and hostile behavior” is unclear. “Severe” and “hostile” are not defined by the
statute, which gives this statute a very broad range of possible interpretations.
The lack of clear definitions does not give notice to the public about what
the prohibited behavior entails and makes the statute untenable and
potentially constitutionally vague.

D. EDUCATION

1. School Regulation

Another proposed solution is to allow the schools and school districts to
regulate the cyberbullying. The ability of schools to administer punishment
for offsite cyberbullying behavior has yet to be fully decided by the Supreme
Court. However, the Court has examined whether a school has the authority
to regulate and punish off-campus behavior. If the Court ultimately
determines that schools have the authority to regulate off-campus

144. Rep. Linda Sanchez, Protecting Victims, Preserving Freedoms, HUFFINGTON POST, May
198079.html.

145. Posting of Eugene Volokh to The Volokh Conspiracy, Federal Felony To Use
Blogs, the Web, Etc. To Cause Substantial Emotional Distress Through “Severe, Repeated,
PST).

146. Steven Kotler, Cyberbullying Bill Could Ensnare Free Speech Rights, FOXNEWS.COM,
May 14, 2009, http://www.foxnews.com/politics/2009/05/14/cyberbullying-ensnare-free-
speech-rights/.

147. See Morse v. Frederick, 551 U.S. 393 (2007) (holding that the First Amendment
does not require schools to tolerate student speech that could contribute to the dangers of
drug use); Hazelwood Sch. Dist. v. Kuhlmeier, 484 U.S. 260 (1988) (finding that a court
must be able to set standards for student speech that originates with school resources);
Bethel Sch. Dist. No. 403 v. Fraser, 478 U.S. 675 (1986) (holding that a “plainly offensive”
speech by a student in a school environment infringed upon the rights of other students);
Amendment prevented school authorities from disciplining students for peacefully wearing
armbands to protest the Vietnam War). See generally Darryn Cathryn Beckstrom, State
Legislation Mandating School Cyberbullying Policies and the Potential Threat to Students’ Free Speech
cyberbullying, or if there is legislative action granting schools authority, schools are the logical choice to regulate both traditional bullying and cyberbullying.

A singular source of authority over bullying would be ideal because it would ensure continuity and would make the punishment and enforcement regime clear to the children. Just as teachers and principals regulate traditional bullying at school, schools officials would have authority to discipline offsite cyberbullying. One tool that the schools could use to help monitor offsite cyberbullying is an anonymous reporting system where students could report instances of cyberbullying without fear of retribution.148

In the absence of explicit authority from the courts to exert power over all off-campus cyberbullying, parents are charged with the task of monitoring and disciplining their children’s internet activities. The result has been uneven enforcement; some parents are unaware, too busy, or unwilling to discipline their children and curtail their Internet use. Schools can serve as an impartial governing body to protect the educational interests of the students. Children spend a great deal of time in school, and teachers with the authority to regulate and punish bad internet behavior will help to ensure the educational experience of students is not weighed down by cyberbullying.

2. Education Beyond School

Another suggested approach focuses on Internet education instead of changing laws or creating a new regulatory regime. In May 2009, Senator Robert Menendez (D-NJ) introduced the School and Family Education about the Internet (SAFE Internet) Act.149 The SAFE Internet Act would allocate $175 million over five years to educate children on Internet safety issues.150 The education grant program would be administered by the Department of Justice, which would work with the Department of Education and the Department of Health Services to determine how to administer the money to state and local education agencies that would educate children on how to use the Internet safely and ethically.151 Senator Menendez stated on his website:

148. HINDUJA & PATCHIN, supra note 7, at 167.
150. Id.
The way to meet the challenges and opportunities the Internet presents isn’t to deny our children access to this great resource but to make sure they know how to use it wisely. Just as we make sure our children know not to talk to strangers, not to bully kids on the playground, and not to give out their personal information, we have the same responsibility to teach them to apply these values online.152

The grant money can be used in a variety of ways, including educating parents and teachers about how to better teach children about the dangers of online use as well as how to ethically and morally use the Internet.153

Educating children on safe and ethical use of the Internet could have a positive, lasting impact on the next generation. The SAFE Internet Act lists as one of its findings the promising success of a mandated internet education program in Virginia, wherein “according to an empirical study of 1,379 fourth grade students in Virginia, the first State to mandate Internet safety education in its schools, the students improved their responses to eight of ten questions after completing an Internet safety education program, especially in 2 major areas, uncomfortable content and cyberbullying.”154 Parents, teachers, law enforcement officers, other community leaders, and children all must work together to create a baseline of Internet safety knowledge for the next generation of Internet users.155 Much like teaching children to look both ways before crossing the street, a concerted effort from many different sources to educate children on limiting the amount of personal information displayed on social networks and humanizing cyberbullying victims could drive home safe and moral internet practices.

Integrating educational materials into the registration process for social networking sites could also provide value. Children often do not understand the true impact of what they are doing in the name of fun. Through education programs and parental guidance the impact of these behaviors will be relayed to the children.156 Empathy is one of the keys to fight cyberbullying; once children understand the harmful effects of their actions they will be less inclined to continue.157 An educational video on Internet best practices, followed by a quiz, could be required when children attempt to

152. Id.
153. For the statutorily approved uses see the SAFE Internet Act, S. 1047, 111th Cong. (2009).
154. SAFE Internet Act, § 2(a)(4).
155. HINDUJA & PATCHIN, supra note 7, at 130.
157. Id. at 87.
sign up for Facebook or similar sites. The video could inform them that posted pictures and comments made in cyberspace are available to the whole world, and can be used against them by cyberbullies or be seen by college admissions officers.\footnote{158} The registration process could also educate children about the lasting and damaging effects of cyberbullying. Real life stories about suicides, such as Megan Meier’s, might provide some context for children. There will undoubtedly be cheating and people will find ways to not pay attention or bypass the training, but there will also be people who will learn something from the training and will walk away with better practices.

Of course, education is best when it starts early.\footnote{159} Parents can go online with their children at a young age and instill safe and moral practices. One problem is that many parents may themselves need education. The gap in technical prowess between parents and children could be very wide. Training sessions held at local schools to educate parents on how to monitor and teach safe online use would be an appropriate and productive use of the grant money. When armed with the knowledge of safe Internet practices, parents can pass along that knowledge to their children at an early age. These educators would then pass on the information to students.

V. CONCLUSION

At this time, education is the best legal avenue to instill a culture of online safety in children. Creating new crimes and deputizing intermediary firms are problematic because they raise constitutional concerns. The SAFE Internet Act is a positive step in the attempt to educate parents and teachers so they can in turn educate children. As children learn about safe Internet practices at home, the benefits are more likely to multiply and grow through peer sharing. Peer education is important because children are more likely to listen to their peers than an authority figure.\footnote{160}

Still, education must start at home. If parents start early and teach their children at a young age about the dangers of using the Internet, as well as respectful and ethical Internet practices, those lessons are likely to stay with them. Ideally, schools would be able to regulate off-campus cyberbullying, creating a consistent regime for traditional bullying and cyberbullying. However, even in the absence of school authority over offsite cyberbullying, if parents, teachers, and the children themselves all work together to educate and build awareness, then there can be lasting effects.

\footnotesize{158. Hinduja & Patchin, infra note 7, at 101.}
\footnotesize{159. Id. at 148.}
\footnotesize{160. Id. at 137.}
INTERNET GAMBLING: RECENT DEVELOPMENTS
AND STATE OF THE LAW

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Have you ever wondered whether internet gambling\(^1\) is legal in the United States? The answer seems to depend on the source.\(^2\) Such conflicting responses are not surprising given the state of the law. Federal and state laws from both before and after the conception of the Internet have created an unnavigable patchwork of regulation. And although the past few years have seen a new federal law in 2006, new agency regulations in 2009, and a host of controversial enforcement actions, the law remains frustratingly murky. In fact, the federal law enacted in 2006, the only one to target internet gambling, provides no definition of “unlawful internet gambling.”\(^3\) The Treasury and Federal Reserve regulations promulgated under that law, likewise, fail to provide a definition or any helpful clarification.\(^4\) Thus, the uncertainty of the law forces would-be bettors and companies to either play it safe or throw the dice.\(^5\)

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4. 12 C.F.R. pt. 233, 31 C.F.R. pt. 132 (2009). However, the agencies did acknowledge the difficulty in interpreting current law and thus refused to undertake that interpretation. See Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. 69,382, 69,384 (codified at 12 C.F.R. pt. 233 and 31 C.F.R. pt. 132) (concluding that defining “unlawful internet gambling” under current state and federal law “would not be practical” because “the underlying patchwork legal framework does not lend itself to a single regulatory definition”).

5. For example, gambling website operators located in the European Union, faced with the ambiguity of U.S. laws, took a chance by accepting bets originating in the United States; however, they were forced to withdraw from the U.S. market in 2006 when the
The stakes are high. Americans gambled away almost $6 billion online in 2008. Furthermore, by not legalizing and regulating internet gambling, the federal government may forego up to $62.7 billion in taxes over the next decade. Moreover, offshore operators of internet sports-gambling sites unlucky enough to fall under Department of Justice scrutiny and U.S. jurisdiction are serving prison sentences and have forfeited millions of dollars.

Yet no federal or state government in the United States regulates these sites, so bettors have no assurance of fair gaming. If American bettors feel cheated, they have little chance of keeping lawsuits against foreign corporations in stateside courts. And since the most reputable foreign companies have withdrawn from the U.S. market, Americans must place their bets with less trustworthy sites.


8. This Note uses the term “internet sports-gambling” to mean wagering on sporting events via the Internet.


10. With the exception of internet gambling on horse racing, which states regulate. See, e.g., Rousseau, infra note 2; see also infra Section I.B.


Congress could take leadership by enacting a clear statutory scheme either to legalize, regulate, and tax internet gambling or to establish unequivocally which forms of internet gambling are prohibited. Alternatively, Congress could vest in states full authority to regulate internet gambling by explicitly delegating that power and delineating its bounds. Absent congressional leadership, courts will continue to wander through the legal thicket, and gaming advocates will continue to challenge state regulation.

Part I of this Note explores the current legal thicket created by federal gambling statutes. The ambiguity in federal law largely stems from the old Wire Act and its interaction with subsequent legislation. Part I advocates interpreting the Wire Act such that it does not prohibit all internet gambling. Part II provides an overview of state law and highlights two recent cases: the internet domain name seizures in Kentucky and a declaratory action brought by an amateur poker player in Washington. Finally, Part III offers concluding thoughts.

I. FEDERAL LAW

States have traditionally regulated gambling. Their attitude has generally been tolerant, with state lotteries being the predominate manifestation. Congress first enacted anti-gambling legislation at the turn of the Twentieth Century with two laws that prohibited the interstate transportation of lottery paraphernalia. The next burst of federal legislation did not occur until the 1960s and 70s when Congress passed legislation to target organized crime,

17. See United States v. King, 834 F.2d 109, 111 (6th Cir. 1987).
18. Id.; see also Champion v. Ames (The Lottery Case), 188 U.S. 321 (1903).
which had turned to illegal gambling as a source of revenue after the end of Prohibition left them without their original financial fount, the speakeasy.19

One of these old statutes, the Wire Act of 1961,20 has become a major weapon against internet gambling,21 but controversy has surrounded the interpretation of its scope. In addition, the legal landscape was complicated by the 2000 Amendment to the Interstate Horseracing Act of 1978 (IHA),22 which may have provided a safe harbor for internet gambling on horse racing. Congress first took up the issue of internet gambling on a wider scale with the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA),23 which mandated the Department of the Treasury and the Federal Reserve to promulgate regulations.24 However, the government built these laws upon the shaky foundation of the Wire Act, and neither the UIGEA nor the agency regulations provided any real clarity to what types of gambling U.S. law actually prohibits.

A. THE WIRE ACT

Even though Congress enacted the Wire Act25 before the conception of the Internet, most commentators agree that its language is sufficiently flexible
to encompass internet gambling. However, uncertainty surrounding its scope creates the first bramble bush in the legal thicket of internet gambling.

The debate centers on whether the Wire Act applies only to gambling on sporting events, such as betting on football games, or to all forms of gambling, including casino games, like poker and blackjack. Courts have ruled both ways. The Fifth Circuit takes the view that it applies only to gambling on sporting events; the District of Utah (and, for that matter, the Department of Justice) takes the view that it applies to all forms of gambling.

The consequences of this debate are significant. If the Wire Act applies to all forms of gambling, then all internet gambling, no matter the subject, is currently illegal in the United States. If, on the other hand, the Wire Act only applies to gambling on sporting events, or if its original scope has been limited by subsequent legislation, then some internet gambling—for example, internet gambling on horse racing—could be legal.

1. Language of the Wire Act

Subsection (a) of the act provides the following:

Whoever being engaged in the business of betting or wagering knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest, or for the transmission of a wire communication which entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers, shall be fined under this title or imprisoned . . . .

26. See, e.g., Rodefer, supra note 16, at 396; cases cited infra note 32. But see U.S. GEN. ACCT. OFF., GAO-03-89, INTERNET GAMBLING: AN OVERVIEW OF THE ISSUES 12–13 (2002) [hereinafter GAO REPORT] (“Depending on how the phrase is interpreted, the act might not apply to Internet gambling in some instances . . . .”).

27. Thompson v. MasterCard Int'l Inc. (In re MasterCard Int'l Inc.), 313 F.3d 257, 262 (5th Cir. 2002).


29. Note, however, that the term “illegal” does not identify which party to the transaction is committing the crime. As discussed infra Section I.A.1, the Wire Act only targets those “engaged in the business of betting or wagering.” 18 U.S.C. § 1084(a) (2006). Thus, the gambling website and perhaps the professional gambler would be violating the Wire Act, but the casual gambler would not.

As threshold elements, then, the Wire Act requires that one be “engaged in the business of betting or wagering,” that he commit the acts “knowingly,” that he use a “wire communication facility,” and that the transmission cross state or national boundaries. If the threshold elements are met, the Wire Act prohibits three types of transmissions: (1) transmissions of bets or wagers (or information assisting in the placement therein) on any “sporting event or contest;” (2) communications that entitle the recipient to receive money or credit as a result of “bets or wagers;” and (3) information assisting in the placing of “bets or wagers.” This Section will refer to these as the first, second, and third prohibitions of § 1084(a).

The phrase “sporting event or contest” limits the phrase “bets or wagers” in the first prohibition of § 1084(a); however, “sporting event or contest” does not appear in the second and third prohibitions. This textual ambiguity laid the groundwork for the debate.

2. **The Fifth Circuit Held That the Wire Act Only Applies to Sporting Events**

The Fifth Circuit has held that the Wire Act only prohibits gambling on sporting events. The plaintiffs were gamblers who had used their credit cards to fund their wagering accounts at online (non-sports) gambling sites. The class action suit against their credit card companies alleged, among other things, that the companies had violated the Wire Act by processing the transactions.

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31. At least one court has interpreted this language to include anyone involved in the business, not just those “running the show.” United States v. Corrar, 512 F. Supp. 2d 1280, 1287 (rejecting defendant’s argument that being a middle man precludes prosecution under the Wire Act). The law, however, was never intended to be used against casual bettors. See 107 CONG. REC. H16, 533-38 (daily ed. Aug. 21, 1961) (statement of Rep. Cellar).

32. At least one defendant has argued that the Internet is not a “wire communication facility,” but the court did not agree. Lombardo, 639 F. Supp. 2d at 1289 (reasoning that the Wire Act “clearly contemplates any form of electronic transmission via wire”); accord United States v. Cohen, 260 F.3d 68, 76 (2d Cir. 2001) (“Cohen established two forms of wire facilities, internet and telephone.”).

33. Thompson v. MasterCard Int’l Inc. (In re MasterCard Int’l Inc.), 313 F.3d 257, 262 (5th Cir. 2002). Since the Eastern District of Louisiana opinion provides a full analysis and the Fifth Circuit opinion does not repeat that analysis, this Section cites to the district court opinion. Compare id. at 262 (“The district court concluded that the Wire Act concerns gambling on sporting events or contests . . . . We agree with the district court's statutory interpretation, its reading of the relevant case law, its summary of the relevant legislative history, and its conclusion.”) with In re MasterCard Int’l Inc., Internet Gambling Litig., 132 F. Supp. 2d 468 (E.D. La. 2001), aff’d, 313 F.3d 257 (5th Cir. 2002).


35. Id. at 472, 479.
The court used typical tools of statutory construction and concluded that the credit card companies had not violated the Wire Act because the Wire Act only applies to sporting events. The court reasoned that “a plain reading of the statutory language clearly requires that the object of the gambling be a sporting event or contest.” The court also pointed to a statement made by the chairman of the House Judiciary Committee, Emmanuel Cellar, while the bill was being considered: “[T]his particular bill involves the transmission of wagers or bets and layoffs on horse racing and other sporting events.” In addition, the court took note of past and then-pending legislation that would have amended the Wire Act to prohibit all internet gambling—if the Wire Act extends beyond sporting events, the court reasoned, such amendments would have been unnecessary.

3. The District of Utah Held That the Wire Act Applies to All Gambling

The District of Utah disagreed with the Fifth Circuit in a more recent case involving a criminal enterprise that provided transaction-processing services to illegal gambling websites. The defendants challenged the sufficiency of the Wire Act allegations by arguing that the act only reaches wire communications concerning betting or wagering on sporting events or contests and does not include other games of chance like those used by online casinos.

The court rejected the defendants’ argument and disagreed with the Fifth Circuit’s statutory construction. The court found “conspicuous” the lack of the qualifier “sporting event or contest” in the second and third prohibitions of § 1084(a). In addition, the court reasoned that if all three prohibitions reached only sporting events, then the third prohibition would be pure surplusage. Since both the first and the third prohibitions use the phrase “information assisting in the placing of bets or wagers,” the third prohibition would be unnecessary unless it had a wider scope than the first prohibition’s “sporting event or contest.” The court also noted legislative history in its

36. Id. at 481.
37. Id.
38. Id. at 480–81 (quoting 107 Cong. Rec. 16,533 (1961)).
39. Id. at 480.
40. United States v. Lombardo, 639 F. Supp. 2d 1271, 1275 (D. Utah 2007). As an aside, it is interesting to note that Utah is the only state in the union that prohibits all forms of brick-and-mortar gambling. See sources cited infra note 132.
41. Id. at 1277–78.
42. Id. at 1282.
43. Id. at 1281.
44. Id.
45. Id.
favor. The committee report from the House Judiciary Committee stated that the bill’s purpose was to assist states “in the enforcement of their laws pertaining to gambling, bookmaking, and like offenses.”\(^{46}\) According to the court, “like offenses” contemplated a wider scope.\(^{47}\)

The court also engaged in a whole act approach to statutory interpretation, but it found the evidence inconclusive because of inconsistent usage of “sporting event or contest.” The exceptions listed in § 1084(d) of the act “require[] a common carrier, upon notice, to cease from operating any facility that is or will be used ‘for the purpose of transmitting or receiving gambling information,’ unqualified by any relation to a sporting event or contest.”\(^{48}\) However, “the exceptions in § 1084(b) refer to betting on sporting events or contests alone.”\(^{49}\) Thus, the inconsistent uses of “sporting event or contest” in other parts of § 1084 fail to clarify the interpretation of § 1084(a).

4. **Analysis**

The District of Utah’s reading of the statute is not without its own problems, though. As a consequence of not carrying over “sporting event or contest” to the second and third prohibitions of § 1084(a), all three prohibitions would apply to sporting events, but only the second and third would apply to other games of chance. The result would be irrational. For non-sporting events, transmitting the bets themselves would be legal under the first prohibition of § 1084(a), but transmitting information to assist those bets would be illegal under the second and third prohibitions. It seems unreasonable to impute this intent to Congress. In addition, the resulting structure of § 1084(a) would become highly suspect. Normally Congress starts with a broad or general term and then carves out specifics; under the District of Utah’s reading, Congress has begun with a specific carve out and then followed it with two broader, more general prohibitions.

Furthermore, the legislative history is ambivalent, even more so than either court let on. The same committee report cited by the District of Utah lists the “immediate receipt of information as to results of a horserace” and the dependency of “bookmakers . . . upon telephone service for the placing of


\(^{47}\). *Id.*

\(^{48}\). *Id.* at 1281.

\(^{49}\). *Id.*
bets and for layoff betting on all *sporting events*” as examples of the evils the bill was to address.50

On the other hand, the committee report from the Senate Judiciary Committee, which drafted the language in question, implies a wider scope. It states that the bill’s purpose was “to amend ‘Chapter 50: Gambling,’ of title 18 . . . with respect to the transmission of bets, wagers, and related information to assist the several States in the enforcement of their laws pertaining to gambling.”51 This language does not limit the bill’s purpose to betting on sporting events.

Other courts have noted that this statute was part of a larger crime bill that “does not stand alone, but appears as part of an independent federal policy aimed at those who would, in furtherance of *any* gambling activity, employ any means within direct federal control.”52 Still, the only type of gambling activity for which crime syndicates were using wire communication facilities at that time was bookmaking.53

Overall, the Fifth Circuit’s construction is more convincing. Given the ambiguity at all levels of statutory construction—the text of § 1084(a), the text of the whole act, the legislative history, and the legislative intent—two facts should serve as tiebreakers. First, the District of Utah’s reading produces an absurd result. Second, the subsequent legislative history, although not normally a strong indicator of legislative intent, weighs in favor of the Fifth Circuit’s interpretation. Specifically, in the early 2000s Congress introduced a number of bills that would have broadened the Wire Act to encompass non-sports gambling.54 In addition, the Amendment to the Interstate Horseracing Act 55 (“IHA amendment”) contemplates legalized internet gambling on horse racing.56 Similarly, the Unlawful Internet Gambling Act of 200657 (UIGEA), by only outlawing “unlawful” internet

52. Martin v. United States, 389 F.2d 895, 898 (5th Cir. 1968) (dicta) (emphasis added).
53. The only examples given on the record concern betting on sports and horseracing. See, e.g., sources cited supra notes 38 and 50 and accompanying text.
54. See *In re MasterCard Int’l. Inc.*, Internet Gambling Litig., 132 F. Supp. 2d 468, 480 (E.D. La. 2001), aff’d, 313 F.3d 257 (5th Cir. 2002).
56. See GAO REPORT, supra note 26, at 42–44; EC REPORT, supra note 5, at 25–26; see also infra Section I.B.
gambling and by providing a “safe harbor” for certain types of transactions, contemplates that some forms of internet gambling are legal.\(^\text{58}\)

Furthermore, even if the Wire Act originally prohibited all forms of internet gambling, the IHA amendment can be seen as modifying that prohibition—Congress enacted the amendment after passing the Wire Act, and so where their provisions conflict, those of the IHA amendment should trump.\(^\text{59}\) The UIGEA’s safe harbor provisions should then be interpreted as a congressional affirmation of this legislative modification.\(^\text{60}\)

5. Recent Enforcement of the Wire Act

The Department of Justice has maintained that the Wire Act applies to every form of gambling that involves wire transmissions in interstate or foreign commerce, not just gambling on sporting events.\(^\text{61}\) The Department’s most recent conviction, though, did concern an internet sports-gambling site, BetOnSports.com.\(^\text{62}\) Founder Gary Kaplan had based his business in Aruba, Antigua, and Costa Rica in the mid-90s.\(^\text{63}\) The company accepted bets via telephone and Internet from wagering accounts registered to bettors in the United States.\(^\text{64}\) In 2003, the company had almost one million registered customers and accepted over ten million sports bets in a cumulative gross amount in excess of $1 billion.\(^\text{65}\) By 2004, Kaplan had taken the company public on the London Alternative Investment Market.\(^\text{66}\) Yet, in taking sports bets over the Internet, the company’s operations violated U.S. law. Thus, in November 2009, a U.S. court sentenced Kaplan to fifty-one months in


\(^{59}\) See Credit Suisse Securities (USA) LLC v. Billing, 551 U.S. 264 (2007); see also EC REPORT, supra note 5, at 25, 52 (arguing that the language of the IHA amendment, the actions of the horse racing industry, and the lack of enforcement actions by the Department of Justice imply that internet gambling on horse racing is legal).

\(^{60}\) See EC REPORT, supra note 5, at 25 (“The [UIGEA] contained language that recognizes the ability of the horse racing industry to offer account wagering under the IHA of 1978 as amended . . . .”) (quoting Press Release, National Thoroughbred Racing Association, Congress Affirms Horse Racing’s Position in Internet Gaming; Legislation Passed by Both Houses Early This Morning, Sep. 30, 2006).

\(^{61}\) See Hichar, supra note 58, at 107–08, 111–12; EC REPORT, supra note 5, at 24.

\(^{62}\) DOJ Press Release, supra note 9.

\(^{64}\) See id.

\(^{65}\) Id.

\(^{66}\) Id. Going public personally netted Kaplan over $100 million. Id.
prison after he pled guilty to charges of racketeering and violating the Wire Act.67

B. THE INTERSTATE HORSE RACING ACT

In many ways, horse racing stands apart from other corners of the gaming industry.68 Some states, for example, have separate regulatory bodies just for horse racing.69 On a national level, horse racing has its own lobbying group distinct from the American Gaming Association.70 And at a statutory level, internet gambling on horse racing is the only class of internet gambling that enjoys the privilege of being (sort of) recognized as legal under federal law.71

Off-track betting (OTB), in which a player can bet on a horse race from a remote location and view the race via broadcast, began before federal legislation in the field.72 In 1978, however, Congress passed the Interstate Horseracing Act (IHA), which prohibits all OTB except that which complies with its provisions.73 Mainly, the IHA requires that OTB corporations obtain the consent of state racing associations and racing commissions before accepting bets.74

Even before the IHA was passed, a gambler could walk into an OTB facility in New York, place his bet on a Kentucky horse race, and collect his

67. Id.
68. Other subsets of gambling have also been given individual treatment by the law. For example, Congress has passed laws targeting sports gambling and lotteries. See generally Rodefer, supra note 16, at 396–411.
69. For example, the New Jersey Racing Commission is a division with rulemaking powers within the Department of Law and Public Safety, N.J. STAT. ANN. § 52:17B-95 (2009), separate from the Division of Gaming Enforcement, N.J. STAT. ANN. § 5:12-55 (2009), which is housed in the same department. Confusingly, there is also an independent agency called the Casino Control Commission, N.J. STAT. ANN. § 5:12-50 (2009).
70. The American Horse Council calls itself the “association that represents all segments of our nation’s diverse horse industry.” American Horse Council Homepage, http://www.horsecouncil.org (last visited Jan. 31, 2010); see also The 25th Anniversary of the Passage of the Interstate Horseracing Act of 1978, HORESMEN’S J. (Winter 2003), available at http://www.hbpa.org/HorsemensJournalDisplay.asp?section=3&key1=2391 (noting that, when the horse industry lobby showed up in Washington, D.C., the “Las Vegas and casino interests sure didn’t want to see us there”) (internal quotes omitted); National Thoroughbred Racing Association, www.ntra.com (last visited Jan. 31, 2010).
74. 15 U.S.C. § 3004; see also GAO REPORT, supra note 26, at 42.
winnings from the New York OTB facility. In this situation, only the race information crosses state lines: which horses are racing, the odds, and which horses have won. Although the Wire Act generally prohibits such transmissions across state lines, it provides an exception that would have applied.\textsuperscript{75} However, were the wager to cross state lines, the exception would not apply, and the wager would have violated the Wire Act.\textsuperscript{76}

An open question, which became more relevant after the birth of the Internet, was whether the IHA had widened the Wire Act exception to include, at least in the context of horse racing, the interstate wagers themselves. In 1999, the Department of Justice clarified in a letter to Congress that, under its interpretation, the IHA did not sanction internet OTB if the wager crossed state lines—such wagers would still violate the Wire Act.\textsuperscript{77}

Then, hidden amidst a mammoth appropriations bill in 2000,\textsuperscript{78} Congress amended the definition of “off-track wager” in the IHA so that the amended provision now reads,

“[I]nterstate off-track wager” means a legal wager placed or accepted in one State with respect to the outcome of a horserace taking place in another State and includes pari-mutuel\textsuperscript{79} horserace wagers, where lawful in each State involved, placed or transmitted by an individual in one State via telephone or other electronic media and accepted by an off-track betting system in the same or another State, as well as the combination of any pari-mutuel wagering pools.\textsuperscript{80}

\begin{itemize}
\item \textsuperscript{75} The exception is for “the transmission of information assisting in the placing of bets or wagers . . . from a State . . . where betting on that sporting event or contest is legal into a State . . . in which such betting is legal.” 18 U.S.C. § 1084(b) (2006); see also United States v. Bala, 489 F.3d 334, 341–42 (8th Cir. 2007) (interpreting the exception).
\item \textsuperscript{76} Thus, if the gambler were to have phoned the Kentucky track from New York and placed a bet with the Kentucky track on the race, a violation of the Wire Act would have occurred. See supra Section I.A.
\item \textsuperscript{77} Letter from the Department of Justice to Senator Leahy regarding S. 692, The Internet Gambling Prohibition Act of 1999 (June 9, 1999), available at http://www.usdoj.gov/criminal/cybercrime/s692ltr.htm (“The [IHA] does not allow for [the legal transmission and receipt of interstate horseracing bets or wagers], and if a pari-mutuel [horse racing] wagering business currently transmits or receives interstate bets or wagers . . . it is violating federal gambling laws.”).
\item \textsuperscript{79} Gambling on horse racing falls under the heading of “pari-mutuel wagering,” which describes the method by which the winners are paid a portion from the pooled bets.
\item \textsuperscript{80} 15 U.S.C. § 3002(3) (italics indicate language added by the amendment).
\end{itemize}
By its plain language, therefore, the amendment legalized telephone and internet gambling on horse racing.\textsuperscript{81}

The Executive Branch, however, has maintained that the amendment did not legalize internet gambling on horse racing. President Clinton issued a signing statement insisting that the Wire Act still prohibits it,\textsuperscript{82} and the Department of Justice under President George W. Bush held the same position.\textsuperscript{83} However, it is difficult to defend this assertion. The plain language of the IHA amendment disputes it. The IHA amendment came after the Wire Act; later-enacted statutes tend to trump earlier ones where they clearly contradict each other.\textsuperscript{84} Moreover, the IHA amendment is specific to horse racing, whereas the Wire Act applies generally to all sporting events; specific statutes tend to trump general ones.\textsuperscript{85} Finally, the legislative history of the IHA amendment supports the proposition that the legislative purpose of the amendment was to legalize internet pari-mutuel (horse race) wagering.\textsuperscript{86} Although no federal court has addressed this proposition, many states have authorized internet pari-mutuel wagering for their residents,\textsuperscript{87} and the Department of Justice has never prosecuted these internet sites.\textsuperscript{88}

In summary, at the turn of the Twenty-first Century, the law of internet gambling was still murky. The Wire Act may have prohibited all internet betting (District of Utah interpretation), may have prohibited only internet sports gambling (including gambling on horse racing), or may have prohibited only internet sports gambling that was not sanctioned by the amended IHA. Meanwhile, both the number of internet gambling sites and the number of wagers originating in the United States were increasing.\textsuperscript{89} It was into this environment that the first federal law enacted specifically to address internet gambling was born. Unfortunately, it did nothing to improve clarity.

\textsuperscript{81} See supra note 59.
\textsuperscript{82} See Rodefer, supra note 16, at 410–11.
\textsuperscript{83} EC REPORT, supra note 5, at 24.
\textsuperscript{84} Credit Suisse Securities (USA) LLC v. Billing, 551 U.S. 264 (2007).
\textsuperscript{86} See Rodefer, supra note 16, at 410–11.
\textsuperscript{88} EC REPORT, supra note 5, at 52.
\textsuperscript{89} Id. at 19–20.
C. The Unlawful Internet Gambling Enforcement Act of 2006

Concerned after 9/11 that money from internet gambling sites was funding terrorist activities, Congress began to hold hearings in 2001 about how to reduce American participation in internet gambling. The Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) was the result.

The UIGEA is the first and only federal law to specifically address internet gambling. It provides new enforcement tools and imposes reporting and due diligence requirements on financial institutions to prevent unlawful internet gambling transactions from occurring. However, the UIGEA does absolutely nothing to clarify exactly what type of internet gambling is unlawful.

The primary purpose of the statute was to “give U.S. law enforcement new, more effective tools for combating offshore Internet gambling sites that illegally extend their services to U.S. residents via the Internet.” Unlike the Wire Act, the UIGEA does not purport to define the type of wagering it prohibits; instead, it looks to existing federal and state law in its definition of “unlawful Internet gambling”:

“[U]nlawful Internet gambling” means to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made.

Section 5364 contains the most relevant substantive provision. In it, the UIGEA directs the Secretary of the Treasury and the Board of Governors of the Federal Reserve System to prescribe regulations “requiring each designated payment system . . . to identify and block . . . restricted transactions.” A designated payment system is defined as “any system utilized by a financial transaction provider that the Secretary [of Treasury] and the Board of Governors of the Federal Reserve System . . . jointly determine . . . could be utilized in connection with, or to facilitate, any restricted transactions.”

95. Id. § 5364(a).
A restricted transaction, in turn, is defined as the knowing receipt of funds in connection with unlawful internet gambling by a person engaged in the business of betting or wagering.97

In other words, the UIGEA calls for regulations that mandate financial transaction providers to implement measures—with respect to certain payment systems that could be used in connection with Internet gambling—to identify such prohibited transactions and block them. The UIGEA does not target Joe the Gambler; instead, it targets the flow of funds to internet gambling operators.

The UIGEA is young and has yet to be enforced. Still, it has already withstood its first constitutional challenge.98 And even before regulations were promulgated under the UIGEA, the very signing of the UIGEA had a chilling effect on European suppliers of internet gambling: the largest competitors in the internet gaming market stopped accepting new U.S.-based accounts.99 This voluntary withdrawal from internet gaming companies may be the UIGEA’s only long-lasting accomplishment. As explained in the next Section, the regulations promulgated under the UIGEA added no clarity and gave it little bite.

D. Regulations Promulgated Under the UIGEA

The UIGEA gave joint rulemaking responsibility to the Department of the Treasury and the Federal Reserve System.100 The proposed rules identified which payment systems were at risk of being used in unlawful internet gambling (“designated” payment systems) and subjected all participants in those payment systems to the regulations; however, they also exempted certain groups of participants from regulation.101 The five

96. Id. § 5362(3) (emphasis added).
97. Id. §§ 5362(7), 5363. Note that this language tracks that of the Wire Act. See supra Section I.A.1 and note 31.
98. Interactive Media Ent. & Gaming Ass'n v. Gonzales, No. 07-2625, 2008 WL 5586713 (D.N.J. Mar. 4, 2008), aff’d sub nom. Interactive Media Ent. & Gaming Ass'n v. Att’y Gen., 580 F.3d 113 (3d Cir. 2009) (upholding constitutionality against First Amendment expressive association, commercial speech, and overbreadth arguments, as well as void-for-vagueness and privacy arguments).
99. See PBS Transcript, supra note 12; EC REPORT, supra note 5, at 79; ROBERT J. WILLIAMS & ROBERT T. WOOD, INTERNET GAMBLING: A COMPREHENSIVE REVIEW AND SYNTHESIS OF THE LITERATURE 10 (2007) (“approximately 25% of online gambling sites stopped taking bets from U.S. citizens immediately after the law took effect.”).
100. 31 U.S.C. §§ 5362(8), 5364(a).
designated payment systems were automated clearing house (ACH) systems, card systems, check collection systems, money transmitting businesses, and wire transfer systems. The regulations gave exemptions to all participants in ACH, check collection, and wire transfer systems except for one group of participants: those who possessed a customer relationship with the putative internet gambling business or who had direct contact with foreign payment service providers in cross-border transactions. The rationale for the exemptions was that the non-exempted participants would bear the entire burden of regulation for each of those three payment systems. The proposed rules called for due diligence in screening new customers, monitoring of patterns in card systems and money transmitting systems, and the possible development and use of more specialized merchant category and transaction codes for card systems.

The agencies received comments from 225 members of the public, including customers, depository institutions, gambling-related entities, public advocacy groups, payment system operators, federal agencies, and members of Congress. The Interactive Media Entertainment & Gaming Association (iMEGA), for example, worried about the “chilling effect on innovation surrounding the Internet” and the “unprecedented burdens on the intricate system of financial transaction.” Whereas the financial processing systems in the past were content neutral, iMEGA worried that the “natural” reaction for a financial intermediary would be to deem every transaction from an internet gaming operator to be an unlawful one, even though the UIGEA contemplates that some of those transactions are not now (or will not be in the future) barred by law.

Two members of the House Subcommittee on Commercial and Administrative Law were “deeply concerned” that the regulations did not provide any definition of “unlawful Internet gambling.” The purpose of

102. Id.
103. Id. at 56, 685–86.
104. Id.
105. Id. at 56, 688–89.
108. Id.
rulemaking under the APA, they reasoned, is to let the regulated community
know exactly with what they must comply under the statute.\textsuperscript{110} As such, the
House Subcommittee members proposed that the regulations examine on a
state-by-state basis what sorts of transactions should be blocked.\textsuperscript{111}

Bank of America (BOA) also wanted a definition of “unlawful Internet
gambling” and, ideally, a government-produced black list of companies to
block.\textsuperscript{112} Giving substance to iMEGA’s concern, BOA opined that otherwise
they would be forced to block legitimate transactions and engage in costly
disputes with their customers.\textsuperscript{113} Many depository institutions expressed
similar concerns that the proposed regulation would be unduly burdensome
and could adversely affect the competitiveness of the U.S. payments
system.\textsuperscript{114}

The final rules took effect January 19, 2009, but the rules did not require
the regulated entities to comply until December 1, 2009.\textsuperscript{115} Despite the
request from members of Congress, the final rules still lacked a definition of
“unlawful internet gambling” because the agencies determined that “a single,
regulatory definition . . . would not be practical.”\textsuperscript{116} In addition, the final rules
did not provide for a black list, which the agencies determined would be
neither efficient nor effective.\textsuperscript{117} The agencies seemed particularly unwilling
to “formally interpret” the underlying state and federal laws in order to
determine what types of internet gambling were actually unlawful.\textsuperscript{118}

The focus of the final rules is on a “flexible, risk-based due diligence”
process that payment systems may use to gain compliance.\textsuperscript{119} The rules
mandate “[a]ll non-exempt participants in designated payment systems shall
establish and implement written policies and procedures reasonably designed
to identify and block or otherwise prevent or prohibit restricted
transactions.”\textsuperscript{120}

\textsuperscript{110} Id. at 2.
\textsuperscript{111} Id.
\textsuperscript{112} Comment from Bank of America on the Proposed Rules Implementing Prohibition
on Funding of Unlawful Internet Gambling, at 2 (Dec. 12, 2007), available at
\textsuperscript{113} Id. at 2–3.
\textsuperscript{114} Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. 69,382,
\textsuperscript{115} Id. at 69,382.
\textsuperscript{116} See id. at 69,384.
\textsuperscript{117} Id.
\textsuperscript{118} See id.
\textsuperscript{119} Id.
\textsuperscript{120} 31 C.F.R. § 132.5(a) (2009).
The rules give a list of “non-exclusive examples” of how to comply with this mandate. One method for complying is to perform “due diligence” when establishing relationships with commercial customers.121 In essence, if a participant determines that there is more than a minimal risk that a commercial customer is engaged in an internet gambling business (but does not know for sure), the participant can satisfy its legal obligations by requiring the customer to declare in writing that it is not engaged in an internet gambling business.122 If the commercial customer is engaged in an internet gambling business, the participant must require that the customer present evidence of legal authority to engage in such business and a third-party certification that the customer has systems in place reasonably designed to ensure that it will remain within the law.123 Finally, the participant must notify all commercial customers that restricted transactions are prohibited from being processed through the account.124

The rules provide another option for card systems: they may use the “[i]mplementation of a code system, such as transaction codes and merchant/business category codes, that are required to accompany the authorization request for a transaction.”125

Some commentators think that the regulations themselves will not change any behavior in the financial services industry.126 The card systems already use a coding system, and the agencies noted that “[s]ome payment system operators have indicated that, for business reasons, they have decided to avoid processing any gambling transactions, even if lawful, because, among other things, they believe that these transactions are not sufficiently profitable to warrant the higher risk they believe these transactions pose.”127 Furthermore, banks already conduct due diligence in opening new commercial accounts. All the regulations add is extra paperwork, which comes with a cost—an estimated $88.5 billion in increased record-keeping costs imposed on the financial services industry.128 This cost, coupled with concern over current economic conditions, prompted members of Congress

121. Id. § 132.6(b).
122. See id. § 132.6(b).
123. See id.
124. See id.
125. Id. § 132.6(d).
to request that the agencies postpone the December 1 deadline for one
year;\textsuperscript{129} on November 27, the agencies announced that they would postpone
the deadline for six months to June 1, 2010.\textsuperscript{130}

So, the regulations promulgated under the UIGEA impose new record-
keeping requirements on the financial services industry but, again, \textit{do not define unlawful internet gambling}. Thus, they do nothing to clarify the murky situation
created by the Wire Act and the IHA.

The UIGEA contemplates that some types of internet gambling are not
prohibited by federal law. If some gambling is not prohibited by federal law,
then logically such gambling would be legal as long as it was not prohibited
by state law. However, the structure of most (if not all) states’ gambling laws
requires an affirmative legalization for any type of gambling. Part II explores
the topic of state laws.

II. STATE LAW

In terms of brick-and-mortar gambling, the District of Columbia and
forty-seven states allow lotteries, commercial casinos, or pari-mutuel gaming
such as horse racing.\textsuperscript{131} Of the remaining three states, Alaska allows only
charitable gaming and social gambling (although there are Indian casinos
within its borders), Hawaii only allows social gambling, and Utah does not
allow gambling of any sort.\textsuperscript{132} Despite the general acceptance of gambling
across the United States, each state so heavily regulates gaming that
“[v]irtually all States prohibit the operation of gambling businesses not
expressly permitted by their respective constitutions or special legislation.”\textsuperscript{133}

Although a number of states do explicitly allow internet horserace
gambling,\textsuperscript{134} only Nevada has attempted to legalize all internet gambling.\textsuperscript{135} In
2001, the Nevada legislature passed a law that would allow for “interactive

\begin{thebibliography}{99}
\bibitem{129} Letter from Rep. Barney Frank and Rep. Peter King to Timothy Geithner and Ben
_dem/uigea_letter_copy.pdf.
\bibitem{130} Associated Press, \textit{Treasury, Fed Delay Ban on Internet Gambling}, WASH. POST, Nov. 28,
2009, at A15; Prohibition of Funding of Unlawful Internet Gambling, 74 Fed. Reg. 62,687
(Dec. 1, 2009).
\bibitem{131} AMERICAN GAMING ASSOCIATION, \textit{FACTSHEET: STATES WITH GAMING},
http://www.americangaming.org/Industry/factsheets/general_info_detail.cfv?id=15 (last
visited Mar. 1, 2010).
\bibitem{132} See \textit{id.; CHUCK HUMPHREY, STATE GAMBLING LAW SUMMARY FOR ALL US
\bibitem{133} H. Comm. Fin. Serv. UIGEA Rpt., supra note 90, at 11.
\bibitem{134} See \textit{supra} Section I.B.
\bibitem{135} INTERNET GAMBLING FACT SHEET, supra note 6.
\end{thebibliography}
gaming,” including internet gaming, if it could determine that such gaming did not violate federal law. However, the Department of Justice advised Nevada that it considered all interstate internet gambling, including casino-style gaming, illegal under the Wire Act. Now, instead of allowing internet gambling, Nevada has become one of the few states to explicitly prohibit it.

Given the depressed condition of most state economies, a number of state legislatures are looking to internet gambling as a possible source of tax revenues. These lawmakers envision websites only accessible to internet connections located in the state. Such legislation would not run afoul of the Wire Act, which only governs interstate and foreign wire transmissions, nor would it fall within the definition of “unlawful Internet gambling” under the UIGEA because of a safe-harbor provision that carves out intrastate internet gaming, as long as minimum regulatory requirements are met. A more difficult question is whether they would run afoul of the dormant Commerce Clause.

136. Id.
137. Id. For a complete discussion of the Wire Act, see supra Section I.A.
138. Id.
140. See, e.g., Clayworth, supra note 139 (“Technology has already been developed that can block out-of-state Web users from accessing pre-paid accounts and violating in-state gambling laws.”).
141. 18 U.S.C. § 1084(a) (2006) (specifying as a threshold element that the transmission be “in interstate or foreign commerce”).
142. 31 U.S.C. §§ 5362(10)(B)–(C) (2006); see also Hichar, supra note 58, at 111–14 (arguing that the Wire Act should not prohibit intrastate internet gambling even if the electronic transmission passes through another state).
143. The Commerce Clause vests in the federal government the power to regulate interstate and foreign commerce. U.S. CONST. art. I, § 8, cl. 3. When Congress exercises this
A number of states have moved in the opposite direction. Eight states have passed laws that expressly ban internet gambling, and the attorneys general of five additional states have issued opinions that internet gambling violates state law. Washington’s law is particularly harsh: internet gambling is a class C felony, the same as third-degree rape.

Two states are currently engaged in high-profile court battles over their internet gambling laws and enforcement actions. In Kentucky, the state seized 141 internet domain names after an ex parte proceeding on the basis that the domain names constituted “gambling devices” subject to the trial power, preemption doctrine applies; however, when Congress is silent, its Commerce Clause power lies “dormant.” See Jesse H. Choper et al., Constitutional Law: Cases—Comments—Questions 221–22 (10th ed. 2006). This dormant Commerce Clause power, however, still prevents states from unduly interfering with interstate and foreign commerce. Id.

Two important questions ripe for analysis, but beyond the scope of this Note, are whether the dormant Commerce Clause prohibits states from directly regulating internet gambling because of the inevitable effects on interstate commerce and, what is more, whether it prohibits them from establishing in-state internet gambling that discriminates against out-of-state providers. See generally Am. Libraries Ass’n v. Pataki, 969 F. Supp. 160 (S.D.N.Y. 1997) (a seminal case on state regulation of the Internet); Pike v. Bruce Church, 397 U.S. 137 (1970) (a seminal case establishing the Pike balancing test used to analyze most dormant Commerce Clause issues); Brian Carver, State Efforts to Regulate the Internet, Cyberlaw Cases (Aug. 31, 2009), http://cyberlawcases.com/?p=58 (identifying judicial trends in state internet regulation cases); Jack L. Goldsmith & Alan O. Sykes, The Internet and the Dormant Commerce Clause, 110 Yale L.J. 785 (2001) (analyzing doctrine through a law and economics lens, attacking the decision in Am. Libraries, 969 F. Supp. 160, and arguing that states should be allowed to regulate the Internet in some circumstances); Michael A. Lawrence, Toward a More Coherent Dormant Commerce Clause: A Proposed Unitary Framework, 21 Harv. J.L. & Pub. Pol’y 395 (1998) (proposing a single framework for the seemingly disparate aspects of the doctrine).


145. Internet Gambling Fact Sheet, supra note 6.

court’s in rem jurisdiction. The internet sites had no contact with Kentucky other than use by Kentucky residents—the court made no findings that the domain names had been registered with in-state registrars, that the companies running the sites were located in Kentucky, or that the company’s servers were located in Kentucky. In a 2-1 decision, the Kentucky appellate court held that since a domain name did not fall within the state statute’s definition of a “gambling device,” the trial court did not have the necessary jurisdiction to seize the domain names. The dissenting judge reasoned that the computers, “linked by the internet and compatible software,” formed one computer system, any part of which could constitute a gambling device.

The Kentucky Supreme Court heard oral arguments in October of 2009. If the Kentucky Supreme Court allows the seizure under the trial court’s theory, then “Kentucky would be able to seize any domain name, from anywhere in the world, that pointed to a website that Kentucky deemed to violate a local law.” On the other hand, the Commonwealth’s briefs have expressed the sense of frustration that arises from the difficulty of policing the Internet:

Petitioners’ argument, distilled to its essence, is that the illegal gambling operations can continue to purposefully target Kentucky residents from offshore, systematically violate Kentucky law and reap profits from illegal gambling in Kentucky—while the courts of the Commonwealth are powerless to act.

In Washington, after the legislature explicitly banned internet gambling by amending an old gambling statute, an amateur poker enthusiast challenged the ban in a declaratory action. Plaintiff Rousso claimed that the law

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149. Wingate, 2009 WL 142995, at *3.
150. Id. at *6 (Caperton, J., dissenting).
violated the dormant Commerce Clause, which prohibits states from impermissibly interfering with interstate commerce.\textsuperscript{154}

The state argued that a dormant Commerce Clause analysis was inapposite—instead, they argued, the court should apply a preemption analysis because there was already a federal law regulating internet gambling, the UIGEA.\textsuperscript{155} The court, however, rejected this argument because the UIGEA did not contain the requisite “unambiguous statement” necessary for the court to consider the federal government’s dormant powers to have been “exercised.”\textsuperscript{156} Thus, the court undertook a dormant Commerce Clause analysis and ultimately upheld the validity of the statute.\textsuperscript{157} In doing so, the court rejected the notion, first posited in a federal district court case and based on a reading of dormant Commerce Clause doctrine,\textsuperscript{158} that any state regulation of the Internet was per se unconstitutional.\textsuperscript{159} Instead, the court undertook a balancing test and determined that the burdens the state regulation imposed on interstate commerce were not “clearly excessive” in relation to the state’s legitimate interest in regulating the “social ills” of gambling and the difficulty of doing so without directly regulating the Internet.\textsuperscript{160} Rousso appealed, and the case is on the Washington Supreme Court’s docket for Spring 2010.\textsuperscript{161}

\section*{III. CONCLUSION}

The Internet has added a new layer of complexity to gambling in the United States, and the patchwork of federal statutes, agency regulations, and state laws has produced a legal framework that is frustratingly ambiguous. Nevada attempted to legalize internet gambling only to be stymied by the Department of Justice, whose reading of the law was most likely incorrect. Some states are considering legalization of in-state internet gambling, the constitutionality of which has yet to be tested. Others, citing a desire to protect the morals and welfare of their citizens, have passed laws explicitly prohibiting internet gambling.

Congress’s only attempt at a targeted act, the UIGEA, added new enforcement mechanisms to old laws like the Wire Act but gave no clarity to

\begin{thebibliography}{9}
\bibitem{154} Id.; see also supra note 143.
\bibitem{155} Id. at 246.
\bibitem{156} Id. at 248–49.
\bibitem{157} Id.
\bibitem{159} See Rousso, 204 P.3d at 253 (citing Goldsmith & Sykes, supra note 143).
\bibitem{160} Id. at 250, 253.
\bibitem{161} Rousso v. State, 217 P.3d 337 (Wash. 2009) (granting petition for review).
\end{thebibliography}
federal gambling law as applied to the Internet. The administrative agencies to whom Congress delegated the administration of the statute—the very bodies charged with filling in the statute’s details—refused to indicate when internet gambling is “unlawful” and rejected the financial institutions’ pleas for a government-created black list of internet gambling companies. Thus, despite the added cost that will accompany the new paperwork requirements, the administrative regulations have little hope of actually curbing prohibited gambling activity.

Meanwhile, in part because of scanty and conflicting case law, the scope of the old Wire Act is still ambiguous. Although its interaction with the IHA remains untested and unclear, U.S.-based websites that process bets on horse racing continue to operate in apparent legality and now comprise a majority of the horse racing industry’s revenues.162

Interested parties on both sides of the internet gambling issue have clamored for reform. Those who would have the federal government ban all internet gambling are concerned about funding terrorism and crime syndicates, sacrificing minors and compulsive gamblers to an addictive vice that can be indulged in one’s pajamas, and destroying families with unmanageable gambling debt.163 Those on the other side claim that even an outright federal prohibition would not stop people from gambling online.164 Pointing to Europe’s legalized internet gambling, they insist that current technology can adequately protect the most vulnerable and at the same time give consumers the legal protections that can only be provided in a regulated environment.165

When the administrative agencies suspended the implementation of the UIGEA regulations, they cited a desire to give recent congressional activity a chance to develop.166 Congress, though, mired in the healthcare overhaul and

162. See EC REPORT, supra note 5, at 33.
164. Safe and Secure Internet Gambling Initiative, Take Action!, http://www.safeandsecureig.org/splash/IGact09.html (last visited Mar. 2, 2010). This organization compares the prohibition on internet gambling to the Prohibition on alcohol. Id.
165. Id.
the financial system reforms, already has a full plate. But as more states let their residents “bet the ponies” online, and as more entrepreneurial (or perhaps desperate) states propose bills to establish in-state casino-style internet gambling, the political mood could become more amenable to nationwide legalization. In the meantime, internet gaming proponents, led by the poker enthusiasts, have made their intentions quite clear: they are all in.167

Judging from the recent activities of local prosecutors, one might think that a crime wave of child pornography offenses perpetuated by middle- and high-schoolers is flooding the nation. In actuality, the flurry of media coverage has shed light on a phenomenon popularly known as sexting: the digital exchange of sexually explicit images between teenagers using text messaging services on camera-equipped cell phones. Local prosecutors across the country are responding to the increase in sexting incidents by charging the teenage participants with child pornography felonies, which may require them to register as sex offenders. Recent polling data suggests that sexting is pervasive among today’s teenagers. Further evidence of the

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2. This Note uses the term “sexting” to describe the exchange of suggestive text messages between juveniles, although there is some popular usage of “sex” and “sexting” to describe exchanges between adults. E.g., Mike Taibbi, Seniors Spice Things Up With ‘Sexting’, NBC NEWS CHANNEL, Nov. 27, 2009, http://www.woai.com/news/local/story/Seniors-spice-things-up-with-sexting/S5qx8-cv1Uq6nYmxXgiKmQ.cspx (describing a trend among older adults of exchanging sexually suggestive text messages).

3. In a recent Ohio case, for example, a fifteen-year-old foster girl plead guilty to charges of production of child pornography after she was found to have taken nude photos of herself with a cell phone camera and distributed them to classmates. Russ Zimmer, Hottinger: Law Didn’t Anticipate Cell Phone Photo Case, ADVOCATE (NEWARK, OH), Oct. 8, 2008, at A1. For a detailed explanation of a sexting investigation and the felony penalties pursued by some prosecutors, see generally Robert D. Richards & Clay Calvert, When Sex and Cell Phones Collide: Inside the Prosecution of a Teen Sexting Case, 32 HASTINGS COMM. & ENT. L. J. 1 (2009).

4. Depending on the study, somewhere between 4% and 20% of teenagers report that they have sent sexually suggestive text messages to another teen. According to a 2008 report by The National Campaign to Prevent Teen and Unplanned Pregnancy (NCPTUP), 20% of teenagers ages 13–19 have “electronically sent, or posted online, nude or semi-nude pictures or video of themselves.” NAT’L CAMPAIGN TO PREVENT TEEN AND UNPLANNED PREGNANCY, SEX AND TECH: RESULTS FROM A SURVEY OF TEENS AND YOUNG ADULTS I (2008), http://www.thenationalcampaign.org/sextech/PDF/SexTech_Summary.pdf; see infra Part I (discussing some of the limitations in the methodology underlying this poll). A narrower 2009 survey by the Pew Internet & American Life Project focused exclusively on cell phone transmission of images, finding that 4% of teenagers ages 12–17 who own cell
widespread nature of this phenomenon: search engine queries of “sexting” are at an all-time high,5 and the New Oxford American Dictionary considered “sexting” among its nominees for new words of the year.6

A stark disagreement over the appropriate societal response underlies the popularity of sexting, which has outpaced both the law and technological limitations of prior generations. In at least ten states, authorities have publicly contemplated, and in some instances followed through with, charging the teenage participants with child pornography production, possession, and distribution.7 In the first appellate decision to explicitly address “sexting among teenagers” in September 2009, the Iowa Supreme Court affirmed that there was sufficient evidence to convict an eighteen-year-old boy of knowingly disseminating obscene material to a minor.8 The boy e-mailed a sexually explicit photo to a fourteen-year-old friend, accompanied by the message of “I love you.”9 While youth educators and child psychologists have pushed for a more moderated response to behavior described as “high-tech flirting”10—teenage acts fueled by hormones and a lack of judgment—some experts in the Internet safety community support the hard-line approach to teenage sexting adopted by law enforcement authorities and the judicial system.11

9. Id.
11. See, e.g., id. (noting that the National Center for Missing and Exploited Children (NCMEC), the non-profit/quasi-government organization that serves as the clearinghouse for reports of child sexual abuse on the Internet, has publicly stated that criminal charges are warranted in some sexting cases).
Although sexting has been described as the modern equivalent of “streaking,” new technologies dramatically enhance the consequences of this behavior. Camera-equipped phones allow permanent recording of images and instant dissemination to large numbers of recipients, transforming fleeting youthful indiscretions into lasting mistakes. Courts have upheld juvenile child pornography convictions for the production and distribution of self-produced pornography in cases of sexting-like activity, including requirements for sex offender registration. The possibility that digital images privately shared between teens will be disseminated to a broader online audience may profoundly affect the participants, causing humiliation at school, pressure at home, and the loss of employment or college prospects. In rarer instances, sexting can be used as a tool to intimidate and harass, and has led to teen suicide in two reported cases in 2009.

The term sexting often describes a broad range of behaviors that differ radically in terms of the actors, motivations, and tactics involved. In this Note, the term “sexting” refers to the self-production and distribution by cell phone of sexually explicit images in the course of consensual, voluntary activity by teenagers. This definition describes a phenomenon differing from the use of texting by sexual predators to exploit youth, a set of issues that is not addressed here, and the use of sexting to cyberbully. This Note

13. This includes the use of e-mail to exchange sexually explicit, self-produced photographs or teens’ recording of their own consensual sexual activity using video cameras. Such activities, although not sexting under the strict definition focused on the use of text messaging services on cell phones, still fall under the umbrella of “sexting-like activities.” See infra Part II.
14. See infra Section II.A.
15. See Libby Quaid, ‘Sexting’ is More Common Than You Might Think, SEATTLE TIMES, Dec. 4, 2009, http://seattletimes.nwsource.com/html/nationworld/2010411092_apus_sextingpoll.html (describing the death of Hope Witsell, a thirteen-year-old in Florida who hung herself after being taunted by classmates after a photo she sexted to a boy she liked was forwarded to other students, and the death of eighteen-year-old Jesse Logan in Ohio who hung herself after weeks of ridicule after a sext she sent to her boyfriend at the time was forwarded to other girls).
16. See, e.g., U.S. v. Hofus, No. 09-10076, 2010 WL 986799 (9th Cir. Mar. 19, 2010) (affirming the conviction of an adult male attempting to entice two teenage girls using sex messages); ‘Sexting’ Case Goes to Trial, SARASOTA HERALD-TRIBUNE, Sept. 5, 2009, at B3 (reporting that in a recent sexting incident clearly constituting child sexual exploitation, a Florida high school teacher used his cell phone to seduce a child after he allegedly coaxed the high school student to send naked photographs to him and exchanged sexual text messages with the teen). Several states, including Colorado and Oregon, have recently passed bills to close loopholes in existing criminal laws to punish sexual predators using text messages services to lure children. See National Conference of State Legislatures, 2009
focuses primarily on the typical sexting case involving the limited exchange of provocative messages concerning consensual sexual activity between willing participants.

The prevalence of sexting and the severity of its consequences have prompted state and federal policymakers to consider various legislative proposals, from crafting new criminal offenses to introducing educational programs.18 In exploring appropriate legal responses to sexting, this Note attempts to strike a balance between competing policy objectives, such as teenage privacy and the state’s interest in preventing child sexual abuse and child pornography, while respecting the extent to which the digital revolution changed how teenagers communicate and interact in social spaces. While society may want to minimize teenagers’ production and distribution of provocative images even under consensual and private circumstances, sexting should be exempt from treatment under child pornography statutes. In Part I, this Note explores the sexting phenomenon and its underlying causes in the context of a digital generation of teenagers. Part II surveys the varied responses of authorities to sexting incidents, including prosecutors and state legislators. Part III discusses the range of policy issues implicated in designing an appropriate legal framework to address sexting. Part IV concludes by suggesting several legislative components that could help authorities discipline the harms of sexting without resorting to ill-suited child pornography statutes.

I. DEFINING THE SEXTING PHENOMENON

Recent polls suggest that the practice of sexting is well-engrained in teen culture, although there is a range in survey data concerning the extent of the practice. According to a 2008 report by The National Campaign to Prevent Teen and Unplanned Pregnancy (NCPTUP), 22% of teen girls and 18% of teen boys have used technology to send or post nude or semi-nude pictures or video of themselves to other people, with two-thirds of the recipients being a boyfriend or girlfriend.19 Beyond the finding that one-in-five teens send “sexts,” the NCPTUP’s research suggests that an even greater number of teens receive such images and may forward them on to others, making them liable for possession and distribution charges under child pornography statutes.

17. See infra Section I.B.
18. See infra Section II.B.
19. NAT'L CAMPAIGN TO PREVENT TEEN AND UNPLANNED PREGNANCY, infra note 4, at 1.
laws. According to the NCPTUP survey, 31% of teenagers between the ages of thirteen and nineteen report receiving a nude or semi-nude image or video featuring the sender, and 29% of the same group report having had a nude or semi-nude image or video shared with them that was intended to be private. Individuals in relationships exchanged more than half of these photos. Furthermore, 14% of teens acknowledge that they have shared a nude or semi-nude picture or video with someone other than the intended recipient. A 2009 survey conducted by Cox Communications reports similar findings, including the fact that 19% of teens surveyed have engaged in sexting, “sending, receiving, or forwarding sexually suggestive nude or nearly nude photos through text message or email.” Most recently, polling by the Pew Internet & American Life Project produced lower figures, finding that 4% of teenagers ages 12-17 with cell phones report texting nude or nearly nude images of themselves and 15% of that group has “received a sexually suggestive nude or nearly nude photo or video of someone they know on their cell phone.”

While these figures undoubtedly reflect a significant trend, either extreme of the polling data deserves some skepticism. For starters, the NCPTUP poll relied exclusively on an online survey to query youth about their online experiences. Results of online surveys may not be representative when there is a correlation between the subject matter and respondents’ comfort in sharing personal information—teenagers who sext may also be the most likely to reveal such behavior in an online poll. In the opinion of one academic who conducted well-known studies of online teen behavior over the phone, “online poll-takers might be two to four times more likely to send nude photos of themselves than the average teen.” At the same time, the lower numbers found in the Pew Internet & American Life poll for sending

21. NATIONAL CAMPAIGN TO PREVENT TEEN AND UNPLANNED PREGNANCY, supra note 4, at 11.
22. Id. at 13; Mathias H. Heck, Sexting and Charging Juveniles—Balancing the Law and Bad Choices, 43 PROSECUTOR 28, 28 (2009).
23. NATIONAL CAMPAIGN TO PREVENT TEEN AND UNPLANNED PREGNANCY, supra note 4, at 11.
25. LENHART, supra note 4, at 4–5.
27. Id. (quoting David Finkelhor at the University of New Hampshire’s Crimes Against Children Research Center).
and receiving explicit text messages may underreport the actual incidence of sexting given that the topic is loaded with “a relatively high level of social disapproval” and thus subjects may not admit to the behavior. Yet even if some fraction of reported teens are engaging in sending or receiving sexually explicit texts, the data is significant enough to warrant discussion.

The prevalence of sexting among today’s teenagers reflects the intersection of two trends influencing teenage behavior: the omnipresence of digital technologies and the enhanced sharing and personal expression facilitated by these technologies. In contrast to their parents and grandparents, the current generation of youth is “born digital,” meaning that most major aspects of their lives are mediated by digital technologies, from social interactions to academics to hobbies and entertainment. These individuals never knew an offline world—they “do not stay in touch with pens and scented paper,” but with an endless array of technological gadgets. For adults who view Internet-based socializing as a supplement to life in real spaces, the notion of teens moving seamlessly between face-to-face and computer-mediated social interactions is novel. The concept of using text messaging services to send highly personal photos may sound bizarre to adults, but it is much less so to teens who rely on cell phones as a critical tool to maintain their social connections. According to recent research by the Pew Internet & American Life project, 71% of teens owned cell phones in 2008, an increase from 45% in 2004. Among teen cell phone users, 76% used their phones to send text messages. Another study by the mobile phone industry suggest that 54% of teenage girls and 40% of teenage boys think that their social life would “end” or significantly worsen if texting were no longer available on cell phones. And cell phones are not the only distribution channel by which teens exchange sexts; similar message can also be sent through desktop and laptop computers, usually through e-mail.

28. Lenhart notes that the number of teens in the focus groups who were able to talk about sexting experiences suggests that this effect may have been present in the Pew poll. See Lenhart, supra note 4, at 4 n.10.
30. Humbach, supra note 20, at 3.
31. Sameer Hinduja & Justin W. Patchin, Bullying Beyond the Schoolyard: Preventing and Responding to Cyberbullying 25 (2009) (noting that “[f]or many youth, there really is no clear distinction between life as lived in real space and in cyberspace; one social sphere is now a natural and complementing extension of the other”).
33. Id. at 8.
services or social networks. For example, earlier this year, a fourteen-year-old New Jersey girl was charged with distribution of child pornography after posting nearly thirty nude portraits of herself on the social networking site MySpace.

A. TYPICAL Sexting INCIDENTS

Much remains to be learned about the motivations underlying teenage sexting. Many of the news accounts, however, report behavior reflecting typical expressions of teenage emotions, such as the instance where photos are taken to impress a member of the opposite sex or to record private encounters between teens in a relationship. Although social norms affecting adult behavior may warn against sharing revealing images over cell phones or uploading them to public profiles on social networking sites, teens’ online behaviors reflect a different set of norms developed in their online communities. Sometimes these social norms, influenced by an entertainment industry glamorizing outrageous online personalities and the public disclosure of titillating personal information, support brash behavior such as sexting. Among peer-conscious teenagers, an “everybody does it” rationalization can further perpetuate inappropriate activities. According to the NCPTUP poll, of those who have sent suggestive content online, 66% of girls and 60% of boys said that they did it to be “fun or flirtatious.”

Research about youth cognitive development supports the notion that teenage brains are generally not sufficiently matured to enable consistently good decision-making. The possibility that an innocent effort to impress friends could have serious consequences does not enter most sexting teenagers’ minds. In a spring 2009 Good Morning America “town hall” on sexting, one Texan

35. LENHART, supra note 4, at 12.
36. Golson, supra note 10 (noting that the photos were allegedly for the girl’s boyfriend to see).
37. See, e.g., Naked Photos, E-Mail Get Teens in Trouble, supra note 1; see also Stephen F. Smith, Jail for Juvenile Child Pornographers?: A Reply to Professor Leary, 15 VA. J. SOC. POL’Y & L. 505, 524 (2008) (discussing how the bulk of teenage self-produced pornography is created by minors in connection with their own consensual sexual activities).
39. Id. at 142.
40. NATIONAL CAMPAIGN TO PREVENT TEEN AND UNPLANNED PREGNANCY, supra note 4, at 4.
41. Quaid, supra note 15. By the mid-teens, the brain’s reward centers linked to emotional arousal are well-developed, making teens vulnerable to peer pressure. Id. However, the frontal cortex, which connects reasoning with emotion and enables people to weigh consequences, is not fully formed until the early twenties. Id.
teenager gave a common explanation of how she started sexting at her boyfriend’s insistence: “He had kept asking me for [it]... [f]irst, I was kind of like, ‘No.’ Well then, the further along we got on in the relationship, you know, I thought I really cared about him, and I figured he cared about me, too.” The concern that sexted images can be easily distributed over peer-to-peer networks or otherwise fall into the hands of sexual predators, a primary fear of those outraged about sexting, is not a risk most teens recognize. Nor do most teens realize that their actions are illegal and could qualify them for a decades-long sex offender registration requirement. On the other hand, it is not clear that knowledge of the consequences of sexting would deter most teens. According to an Associated Press-MTV poll, about half of the teens surveyed identified sexting as a behavior carrying the risk of serious punishment, but did it anyway. In the Ohio case described earlier, the fifteen-year-old who distributed nude images of herself via her cell phone did so after a county prosecutor visited her high school to warn students that they might serve twenty years in jail if they were found with or sent sexually explicit images of teenagers on their cell phones. Among experts studying adolescence health, the phenomenon of “teens participating in high-risk behaviors, even though they know that they should not” is well-understood. According to the NCPTUP poll, three-fourths of teens surveyed agreed that sexting can have serious negative consequences.


43. See, e.g., Mary G. Leary, Self-Produced Child Pornography: The Appropriate Societal Response to Juvenile Self-Sexual Exploitation, 15 VA. J. SOC. POL’Y & L. 1, 12–14 (2007) (discussing how juvenile self-produced pornography can fuel the child pornography industry, creating more demand and putting more children at risk of exploitation); see also Smith, supra note 37, at 544 (finding that “[m]inors who distribute pornographic images of themselves place may [sic] themselves at risk of being victimized by pedophiles”).

44. Quaid, supra note 15.

45. Heck, supra note 22, at 28–29 (A prosecuting attorney in Montgomery County, Ohio reports that many of her fellow prosecutors are finding that the teenagers engaged in sexting “are completely unaware that what they are doing is illegal.”).

46. Quaid, supra note 15.

47. Girl Charged with Sending Nude Photos To Classmates, WBNS 10TV, Oct. 7, 2008, http://www.10tv.com/live/content/local/stories/2008/10/07/story_nude_photos.html?sid=102 (noting that the principal of the school “felt there was a good understanding by our student body about the seriousness of the matter”).

although they may not fully understand the particular long-term consequences of sexting.49

A final explanation for the sexting trend is the reality that nearly half of American high-schoolers report sexual activity.50 More generally, as one commentator observes, today’s teens, “for better or worse...do not regard sexuality as the monopoly of older generations but as a part of their lives.”51 Sexting could be viewed as merely an expression of teen sexuality in a digital age, reflecting a long-documented trend of teens “using whatever technology is at hand to express themselves and share their behavior with the world.”52

However, in contrast to previous generations, where the flashing of a classmate might have had only momentary consequence, new technologies greatly enhance the likelihood that such indiscretions will be permanently recorded and disseminated to large audiences.53 Historically, teenagers who took provocative self-portraits faced the hurdle of developing the film at a photo lab, and distribution was limited by the number of copies purchased. In contrast, today, camera phones and broadband connections enable instantaneous production and distribution, even if the original sender did not intend it.54 In a recent Massachusetts incident, pictures of a naked fourteen-year-old were allegedly “sexted” to more than 100 cell phones.55 While the impact of an embarrassing incident in the offline world is largely limited to physical witnesses, an image captured digitally and shared via cell and broadband networks can reach an endless number of people. Further, it is practically impossible to remove the offending object once it has been widely shared.56

49. Id.
51. Humbach, supra note 20, at 3.
52. Muscari, supra note 12.
53. The permanent recording enabled by technologies, and the introduction of child exploitation laws, also has dramatically enhanced the consequences of such activity. See id. (noting that although “streaking may have been just a nuisance in its heyday, but it could be deemed a sexual offense today, just as a photo of an underwear-clad teen may now be considered child pornography”).
B. THE CONVERGENCE OF SEXTING AND CYBERBULLYING

The detrimental effects of sexting greatly compound when teenagers use sexting as a tool for online bullying—what is popularly referred to as “cyberbullying” or “sending or posting harmful material or engaging in other forms of social aggression using the Internet or other digital technologies.” 57 A significant difference exists between the exchange of explicit messages between two high-schoolers in a relationship—a sixteen-year-old girl sending a nude photo of herself to her boyfriend—and the use of sexting as a means of harassment—teen girls secretly taking and sending nude photos of a peer changing in a locker room. 58 Whereas in the first instance both individuals voluntarily agreed to the production and distribution, the latter case involves images taken without the consent or control of those involved, and forwarded to large numbers of outsiders with malicious intent. A recent policy statement by the National Center for Missing and Exploited Children (NCMEC) recognized the distinction between sexting and other forms of online harassment and exploitation, noting that “sexting is not the appropriate term to describe youth sending sexually explicit images of themselves to others as a result of blackmail, duress, coercion or enticement,” nor does it include “situations in which young people send sexually explicit images of themselves to adults.” 59 To differentiate voluntary sexting with limited distribution from instances of online harassment, this Note refers to the later as “sextbullying,” a subset of the cyberbullying phenomenon. Although most of the publicly reported cases of sexting involve consensual sharing between teens in a relationship, there are increasingly more examples of sext messages used as tools of coercion and harassment.

Public accounts of two teenagers who committed suicide as a result of sexting incidents tragically illustrate the harms that can result when the lines between sexting and cyberbullying blur. 60 The story of Jesse Logan placed the sexting issue squarely in the public spotlight in 2008. 61 Logan, a high school student from Cincinnati, committed suicide after nude photos she sent to her

57. Id. at 1.
58. See Muscari, supra note 12 (contrasting the differences between sexting, cyberbullying, harassment, and sexual offenses).
60. Quaid, supra note 15.
61. See Mike Celzie, Her Teen Committed Suicide over Texting, TODAY SHOW.COM, Mar. 6, 2009, http://www.msnbc.msn.com/id/29546030/.
boyfriend were forwarded to other teens and used to harass her. More recently, a Florida thirteen-year-old, Hope Witsell, committed suicide after facing months of incessant bullying by her middle-school peers stemming from a topless photo of herself she sexted to a boy she liked.

Several attributes of cyberbullying distinguish it from its counterpart in the physical world, and in some ways exacerbate the well-established harms of bullying. Simply put, online communities enforce fewer behavioral restraints than the offline world. The anonymity and pseudonymity offered by digital technologies, the viral nature of computer-based communications, and the difficulties in supervising youth activity online, compound the impacts of sexting in sextbullying cases. Besides not requiring the courage needed to confront someone in person, digital aggression is furthered by a disinhibition effect, whereby spatial distance insulates the aggressor from fully comprehending the harmful effect of his actions on the victim. Also, technologies like text messaging or e-mail forwarding dramatically amplify the wildfire effect of spoken rumors; in instances of sextbullying, viral digital transmission means that victims are humiliated over and over again, with the
harassment not limited to the school day or campus. The reliance of teens on their cell phones for social connectedness or for safety enhances the problem, as it makes them less likely to ever turn off their phones and escape the victimization. A lack of adult supervision also exacerbates cyberbullying harms. Because most teens are far more tech savvy than their caregivers, they may text freely without the concern that others will discover their bullying or victimization and restrict their access.

To the extent that sexting is used as a tool for online harassment, it presents a far more challenging set of issues than the more orthodox aforementioned sexting behavior. While the primary focus of this Note concerns the common circumstance of teenagers voluntarily producing and exchanging sexually explicit images in a closed circle, it is important to recognize the spectrum of sexting behaviors and the corresponding range of appropriate solutions. Remedies for addressing more typical sexting incidents may not be sufficient in a sextbullying case. This theme is revisited in Part IV’s discussion of a model framework for sexting legislation.

II. LEGAL RESPONSES TO SEXTING

In response to the phenomenon described in Part I, state authorities have taken a range of actions to limit sexting that reflect varying degrees of punitive intent. This Part analyzes the actions of local prosecutors, the courts, and legislators in addressing sexting and similar behaviors involving teenagers’ exchange of self-produced pornography.

A. PROSECUTORIAL DISCRETION AND COURTS’ RESPONSES TO SEXTING

Across the country, the discretion of local prosecutors drives a range of different outcomes in sexting cases. Responses range from police officers confiscating cell phones and offering education about the criminal consequences for involved students to more serious felony charges against the primary actors. In the New Jersey case, supra Part I, the fourteen-year-old girl charged with the distribution of child pornography for posting nude photos for her boyfriend on MySpace will face a prison sentence of up to seventeen years and the possibility of sex offender registration under the state’s equivalent of Megan’s Law, if convicted. Although the local

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67. Id. at 23.
68. See WILLARD, supra note 38, at 3–5 (discussing how “[c]hildren can quickly leave their parents behind in embracing emerging online technologies and activities”).
70. 42 U.S.C. § 14071(e)(2) (2006) (mandating federally that all states pass legislation to make their federal sex offender registries available to the public). See Phoebe Geer, Justice
prosecutor involved downplayed the likelihood that a minor without a
criminal record would be forced to register as a sex offender, the president of
the state’s County Prosecutors Association has commented about the need
for “very serious consequences” in response to this sort of teen behavior.Prosecutors, as elected officials, may experience intense pressure from
constituents on either side of the issue; they may be lobbied to express
leniency or could be overwhelmed with requests from parents of teen victims
insisting that another teen be prosecuted for the misconduct. Nothing in
child pornography laws exempts instances in which minors produce or
disseminate pornographic images of themselves. The definitions of these
offenses may vary across jurisdictions, but “criminal statutes typically
prohibit the production and dissemination of pornography featuring minors
in terms that are broad enough to apply to self-produced child
pornography.”

Although prosecutors may initially charge teens with child pornography
offenses in an effort to educate them about the dangers of sexual
exploitation on the Internet and to facilitate agreement to lesser penalties,
most teens end up with less extreme consequences, such as confiscation of a
cell phone, curfews, supervised Internet usage, and community service. Even though the number of reported cases involving teenagers sharing self-produced sexually explicit images is understandably few, some local prosecutors have successfully sought child pornography charges in sexting-like situations. And there is at least some appellate authority affirming
minors’ convictions for producing sexually explicit images of themselves.

In Iowa v. Canal, likely the first case explicitly upholding a “sexting”
prosecution, the Iowa Supreme Court recently affirmed an obscenity conviction of an eighteen-year-old boy who sent an explicit photo of himself
to a fourteen-year-old friend, accompanied by a photograph of his face and
the message, “I love you.” The teenage boy sent the photograph only after
the girl repeatedly asked him to send the photo, which her parents later

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72. Id.
73. Patrick E. Corbett, Cyberbullying and Other High-Tech Crimes Involving Teens, J.
74. Smith, supra note 37, at 513.
75. See e.g., Dave Gram, Vermont May Set Aside Harshest Penalties for ‘Sexting’, HERALD,
Apr. 15, 2009, at 3A.
76. Smith, supra note 37, at 513.
77. Id. See also Smith, supra note 37, at 513.
78. 773 N.W.2d 528, 529 (Iowa 2009).
uncovered in the girl’s e-mail account and sent to the police.79 Reviewing a jury verdict challenged on sufficiency of the evidence grounds, the Iowa court found sufficient evidence to convict the eighteen-year-old of knowingly disseminating obscene material to a minor, a misdemeanor requiring him to register as a sex offender.80 Recognizing the latitude a jury has to determine what constitutes obscenity for its own community under the Supreme Court’s Miller test,81 the Iowa court found that the jury could find, applying its own contemporary community standards, that “the material appealed to the prurient interest, was patently offensive, and lacked serious literary, scientific, political, or artistic value.”82

Besides Canal, state courts have upheld child pornography convictions for teenagers’ production and distribution of self-produced pornography using technology such as e-mail and video cameras. These cases present policy issues analogous, if not identical, to sexting using cell phones.

In A.H. v. State, a teenage girl’s conviction of a child pornography offense after exchanging self-produced pornography over e-mail was upheld by a Florida state appellate court.83 A sixteen-year-old female, A.H., and her seventeen-year-old boyfriend took digital photos of themselves engaged in “sexual behavior,” uploaded them to the girl’s home computer, and sent them to the boy’s personal e-mail account.84 Although neither teen reportedly showed the photos to a third party, they somehow made their way into the hands of the police.85 On appeal, A.H. moved to dismiss the charges as an unconstitutional violation of her privacy rights.86 Given the lack of a significant age difference or any allegation that the pictures were shown to a third party, A.H. argued that the only compelling state interest implicated in

79. Id. at 529.
80. Grant Schulte, Iowa Court Upholds ‘Sexting’ Conviction, DES MOINES REGISTER, Sept. 18, 2009.
81. Canal, 773 N.W.2d at 531. Miller v. California sets forth the “basic guidelines” for obscenity:
   (a) whether ‘the average person, applying contemporary community standards’ would find that the work, taken as a whole, appeals to the prurient interest; (b) whether the work depicts or describes, in a patently offensive way, sexual conduct specifically defined by the applicable state law; and (c) whether the work, taken as a whole, lacks serious literary, artistic, political, or scientific value.
413 U.S. 15, 24 (1973) (internal citations omitted).
82. Canal, 773 N.W.2d at 532.
84. Id.
86. A.H., 949 So. 2d at 235.
her conviction was protecting her and her co-defendant from engaging in sexual behavior until their minds and bodies matured.\textsuperscript{87} She further argued that pursuing that interest through a second-degree felony charge for child pornography distribution did not meet the “least intrusive means” test required under state law.\textsuperscript{88}

However, while the Florida Supreme Court previously recognized constitutional protection for consensual sexual activity between two sixteen-year-olds in \textit{B.B. v. State},\textsuperscript{89} the \textit{A.H.} court found that this privacy right does not extend to situations where the “minor memorializes the act through pictures or video.”\textsuperscript{90} Distinguishing self-produced images of adults engaging in sexual behavior, the court argued that minors cannot reasonably expect that their relationships will continue and the photographs will not be shared with others unintentionally or intentionally, for “profit or bragging rights.”\textsuperscript{91} Even if the \textit{A.H.} court recognized a teen’s privacy right in the photos, it found an overriding, compelling state interest in the convictions, stating that “protecting children from exploitation in this statute is the same regardless of whether the person inducing the child to appear in a sexual performance and then promoting that performance is an adult or a minor.”\textsuperscript{92} Almost a decade earlier, a Florida appeals court reached a similar conclusion about the state’s interest in “protect[ing] minors from exploitation by \textit{anyone} who induces them to appear in a sexual performance,” recognizing the states’ interest in prosecuting a fifteen-year-old boy who videotaped himself and a younger minor engaged in sexual activity and then shared the tape with a friend when the girl was not present.\textsuperscript{93}

Convictions for sexting-like activity in other states have been affirmed on similar rationales. In an unpublished Washington state opinion from 2005, \textit{State v. Vezzoni}, the court upheld a sixteen-year-old boy’s conviction for production and possession of child pornography where he took sexually explicit photos of his girlfriend and then showed them to classmates at school after the couple broke up.\textsuperscript{94} Appealing the charges, the boy argued

\textsuperscript{87} \textit{Id.}
\textsuperscript{88} \textit{Id.}
\textsuperscript{89} 659 So. 2d 256, 259 (Fla. 1995). The court established that the crux of the State’s interest in regulating minor-minor sexual contact was “protecting the minor from the sexual activity itself for reasons of health and quality of life,” and that in the instance of consensual sexual relations between two sixteen-year-olds, the state failed to demonstrate that a conviction for sexual battery was “the least intrusive means of furthering what we have determined to be the State’s compelling interest.” \textit{Id.}
\textsuperscript{90} \textit{A.H.}, 949 So. 2d at 236.
\textsuperscript{91} \textit{Id.} at 237.
\textsuperscript{92} \textit{Id.} at 238.
that the legislature did not intend for child pornography statutes to apply in situations where teens capable of consenting to sexual activity take nude photos of each other. The court found the plain meaning of the statute unambiguous in its applicability to juvenile offenders, noting the ease by which lawmakers could have created “different degrees of criminal liability on the basis of a specific age disparity between the offender and the victim” if that was their intent.

In a similar case, the Washington Court of Appeals upheld a juvenile conviction for the production of child pornography where a fifteen-year-old boy brought a video camera to high school and taped three female classmates voluntarily exposing their breasts on camera. Though the court determined the boy’s behavior “fell squarely within the unambiguous statutory definition of sexual exploitation of a minor,” it acknowledged that the consequences were “arguably excessive” as applied to a youth “whose conduct lies on the periphery of concerns” that the legislature intended to address with the statute, but declared that “such policy arguments must be directed to the Legislature.”

Cases like *A.H.* and *Vezzoni* prompted action from state legislators looking to moderate the “arguably excessive” penalties attached to sexting. Relying on prosecutors to exercise reasonable discretion in sexting cases is not a desirable approach for several reasons. First, states generally have not designed laws to specifically address teens’ transmission of self-produced explicit images, leaving many law enforcement authorities with the view that their only option is to charge teens under statutes designed to punish child pornography traffickers and sexual predators. Indeed, one Internet safety expert described the recent use of child pornography law as “desperate acts by frustrated law enforcement officials.” Second, prosecutors pursuing harsh penalties for sexting teens may be motivated by constituent pressure or by a strong moral opposition to any form of teenage sexual activity, making their exercise of reasonable discretion unlikely. As the Utah Supreme Court noted in *State ex. rel. Z.C.* in which the court overturned

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95. *Id.* at *1.
98. *Id.* at 256–58.
99. *Id.* at 257–58.
100. *See infra* Section II.B.1.
101. There are, of course, prosecutors developing reasonable responses to teen sexting. For further discussion of such an approach in Montgomery County, Ohio, see *infra* Part IV.
the conviction of a thirteen-year-old boy for having consensual sex with a
twelve-year-old girl, where “there is no discernible victim that the law seeks
to protect,” “[t]he primary fail-safe against the absurd application of criminal
law is the wise employment of prosecutorial discretion, a quality that is
starkly absent in this case.”

Furthermore, data about prosecution rates for the related offense of
statutory rape reveals the hard-line response to teenage sexual activity
pursued by many prosecutors. A 1997 study by the American Bar
Association found that close to one-half of prosecutors surveyed report
“always” or “almost always” filing charges when receiving referrals of
statutory rape cases from law enforcement. In the Florida A.H. and the
Washington State Vezzoni cases, for example, prosecutors sought charges
under statutes with the most severe penalties—“[i]nstead of using
prosecutorial discretion wisely and charging the teenagers with charges that
fit the crime, prosecutors used statutes that potentially would classify the
teenagers as sex offenders.” In other instances, ambiguity over what
constitutes child pornography and the severe consequences associated with
the content may influence prosecutors to err on the side of seeking stringent
penalties. Although the Supreme Court held in Osborne v. Ohio that
“depictions of nudity, without more, constitute protected expression,” lower courts found that images, even without nudity, can constitute child
pornography. Given the uncertainty about these definitions and the
inevitable leeway afforded judicial interpretations, “any teen who takes nude
or semi-nude pictures of herself is, as a practical matter, in definite legal
jeopardy.” And when a zealous prosecutor proceeds with child
pornography charges and secures a conviction, the statutes typically proscribe
mandatory minimum sentences which restrict a judge’s ability to exercise
leniency in sentencing.

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104. State ex. rel. Z.C, 165 P.3d 1206, 1212, 1212 n.9 (Utah 2007).
105. Rigel Oliveri, Statutory Rape Law and Enforcement in the Wake of Welfare Reform, 52
RELATIONSHIPS BETWEEN ADULT MALES AND YOUNG TEEN GIRLS: EXPLORING THE
LEGAL AND SOCIAL RESPONSES 22 (American Bar Ass'n Center on Children and the Law
106. Nix, supra note 7, at 189.
108. Humbach, supra note 20, at 2 n.16. See, e.g., United States v. Knox, 32 F.3d 733, 737
(3d Cir. 1994) (finding that “the federal child pornography statute, on its face, contains no
nudity . . . requirement”).
110. Smith, supra note 37, at 529.
A recent case litigated by the ACLU is a clear example of a prosecutor taking extraordinarily harsh measures in response to sexting.111 After discovering a string of sexting incidents at a local school, a Pennsylvania district attorney threatened to charge three teenage girls with the production of child pornography, felonies carrying prison time and mandatory sex-offender registration in Pennsylvania, unless their parents agreed to probation terms including drug testing and a five-week, ten-hour education program discussing “what it means to be a girl in today’s society.”112 While the district attorney offered the deal to avoid prosecution while still teaching the girls a lesson, the parents refused the terms.113 With the support of the ACLU, the parents sued for a temporary restraining order alleging violations of their constitutional rights stemming from the district attorney’s threatened retaliation if they refused to allow their children to attend the educational program.114 At issue in the litigation are two photographs featuring the teenagers, one showing two of the girls at the age of thirteen wearing white opaque bras, and a second photo showing a girl outside the shower with a towel below her chest, exposing her breasts.115 Among its arguments, the ACLU Complaint contended that “unless the photographs were produced by abusing or coercing the minors, which they were not, or they show the minors engaged in sexual activity or lasciviously displaying the genitals, and again they do not, the photos are expression protected by the First Amendment to the U.S. Constitution.”116 At a March 2009 hearing, the district court found that there was a “reasonable likelihood” that the plaintiffs would prevail in the argument that the photographs are not illegal under Pennsylvania law, as “the images presented to the court do not appear to qualify in any way as depictions of prohibited sexual acts.”117

On appeal, the Third Circuit affirmed the injunctive relief offered the plaintiffs based on their retaliation claim, finding that the district attorney’s threats to pursue a child pornography prosecution after the parents and teenagers exercised their protected rights not to participate in the educational program was unconstitutional.118 Without addressing whether the sext messages constituted legal child pornography, the appellate court found the

111. Zetter, supra note 7.
district attorney’s actions were retaliatory based on his lack of probable cause in pursuing the conviction.\textsuperscript{119} It found “no indication from this record” that the district attorney had evidence that the teenagers possessed or distributed the images.\textsuperscript{120} As one commentator summed up the decision: the court recognized that in pursuing this sexting case, “a prosecutor had gone too far in trying to enforce adult moral standards.”\textsuperscript{121}

B. \textbf{Legislative Responses}

In the absence of state laws specifically designed to address sexting, a zealous prosecutor may always seek the most stringent charges possible, including convicting under offenses that carry a sex-offender registration requirement.\textsuperscript{122} In response to prosecutors’ aggressive pursuit of child pornography charges in sexting cases, state legislators across the country have crafted a range of more tailored responses to sexting.\textsuperscript{123} Four states passed new sexting laws in 2009, and at least fifteen other states have introduced sexting legislation since 2009.\textsuperscript{124}

1. \textit{Enacted Laws}

a) Vermont

Vermont lawmakers’ recent efforts to pass sexting legislation underscore some of the highly divergent views in the debate. In the wake of several high-profile sexting cases in the national media in which teens were charged with child pornography offenses, the Vermont Senate took up the issue in early 2009, adopting an approach later criticized for “legalizing” sexting.\textsuperscript{125} The Vermont Senate bill established an exemption for the production, distribution, and possession of child pornography where the individuals involved are between the ages of thirteen and nineteen, and “the child

\textsuperscript{119}. \textit{Id.}, at *10.
\textsuperscript{120}. \textit{Id.}
\textsuperscript{122}. See Nix, \textit{supra} note 7, at 187.
\textsuperscript{123}. Information on state legislation is current as of March 15, 2010 and does not reflect subsequent legislative developments occurring thereafter. Note that the following survey also does not include those states which have passed or proposed laws to address the use of text message services by sexual predators to contact children, which is a problem distinct from sexting as discussed here. \textit{See supra} note 16.
\textsuperscript{125}. Adam Silverman, \textit{Legalizing Teen ‘Sexting’ Considered}, BURLINGTON FREE PRESS, Apr. 12, 2009, at C01.
knowingly and voluntarily and without threat or coercion, used an electronic communication device to transmit an image of himself or herself to the
person."  

Although the bill contained a provision explicitly stating that prosecutors can pursue charges under the state’s voyeurism statute, it came under fire as some advocates publicly questioned whether the “proposal crosses the line between legalizing a common practice among teens experimenting with sexuality and protecting predators who target and exploit youngsters.” Following the Senate bill’s passage, the NCMEC expressed reservations about the unintended consequences of immunizing genuine sex predators from prosecution: “our concern is that decriminalizing sexting is a blanket response that is too broad a problem not to be handled on a case-by-case basis.” In response to criticism of his bill, the chairman of the Vermont Senate Judiciary Committee wrote an editorial clarifying that the Senate was not “condoning teenage sexting” and asserting its position: “The question is do we want to treat the 20 percent of teens who participate in such behavior as serious felons within our criminal justice system or should we treat it as the societal problem that it is... [W]e have chosen the latter."  

After the public outcry about the Senate’s bill, which necessitated lawmakers defending their approach on national television, the Vermont House of Representatives took a slightly different tactic, creating a new misdemeanor offense that explicitly precludes prosecution under child pornography statutes for sexting offenses. Its version of the sexting bill creates a new offense where a minor “knowingly and voluntarily and without threat or coercion use[s] a computer or electronic communication device to transmit an indecent visual depiction of himself or herself to another person” or the possession of such a transmitted depiction, with an exemption from prosecution where “the person [takes] reasonable steps, whether successful.

127. S. 125 (“[t]his subsection shall not be construed to prohibit a prosecution under section 2605 of this title (voyeurism)).
128. Silverman, supra note 125, at C01.
or not, to destroy or eliminate the visual depiction.” The legislation specifically exempts minors from prosecution under the states’ child pornography laws and any applicable sex offender registration requirements and specifies that first-time offenders be tried for delinquency in family court as juveniles and referred to the state’s juvenile diversion program. Discussing his bill after its passage through the House, the Judiciary Committee chairman explained the committee’s interest in “mak[ing] it clear that [sexting] is not something that’s appropriate,” in expanding state attorneys’ options “from doing absolutely nothing to using the new provisions that we provided,” and in keeping participants “outside of the sex offenders registry where they do not belong.”

In early May 2009, a joint conference committee resolved the differences between the two bills, largely adopting the House approach in the enacted version. In September 2009, state prosecutors dropped the sexting charges against an eighteen-year-old boy who allegedly directed two teenage girls to videotape or photograph themselves performing sex acts and then send him the material, influenced in part by the state legislature’s action to reduce the penalties associated with sexting.

b) Nebraska

While avoiding the pitfall of invoking public criticism about “legalizing sexting,” Nebraska passed a law that takes a similarly lenient approach to teenage sexting by providing an affirmative defense under certain circumstances. According to the state Attorney General, Jon Bruning, Nebraska does not “want to treat childish behavior as criminal activity.” Legislative Bill 97, signed in May 2009, creates an affirmative defense for the possession of child pornography if: (a) the image portrays no person other than the defendant; or (b) the defendant was less than nineteen, the image

133. Id.
portrays only a teen older than fifteen and was “knowingly and voluntarily” created and provided to the defendant by the teen in the image, and “the defendant has not provided or made available the visual depiction to another person except the child depicted who originally sent the visual depiction to the defendant.”\(^{140}\) However, if a person forwards an explicit text they receive to a non-participant, then he or she would face liability for the full range of child pornography charges available under state law.\(^{141}\) In a move that may have contributed to the political success of the Nebraska affirmative defense, the drafters of the bill also included provisions strengthening penalties for sex offenders’ use of social networking sites and cell phones to exploit children.\(^{142}\) As the sponsor of the legislation described the bill’s intent, it sought “to protect children from sexual predators by strengthening penalties and bringing Nebraska’s laws up to date. As technology changes Internet predators find new avenues to pursue their victims . . . . Nebraska’s justice system must keep pace.”\(^{143}\)

c) Utah

Legislators in Utah also took early action to deal with the issue of teen sexting, although their remedy reflects a more heavy-handed approach. Reacting to public concern about a series of incidents in the state involving nineteen teenagers taking nude pictures of themselves and then sending these photos to their friends, the Utah legislature initiated efforts to lessen the penalties associated with sexting in 2008.\(^{144}\) According to one lawmaker in the state Senate, the legislation was prompted in part by parents interfering in law enforcement investigations when they did not want their children charged with felonies for sexting.\(^{145}\)

Utah’s bill, passed in March 2009, modifies the state’s harmful-to-minors statute\(^{146}\) to create a lesser misdemeanor offense for prosecutors to use in pursuing sexting cases instead of charging teens with felonies.\(^{147}\) Although


\(^{141}\) Hammel, supra note 138.

\(^{142}\) L.B. 97, 101st Leg., 1st Sess. § 27 (Neb. 2009).


\(^{146}\) U TAH CODE ANN. § 76-10-1206 (2009) (concerning “[d]ealing in material harmful to a minor”).

\(^{147}\) H.B. 14, Utah Leg., 2009 Gen. Sess. (Utah 2009).
the legislation maintains a sex offender registration requirement for those convicted, it presents some effort at lightening penalties. The amendment, teens under the age of sixteen face a lighter-weight class B misdemeanor charge for sending pornographic materials, teens sixteen and seventeen years old face a class A misdemeanor charge for sending pornographic materials, and those eighteen years and older who solicit a younger person to send pornographic or harmful material could be charged with a third-degree felony. The law also assigns penalties of increasing severity to offenders based on their age when they committed the offense. According to the drafters of the legislation, the bill reflects an effort to give prosecutors more options, beyond felony charges, when youth of certain ages sext, taking “into account an individual’s age, maturity and level of sophistication.”

Some criticize Utah’s use of age distinctions to address the severity of the sexting offense, as opposed to focusing on the actual conduct in an inappropriate situation and fitting the punishment to the crime. Focusing on age does not solve the problem created in assigning a disproportionately harsh penalty to a sexting offense, and “[t]o statutorily draw a line that creates differences in punishment between two friends that engage in the same behavior ignores the realities of teenage life.” Instead, the Utah law might have considered demarcating the degrees of punishment based on conduct and whether the activity was voluntary: “[A] better approach would require the law to draw the line between consensual behavior and intentional infliction of harm instead of focusing solely on age.”

d) North Dakota

Compared to the other three states taking action on sexting in 2009, North Dakota took the most hard-line approach. Passed in August 2009, the state’s sexting law adds a new section to its obscenity law creating a class B misdemeanor offense for a person who knowingly acquires and distributes any image of a nude or partially denuded figure “created without...”

148. See Nix, supra note 7, at 190; Legislative Briefs, DESERET MORNING NEWS, Jan. 28, 2009, at A4.
150. Id.
151. Thomson, supra note 144, at B05.
152. Nix, supra note 7, at 190.
153. Id. at 192.
154. Id. at 191.
155. Talia Buford, Bill Would Ease Penalty for ‘Sexting’, PROVIDENCE JOURNAL, Mar. 2, 2010 (comparing sexting laws passed in Vermont, Utah, Nebraska and North Dakota and finding the North Dakota law the most severe in its assignment of penalties).
the consent of the subject of the image.\textsuperscript{157} A more serious class A misdemeanor applies where a person distributes or publishes a nude or partially nude image “with the intent to cause emotional harm or humiliation to any individual depicted” or where a person distributes or publishes the image after receiving notice of a lack of consent from the individual depicted or a parent or guardian of that individual.\textsuperscript{158}

2. \textit{Some Laws Under Consideration}\textsuperscript{159}

a) Ohio

Lawmakers in Ohio also recently introduced a bill to create more reasonable penalties for sexting.\textsuperscript{160} Importantly, the proposal has the support of Cynthia Logan, the mother of the Ohio teenager who committed suicide after experiencing intense harassment from classmates who circulated a naked photo of her, originally sent to her boyfriend, around her school.\textsuperscript{161} The Logan case generated considerable national press and contributed to the uptick in media and legislative interest in sexting.\textsuperscript{162} Under current Ohio child pornography law, sexting teens could be charged with a second-degree felony and classified as sex offenders for illegal use of a minor in nudity-oriented material or performance.\textsuperscript{163} The new sexting offense, captured in a provision to be added as Section 2907.324 to the state code, would punish teens who create, exchange, receive, or possess nude materials with misdemeanors, requiring time in juvenile detention centers and counseling or attendance at educational programs, and removing the sex offender registration requirement.\textsuperscript{164} Echoing the concerns voiced in other states, Ohio State Representative Ronald Maag, the bill’s sponsor, described the legislation’s intent as “giv[ing] prosecutors direction in how to deal with the matter”


\textsuperscript{158} Id.

\textsuperscript{159} This Part surveys a range of the sexting laws that state legislatures considered in the past year, but is not comprehensive. For a full, and regularly updated, summary of sexting legislation under consideration in 2010, see National Conference of State Legislatures, 2010 Legislation Related to “Sexting”, http://www.ncsl.org/default.aspx?TabId=19696 (lasted visited March 15, 2010).


\textsuperscript{161} \textit{See} Amber Ellis, \textit{Mother Speaks Out for 'Sexting' Bill}, CINCINNATI ENQUIRER, Apr. 13, 2009.

\textsuperscript{162} \textit{See supra} notes 61–62.


\textsuperscript{164} H.B. 132.
without resorting to felony child pornography charges for “stupid” teen behavior.\footnote{165}

b) Illinois

In Illinois, lawmakers recently introduced an anti-sexting bill that takes an approach distinct from other states. The proposed provision would not charge the person who appears in the explicit photo, but would penalize anyone who forwards the image.\footnote{166} Specifically, the proposed legislation creates a new misdemeanor for “a minor under 17 years of age to knowingly disseminate any material that depicts nudity or other sexual conduct by electronic transfer or capture of images of the person’s self image or image of another minor under 17 years of age.”\footnote{167} Furthermore, the Illinois proposal creates a new felony where a person engages in sexting with malicious intent:

It is unlawful for a minor under 17 years of age to knowingly obtain an image in violation of [these provisions] and distribute the image or images by means of uploading the nude image on an Internet website with the intent to injure the reputation of the other person or with the intent to cause emotional distress to the other person and to maintain an Internet website or webpage which is accessible to one or more third parties for a period of at least 24 hours.\footnote{168}

Notably, the new felony offense for using sexting as a means of harassment does not carry a sex offender registration requirement. As Illinois State Representative Darlene Senger, who introduced the bill, noted, “[t]he consequences in this bill will prevent teenagers from making the same mistake twice, while ensuring that their name and picture does not end up on the Illinois Sex Offender registry for the rest of their lives.”\footnote{169}

c) New Jersey

Legislators in New Jersey have focused their efforts on rehabilitative approaches to sexting emphasizing juvenile adjudication and education. New Jersey Senate Bill 2926, introduced June 15, 2009, “[c]reates diversionary

\begin{footnotes}
\item 167. \textit{Id.} § 11-27(a).
\item 168. \textit{Id.} § 11-27(c).
\end{footnotes}
program for juveniles who are criminally charged for ‘sexting’ or posting sexual images.\textsuperscript{170} Those teens who have not been previously adjudicated delinquent for a criminal offense or convicted of a criminal offense under state law and “were not aware that their actions could constitute and did not have the intent to commit a criminal offense,” qualify for a state Attorney General-created comprehensive education program designed to provide teenagers with information about

the legal consequences of and penalties for sexting or posting sexual pictures online, including the applicable federal and State statutes; the non-legal consequences of sexting or posting such pictures, including, but not limited to, the effect on relationships, loss of educational and employment opportunities, and being barred or removed from school programs and extracurricular activities; how the unique characteristics of cyberspace and the Internet can produce long-term and unforeseen consequences for sexting and posting such photographs; and the connection between bullying and cyber-bullying and juveniles sexting or posting sexual images.\textsuperscript{171}

Another legislative proposal introduced in New Jersey, Senate Bill 2925, would require schools and cell phone retailers to create education programs that warn youths about the potential harm accompanying sexting.\textsuperscript{172} Following the pattern in other states, in which a local sexting incident prompts legislative action, legislators introduced the bill after local authorities charged a teenager with a child pornography felony for posting about thirty photos of herself on MySpace.\textsuperscript{173} According to the sponsor, the legislation’s focus on education is necessary as, “[y]oung people, especially teen girls, need to understand that sending inappropriate pictures is not only potentially illegal, but can leave an indelible mark on them socially and educationally.”\textsuperscript{174} A third proposal introduced in New Jersey also adopts an education-oriented approach. Senate Bill 2923 requires school districts to disseminate

\textsuperscript{170} S.B. 2926, 213th Leg. (N.J. 2009).
\textsuperscript{171} Id.
\textsuperscript{174} Id.
information annually to students and parents or guardians about the risks involved in electronically distributing sexually explicit images.  

   d) Indiana and Virginia

In a more cautious move, several states initiated studies on the issue in 2009. The Indiana legislature adopted legislation in April 2009 to direct the state’s sentencing policy study committee to explore the sexting issue. The legislature’s resolution urged the sentencing policy committee to review:

(1) the use of cellular telephones to send explicit photographs and video (“sexting”), especially by children;
(2) the psychology of sexuality and sexual development;
(3) the psychology of sexual deviants and deviancy; and
(4) the mental development of children and young adults and how this affects the ability to make certain judgments; as these issues apply to sex offenses covered by Indiana statutes

and then to “consider revisions to these statutes based on the results of its study.”

Virginia legislators expressed a similar discomfort with prosecuting teenagers under child pornography laws for sending nude images of themselves though a computer or cell phone. The Virginia General Assembly accordingly requested that the state crime commission study the sexting issue and offer legislative recommendations for the 2010 session. Such a recommendation gives legislators more time to study a nascent issue before proposing the right remedy for an offense not under consideration when state anti-child pornography statutes were crafted. As the Co-Chair of the Crime Commission, Senator Kenneth Stolle noted, “I don’t know any member of the General Assembly who a year ago knew what sexting was. I think the concern is we actually have behavior that has not been contemplated by the statutes or by the General Assembly.”

As explored, supra, close to one-fifth of states undertook legislative action on sexting in the last year—a strong testament to the public attention focused on this issue. These responses range in focus from providing

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177. Id.
prosecutors with more lenient offenses for charging sexters, to authorizing more study of the issue, to proposing new educational resources for students and parents to learn more about the potential harms of sexting. At the same time, the vast majority of states ignored the uptick in sexting, leaving prosecutors in those states with few tools to discipline teenage offenders except woefully inadequate child pornography statutes. Part III examines the policy issues that states must balance in order to prudently address the sexting issue.

III. POLICY CONSIDERATIONS

Developing a response to teenage sexting that discourages the behavior while appropriately responding to the magnitude of the harms is challenging. To date, the incidence of state prosecutors pursuing child pornography charges against sexting teens suggests that a balanced response is too often abandoned in favor of harsh and inflexible policies disproportionate to the harms at issue. Such responses may also disregard important public policy issues implicated in sexting cases.

A. BALANCING THE FIRST AMENDMENT AND SEXTING HARMs

Child pornography, which subjects children to unimaginable harm in the creation of the images, differs markedly from sexting, where the images reflect consensual, and likely legal, activity. \(^{180}\) Although state prosecutors pursue child pornography charges against sexting teens, some legal scholars question whether the Supreme Court decisions excluding child pornography from First Amendment protection, mainly to prevent youth from being victims of sexual abuse in the production of explicit materials, apply to images produced voluntarily by teens without exploitation. \(^{181}\)

For good reason, child pornography is categorically denied protection under the First Amendment. \textit{New York v. Ferber} established that regardless of the obscenity analysis, sexually explicit images of children lie outside the protections of the First Amendment. \(^{182}\) The Court grounded this exclusion in the need to prevent the “sexual exploitation and abuse of children” that.

\(^{180}\) Whether the underlying activity is legal will depend on the nature of the activity, the ages of the participants, and the jurisdiction, and applicable statutory rape law, in which the activity is taking place. Of course, this policy issue is not applicable in sexting instances that involve coercion.

\(^{181}\) Humbach, \textit{supra} note 20, at 5 (“It is a question, therefore, whether the categorical exclusion can be suitably understood to include materials produced under entirely different circumstances, where the originally motivating harms may be absent and the brunt of suppression can savage the lives and future prospects of the very people whom the laws are supposed to protect.”).

occurs in the production of the materials—a “government objective of surpassing importance.” The images themselves are “intrinsically related” to the sexual abuse of the child and constitute a “permanent record” of the exploitation.\footnote{Ferber, supra note 37, at 516–21.} Ferber did not clearly limit the categorical exclusion of First Amendment protection to child pornography that perpetuates the harms of child exploitation, finding that a statute could fall within the unprotected category that “does not threaten the harms sought to be combated by the State.”\footnote{Ferber, supra note 37, at 766, 773 (finding that the application of the challenged statute to educational, medical, or artistic works unlikely accounts for “more than a tiny fraction of the materials within the statute’s reach”).} The Court later modified this analysis in Ashcroft v. Free Speech Coalition.\footnote{Ashcroft, supra note 20, at 21.} In Ashcroft, the Court considered whether Ferber applied to “virtual child pornography,” or “sexually explicit images that appear to depict minors but were produced without using any real children,” in considering the constitutionality of a federal statute criminalizing such materials.\footnote{Id. at 23.} In establishing full protection under the First Amendment for virtual pornography, the Court’s analysis “seems to presuppose that the unprotected category is not merely justified but also shaped on the particular harms that motivated its creation.”\footnote{Ashcroft, supra note 20, at 20.} Finding that the ban on virtual pornography “prohibits speech that records no crime and creates no victims by its production,”\footnote{Id. at 241, 239.} the Court arguably clarified that the Ferber ban on child pornography applies in instances where there is a close link between the suppressed speech and imminent criminal activity underlying that speech.\footnote{See Humbach, supra note 20, at 21.}

In the case of sexting, the harms underlying the speech denied constitutional protection in Ferber, which focused on the “exploitation” of children,\footnote{See Humbach, supra note 20, at 21.} differ significantly from teens’ self-produced pornography. Although there is much to learn about the psychological effects of voluntary sexting on teens, “there is no reason to think they are similar in nature or degree to the outrageously exploitative and abusive harms relied on in Ferber.”\footnote{New York v. Ferber, 458 U.S. 747, 753 (1982) (stating that the “single question” in the case concerned “the abuse of children who are made to engage in sexual conduct for commercial purposes”).} Besides the primary exploitation of those children appearing in child pornography, missing in sexting cases, Ferber also recognized that “the
materials produced are a permanent record of the children’s participation and
the harm to the child is exacerbated by their circulation.” 193 Though this
harm may apply in sexting cases where the images exchanged between teens
circulate outside the intended audience with a “haunting” effect on the
participants, the lack of sexual exploitation in sexting factually distinguishes
the degree of this harm from the regulatory interest of “surpassing
importance” central to Ferber.194 Proponents of prosecuting youth who self-
produce pornography under child pornography statutes also argue that a
youth’s self-produced pornography harms other children because the new
images enlarge the market for child pornography and may be used by
offenders to groom new victims.195 However, in analyzing the
constitutionality of state efforts to suppress speech in Ashcroft, the Court
rejected a similar harm argument about virtual child pornography causing
future acts of molestation by pedophiles, concluding that such harm was too
indirect: the “mere tendency of speech to encourage unlawful acts is not a
sufficient reason for banning it.” 196 Where there is no crime underlying
sexting, prosecutions of teenagers under child pornography laws essentially
criminalize “the acts of recording, documenting and communicating—in
effect making crimes out of essentially pure expression.” 197 Further, Ashcroft
suggests that “statutes that suppress speech will ordinarily have to be justified
by a purpose to prevent acts that are not merely harmful, but are harmful
enough to be crimes.” 198

Ultimately, it is unlikely that courts will treat sexting images differently
than other sexually explicit images of minors, given the state’s interest, as
articulated in the Florida and Washington juvenile cases involving e-mails
and videotapes, 199 in preventing the production and dissemination of any
images of minors engaged in explicit activity. However, reviewing the
Supreme Court’s previously articulated rationales for criminalizing child
pornography, mainly preventing the exploitation of youth, suggests caution
in categorically excluding sexting from First Amendment protection. Though
evidence may emerge showing that sexting exploits teens, and those harms
warrant a denial of protection under the First Amendment, this topic has yet

193. Ferber, 458 U.S. at 759.
194. Id. at 757; Humbach, supra note 20, at 24.
198. Id. at 28.
to be studied. Meanwhile, it is important to note that the child protection objective underlying the criminalization of child pornography may not justify the regulation of sexting.

B. RECOGNIZING TEEN PRIVACY

A second policy interest worth examining concerns the privacy values implicated in sexting and teenagers’ rights to autonomy. While the government certainly restricts minors’ personal liberties more than adults’, American jurisprudence recognizes that teens have some rights of privacy and decisional autonomy; Supreme Court decisions about contraception and state laws addressing minors’ access to medical services reflect these rights.

Generally speaking, the extent to which states protect minors’ privacy rights in their sexual activity varies widely and depends largely on the age of the participants. For example, in B.B. v. State, described supra Part II, the Florida Supreme Court found that a minor has a legitimate expectation of privacy in intimate personal activities and that the state failed to meet its burden of proving that a statute criminalizing consensual sex between two sixteen-year-olds furthered a compelling state interest through the least intrusive means (the applicable test in Florida). In contrast to laws that might prohibit adults from engaging in sexual activity with minors, which implicate the state’s interest in preventing the sexual exploitation of children, the Florida Supreme Court found that the state’s interest was grounded in “reasons of health and quality of life.” This state interest did not justify imposing criminal sanctions on minors engaging in consensual sex. Other

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200. Humbach, supra note 20, at 24; cf. id. at 2 n.16 (discussing how the illegal nature of child pornography inherently prevents scholars from empirical research in the area of sexting, including exploring the quantity of teenage sexting that actually legally constitutes child pornography).
201. Oliveri, supra note 105, at 486–87.
202. 659 So. 2d 256 (Fla. 1995).
204. 659 So. 2d at 259.
205. Id. Compare State ex. rel. Z.C, 165 P.3d 1206, 1212 (Utah 2007) (overturning the sexual abuse of minor convictions of a thirteen year old girl and twelve year old boy who had consensual sex, finding “no discernible victim the law seeks to protect”), with J.A.S. v. State, 705 So. 2d 1381, 1386 (Fla. 1998) (finding a compelling state interest in prohibiting consensual sexual activity between two fifteen-year-old boys and two twelve-year-old girls, and affirming statutory rape convictions). Some scholars have attributed these sorts of differing outcomes to courts’ recognition of exploitation in instances where the “minor victim was quite young or if the age disparity was significant, the danger of sexual exploitation would rise to a level that supported adjudicating the older minor delinquent.” Gregory R. Beck, J.A.S. v. State: Striking a Balance Between a Minors’ Right of Privacy and Florida’s Interest in Protecting Minor’s Adolescent Development, 23 NOVA L. REV. 479, 497 (1998).
states have reached opposing conclusions about the privacy rights of a minor to engage in consensual sexual activity with another minor. In *In re T.A.J.*, a California appellate court upheld the misdemeanor conviction of a sixteen-year-old boy accused of having sex with a fourteen-year-old girl, rejecting the youth’s argument that he could not be charged under a statute intended to protect him. In that case, the court found that “despite the fact that minors have privacy rights under California’s constitution—and regardless of the fact that many minors are sexually active—minors in California do not have a constitutionally protected right of privacy to engage in sexual intercourse.”

Of course, no court has found that minors have a privacy right to engage in sex with adults, nor that teens have a general privacy right in sexual activity on par with adults. But where the minors engaging in consensual sexual activity are close in age, reformed statutory rape laws either decriminalize such activity or dramatically lower the penalties. More generally, statutory rape laws have fallen into disuse with the recognition of the increased level of sexual activity among teenagers and more permissive societal attitudes toward sex.

This trend toward the recognition of some teenage right to privacy in instances of consensual sexual activity between participants of similar age warrants caution against assigning severe penalties in the typical sexting case. Although courts addressing the issue of minors self-producing pornography have universally found the state’s interest in combating child pornography to trump any privacy right of teens, there may be reason to revisit this conclusion as researchers learn more about the effects of sexting and its distinctions from child pornography. As the dissent recognized in *A.H.*, where two sixteen-year-olds memorialized legal sexual activity in the context of a relationship and intended to keep the photographs private, a teens’ right to privacy arguably should trump any state interest in preventing exploitation under some circumstances. In the rare instance where criminal sanctions

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206. 73 Cal. Rptr. 2d 331, 339 (Ct. App. 1998) (holding that “a minor does not have a legitimate expectation of privacy to engage in consensual sexual activity with another minor”); see Oliveri, *supra* note 105, at 487.
208. *Id.* at 488.
209. *Id.* at 486 (noting that “minors are subject to more restrictive state control than adults”).
211. See Oliveri, *supra* note 105, at 467–68. But see *id.* at 474–75 (noting that this trend has been counterbalanced by actions in some states to raise the age of consent, enhance penalties for certain kinds of statutory rape, such as adult males’ sexual involvement with teenage girls, and generally increase enforcement of existing laws).
212. See *A.H.*, 949 So. 2d at 239–41 (Padovano, J., dissenting) (finding that the defendant teenager “stands accused of nothing more than taking photographs of herself and
are warranted to address teens’ recording of sexual encounters, statutory rape laws are more likely than child pornography statutes to provide an appropriate punishment.\footnote{Smith, supra note 37, at 528.}

C. ENSURING PROPORTIONALITY IN PUNISHMENT

A final policy consideration in determining the appropriate response to sexting concerns the need for proportionality. Assigning sex felony charges to teens that produce and distribute provocative images of themselves disproportionately vilifies the underlying behavior, which in many instances is legal sexual activity at least partially protected by state constitutional rights to privacy.

A fundamental principle underlying the American criminal justice system is the notion of moral blameworthiness as the critical determinant of punishment, including the determination of who may be criminally punished and how much punishment convicted offenders should receive. In other words, “[t]o be justified, criminal punishment should be proportional to the blameworthiness of the defendant’s offense; those who are convicted should be punished in accordance with their degree of fault.”\footnote{Id. at 508 n.6.} Legislators enacted child pornography laws authorizing severe penalties for producers and distributors to address the “unspeakable harm” caused to children in the creation of these images.\footnote{Id. at 516.} This harm of conventional child pornography is compounded by the young age of most victims and the anxiety they experience from having such horrific abuse permanently captured in images that might emerge at any time.\footnote{Id. at 516–17.} By design, these “severe and inflexible” laws authorize sentences up to forty years and often utilize mandatory minimums to limit the extent to which judges can exercise leniency.\footnote{Id. at 529.} A felony conviction alone is a serious crime that makes it difficult for released individuals to participate in civil society, including finding work, voting, receiving a clearance for security jobs, serving as a juror, holding public office, possessing a firearm, or receiving licensure in certain professions.\footnote{Muscari, supra note 12.} Furthermore, under the Sex Offender Registration and Notification Act (SORNA) in the Adam Walsh Child Protection and Safety Act of 2006, states are required to impose registration requirements on her boyfriend” and that she “did not attempt to exploit anyone or to embarrass anyone…her expectation of privacy in the photographs was reasonable”).
anyone fourteen years of age or older who is convicted of a child pornography offense.219

Simply put, the state’s valid interest in preventing the production and distribution of sexually explicit images of minors does not justify using the bluntness of child pornography statutes to address sexting. Given available data on the scope of teen sexting and applicable laws covering the production, possession, and distribution of child pornography, one scholar estimates that “as many as 40-50% or more of otherwise law-abiding American teenagers are already felony sex offenders under current law,”220 raising significant public policy concerns about the broadly sweeping consequences of using child pornography statutes to discipline sexting.221

Statistically, most teens involved in sexting incidents are likely older minors. The median age at which U.S. teenagers become sexually active is 16.9 for boys and 17.4 for girls.222 Punishing sexting minors who could legally marry in many states under harsh statutes designed to punish sexual predators may not be an efficient use of state resources. In the words of one former federal cybercrimes prosecutor, using child pornography laws to prosecute sexting offenses “turns the whole statute on its head.”223

Furthermore, even where minors are prosecuted in juvenile courts, conviction for child pornography offenses is invariably accompanied by a sex offender registration requirement.224 The stigmatization, as well as the practical constraints imposed on registered sex offenders in terms of where they can legally live and work, would create an almost unbearable burden for any teenager.225 Given the public nature of online registration databases, and the community notification systems that exist in many states, a sexting

219. The Act defines “convicted” to include those: adjudicated delinquent as a juvenile for that offense, but only if the offender is 14 years of age or older at the time of the offense and the offense adjudicated was comparable to or more severe than aggravated sexual abuse . . . or was an attempt or conspiracy to commit such an offense.


221. See National Center for Missing & Exploited Children, supra note 59 (stating that “a blanket policy of charging all youth with juvenile or criminal violations will [not] remedy the problem of sexting”).

222. KAISER FAMILY FOUND., supra note 50, at 1. See also Smith, supra note 37, at 524.

223. Zetter, supra note 54 (quoting Mark Rasch).

224. See supra note 219 and accompanying text.

225. Smith, supra note 37, at 538–39 (“As sex offender registries have taken off, states and local governments have been engaged in an unseemly race to the bottom, trying, in effect, to outdo each other with increasingly draconian residency restrictions aimed at registered sex offenders.”).
teenager convicted of child pornography may be ostracized by classmates.\textsuperscript{226} In some cases, the ensuing harassment and bullying at school might exacerbate the conditions that prompted the sexting in the first instance.\textsuperscript{227} Authorities must also consider the permanence of child pornography charges, as sex offender registration will tarnish a youth’s record for life.\textsuperscript{228}

IV. ELEMENTS OF A MODEL LEGISLATIVE RESPONSE

A survey of the approaches to sexting taken to date by state legislators and a review of the relevant policy issues at stake suggest the need for a cautious response. Although states developing new legislation must tailor it to existing statutes addressing the exchange of sexually explicit materials, the following elements should be considered in new legislative proposals.

A. CONSIDERATIONS IN ADDRESSING TYPICAL SextING INCIDENTS

Most importantly, directing sexting teenagers to juvenile court, and exempting convicted teens from sex-offender registration statutes, will give juvenile adjudicators the flexibility they need to craft appropriate penalties. Particularly in the case of first-time offenders, where the conduct at issue most likely represents a youthful indiscretion rather than exploitation, adjudicating sexting teens in juvenile court provides the most appropriate response to the injury. The mainstream criminal justice system, and penalties created for serious sex offenses, is far too blunt an instrument to resolve a problem that reflects modern teenage life more than a cyber-crime epidemic.\textsuperscript{229}

The juvenile court system may offer further opportunity for more rehabilitative, rather than punitive, responses to sexting. For example, in Montgomery County, Ohio, the local prosecutor and juvenile court created a Prosecutor’s Juvenile Diversion Program, under which local juveniles charged with sexting are screened to determine eligibility for diversion from traditional juvenile court proceedings.\textsuperscript{230} Factors considered in making these determinations include:

\begin{itemize}
\item \textsuperscript{226} See Smith, supra note 37, at 536–37.
\item \textsuperscript{227} As part of registration, teens’ names, pictures, and offenses of conviction will be available online, making it “difficult to see how minors returning to school after a conviction in juvenile court can even begin to reintegrate into school when students are gossiping and teasing them about the sexually explicit . . . pictures they made.” \textit{Id.} at 536–37.
\item \textsuperscript{228} See Mathis & Aisner, supra note 69, at A1 (describing the considerations of Michigan authorities in charging a fourteen-year-old girl involved in a sexting incident with a child pornography offense, which carries a strict sex-offender registration requirement in the state).
\item \textsuperscript{229} See Lithwick, supra note 55.
\item \textsuperscript{230} Heck, supra note 22, at 29.
\end{itemize}
whether the juvenile has any prior sexual offenses, whether any
type of force or illicit substances were used to secure the photos,
whether the juvenile has been involved in this particular
diversionary program previously, or if there is strong opposition by
the victim or law enforcement to the juvenile being involved in a
diversionary program.231

The diversion program requires juveniles to complete a minimum of six
months of supervision, relinquish their cell phones, perform community
service, and complete an educational component focused on responsible use
of the Internet and communications technologies, the legal ramifications of
their conduct, and age-appropriate sexual boundaries.232 Upon successful
completion of the program, any pending charges against the juvenile are
dropped or dismissed.233 The Ohio program addresses the first-time offender
involved in sexting—the teenager who does not realize the illegality of his or
her actions—and who is “unlikely to re-offend after being educated on the
legal ramifications and the possible long term affects on the victim.”234 The
program recognizes, as the founding attorney notes, that “in some cases,
charging a juvenile with a felony and labeling them a sexual offender when
their actions were clearly a result of poor judgment and ignorance of the law
seems harsh for first-time offenders” and the notion that this activity is “best
addressed by education and parental involvement.”235

Further, in instances where local prosecutors want to pursue criminal
charges, crafting penalties outside of sex offense statutes is critical to
avoiding mandatory sex-offender registration requirements wildly
disproportionate to sexting harms. Compliance with the Adam Walsh Act,
and receipt of the federal funding attached to the law, requires states to
mandate that convicted sex offenders enroll in state registries.236 In Virginia,
juvenile and domestic relations court judges retain discretion over whether to
require juveniles adjudicated delinquent to register as sex offenders, but
“[t]his discretion continues to be at odds with the requirements of the Adam
Walsh Act.”237 In deciding whether to charge sexting teenagers with offenses
carrying registration requirements, states should also consider the significant
costs associated with mandating registration for an increasingly large pool of

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231. Id.
232. Id.
233. Id.
234. Id.
235. Id.
236. Michael F. Caldwell et al., An Examination of the Sex Offender Registration and
Notification Act as Applied to Juveniles: Evaluating the Ability to Predict Sexual Recidivism, 14
237. See Block, supra note 178, at 61.
offenders, including those juveniles convicted of sexting crimes. Strong empirical evidence further supports the argument for leniency, as juveniles sex offenders rarely re-offend. 238 This suggests that however serious the injury one might attribute to sexting, recidivism concerns should not bolster harsh punishment regimes.

Besides avoiding the consequences of sex-offender registration, creating new offenses that specifically target sexting will enable legislators to avoid the public perception that offenders are going unpunished or that new laws create loopholes for exploitation. The backlash experienced by the Vermont legislature in creating an exemption to sexting under the state’s child pornography statutes may instruct other states. 239 While media reports create the impression that most Americans share the belief that sexting teenagers should not receive the same treatment as sex offenders, popular opinions are far from uniform. 240 Creating a tailored offense to adjudicate first-time offenders as delinquent in juvenile court of a misdemeanor may help avoid controversy. Criticism that a sexting misdemeanor will somehow allow serious sexual exploitation to go unpunished—that, as Virginia Delegate David Albo has cautioned, you “change the law and create a loophole for child molesters” 241—can also be blunted by narrowly defining the crime at issue. For example, crafting the offense to recognize the age difference between participants can help to distinguish those offenses more likely to reflect exploitation than the far more innocent variety of similarly-aged teenagers voluntarily sharing images between co-participants. An age spread of more than three years more likely reflects the presence of coercion, taking the offense outside the realm of the more conventional sexting discussed in this Note.

State authorities could also go a long way in lessening the likelihood that teenagers committing youthful indiscretions will be treated as felony sex offenders by encouraging prosecutors to exercise reasonable discretion in bringing cases. The appropriate mechanism for communicating this message may vary by state, but a clear policy statement from an Attorney General is likely to be influential in disciplining the zealous prosecutor bent on pursuing the most hard-line penalties against sexting teens.

238. Id. (“In Virginia, for example, the [Department of Juvenile Justice] DJJ has reported that between the fiscal years 2002 and 2006, 513 juvenile sex offenders were released from DJJ facilities. By the conclusion of the 2007 fiscal year, only thirteen of those who were released had been convicted of a new sex offense.” (internal citations omitted)).

239. See supra Section II.B.1.a).

240. For example, consider the outcry about Vermont’s attempt to “legalize” sexting. See supra notes 128-129.

Finally, any effective policy response must also involve an education component directed towards teenagers, parents, and educators. While social science research on sexting is quite nascent, anecdotal evidence suggests that most teenagers charged with criminal offenses in sexting cases did not foresee the consequences. Efforts to incorporate sexting resources into existing Internet and technology safety programs are already underway. For example, schools now crack down on sexting by banning the behavior in codes of conduct, with punishments ranging from mandatory conferences with parents and administrators to new community-based workshops to educate students, parents, and teachers about the dangers of sharing personal information online. Other schools follow the advice of Internet safety experts and require parents and students to sign a contract agreeing to certain conditions regarding the use of cell phones or other personal digital devices on campus, in an effort to ensure that students are aware that sexting is illegal and that their use of technology complies with school disciplinary codes. Although impulsive reactions like banning teenagers’ access to cell phones might provide the easiest short-term solution, they will likely do nothing to address the underlying cause of the behavior.

Other government-funded programs and non-profit organizations are focused on addressing the deficit of knowledge about the risks involved in sexting. As one model, the New South Wales government in Australia recently launched an educational campaign to warn children about the “lifetime consequences” of sexting and posting images on social networking sites, including distributing a fact sheet encouraging parents to talk to their children and monitor their children’s online profiles for illegal images.

242. The Houston Independent School District has implemented a ban, in its district code, on “using a cell phone or other personal communication device to send text or e-mail messages or possessing text or e-mail messages containing images reasonably interpreted as indecent or sexually suggestive while at school or at a school-related function.” Billups, supra note 173.

243. See WILLARD, supra note 56, at 188 (describing a “checklist” of issues that should be addressed in an agreement between schools and parents concerning students’ use of cell phones on campus).

244. In the instance where the teen producer of pornography is a target of cyberbullying, confiscation of what has become a lifeline for modern adolescents may further socially isolate the victim. See HINDUJA & PATCHIN, supra note 31, at 173.

245. See, e.g., ConnectSafely.org, Tips to Prevent Texting, http://www.connectsafely.org/pdfs/sexting_tips.pdf (last visited Jan. 24, 2009) (“If a sexting photo arrives on your phone, first, do not send it to anyone else (that could be considered distribution of child pornography). Second: Talk to a parent or trusted adult. Tell them the full story so they know how to support you. And don’t freak out if that adult decides to talk with the parents of others involved—that could be the best way to keep all of you from getting into serious trouble.”).

While this Note focuses almost exclusively on legal responses to sexting, education and school community-based solutions are arguably the best means of deterring sexting and avoiding any possibility of harmful effects.

B. CONSIDERATIONS IN ADDRESSING INCIDENTS OF SEXTING AND CYBERBULLYING

When sexting morphs into online harassment, the range of remedies already used to address cyberbullying cases provides a variety of options for dealing with adolescent offenders.

For starters, school administrators can address the behavior through disciplinary actions designed to address cyberbullying or, depending on the seriousness of the offense, work with local authorities to utilize cyberbullying laws specifically crafted to combat online harassment and aggression. Though a school’s intervention is limited in some respects by First Amendment restrictions on the extent to which school officials can discipline students for harassing speech that does not involve school resources or occurs off-campus, unless it “materially and substantially” disrupts learning, interferes with school discipline, threatens other students or infringes on civil rights, sextbullying is less likely to raise this limitation. Although not all sexting involves images that legally qualify as child pornography, the legal issues inherent in the transmission of images of nude or partially nude minors, content that is not subject to First Amendment protection, likely provide school officials with sufficient grounds for intervention. An effective policy will include graduated consequences and remedial actions to ensure responses proportional to the severity of the offense. Taking actions like establishing an anonymous reporting system to enable students to come forward without fear of repercussion from other students, which has proved useful in uncovering cyberbullying incidents, could also prove important to limiting the distribution of sextbullying messages.

In the most serious instances of teenagers using sexting as a tool to intentionally harass others, considering criminal sanctions may be appropriate. Authorities, at least in most states, could use the statutory


248. Id. at 122–23.

249. Id. at 123 (discussing the utility of an anonymous reporting system for cyberbullying incidents).

250. Likely, the possibility of criminal liability will provide the grounds for a school’s disciplinary action. See id. at 122.
scheme covering online harassment to address sextbulllying. Forty-five states have laws that explicitly label certain electronic forms of communications as cyberharassment, with some states including cyberharassment offenses under general harassment statutes and others enacting independent laws for cyberbulllying. At least seventeen states have passed specific cyberbullying laws that generally include one or more of the following elements: require school districts to include cyberbullying in school anti-bullying policies; criminalize or provide specific penalties for cyberbullying; authorize administrators to take action when off-campus actions affect on-campus discipline; require schools to develop new reporting and disciplinary procedures in cyberbullying cases; and mandate that school districts create and implement Internet safety curricula.

State legislatures that have not adopted new laws addressing cyberbulllying in a comprehensive manner should address the issue. Otherwise, faced with public pressure to take action, prosecutors may turn to laws ill-suited to address the immediate offense. In the case of Jesse Logan’s suicide, where sexting was used as tool of intentional harassment, Logan’s mother consulted with six lawyers in an ultimately unsuccessful effort to find legal recourse for her daughter’s death; each one told her that prosecuting the involved teens for child pornography distribution was the only applicable law.

In some instances, sextbulllying victims may also find redress through civil tort suits for privacy violations or the infliction of emotional...
Often, the simple initiation of legal action against an offender will stop the malicious behavior. Damages might include pain and suffering, costs of counseling for the youth victim, and losses related to lowered school performance or school avoidance. However, pursuing a tort action against a sexting aggressor would likely involve several challenges, especially identifying the parties at fault when text messages are widely transmitted and individual transmitters might not possess the requisite intent for liability. It may take just a few well-publicized cases where the parents of sextbullies are held financially responsible for the harm caused by their children to encourage greater education and supervision regarding teens’ use of cell phones.

V. CONCLUSION

While recent polls and high-profile stories raised the decibel of the public conversation about sexting, the scope and depth of the issue is still relatively unknown. Whether sexting represents merely the latest teen fad or a lasting expression of teen sexuality engrained in popular culture remains to be seen. As state legislators work to address the issue, this Note offers a framework for developing a more balanced response appropriate to the injuries at stake and the underlying policy issues implicated by the behavior. While legal precedent and zealous prosecutors may support the use of child pornography statutes in addressing sexting crimes, such a harsh and inflexible response will rarely, if ever, represent a proportionate remedy to the harm at hand.

§ 652D (1977). The tort is limited in scope by the great breadth of its newsworthiness exception, which carves out from liability anything occurring in public or which could be considered of social value. Josh Blackman, Omniveillance, Google, Privacy in Public, and the Right to Your Digital Identity: A Tort for Recording and Disseminating an Individual’s Image over the Internet, 49 SANTA CLARA L. REV. 313, 378–79 (2009) (arguing that the breadth of the newsworthiness means that the “tort can no longer be an effective tool for protecting individual privacy”) (quoting Jacqueline R. Rolfs, The Florida Star v. B.J.F.: The Beginning of the End for the Tort of Public Disclosure, 1990 WIS. L. REV. 1107, 1128)). Unless the nudity captured in the text message occurred in public, however, a message containing an image of a minor, who is not legally able to offer consent, is unlikely to qualify for any defenses under the tort. As sext images could be placed online for further dissemination to a potentially limitless audience, the disclosure harms addressed through the public disclosure of private facts make the tort particularly applicable to sexting.

257. Under an intentional infliction of emotional distress theory, a plaintiff would have to show that the defendant intentionally or recklessly took extreme and outrageous action that caused him or her severe emotional distress. RESTATEMENT (SECOND) OF TORTS § 46 (1965). While the tort encompasses action taken with reckless disregard to the possibility of causing distress, so the plaintiff does not necessarily have to show intent, it may be difficult to establish that the sexting itself constituted “extreme and outrageous” conduct.

258. HINDUJA & PATCHIN, supra note 31, at 178.

259. See WILLARD, supra note 56, at 94–95.
Lawmakers looking to address the sexting phenomenon should focus, instead, on crafting a new misdemeanor outside of child pornography statutes that narrowly addresses the behavior at issue and provides for juvenile adjudication. In instances where sexting escalates to the realm of “sextbullying,” school officials and educators should utilize cyberbullying resources, including newly developed laws specifically designed to address online harassment. In the meantime, controlling knee-jerk reactions to issues like sexting and focusing on sensible solutions will help keep everyone out of trouble.
CRAIGSLIST—A CASE FOR CRIMINAL LIABILITY FOR ONLINE SERVICE PROVIDERS?

Shahrzad T. Radbod

“The Communications Decency Act was not meant to create a lawless no-man’s-land on the Internet.”

In 1995, Craig Newmark created Craigslist.org, a website that enables users to post classified ads and interact in forums. Craigslist’s simple design and the fact that it does not sell advertising space have contributed significantly to its success. Its pages are divided into broad categories, such as “Jobs” and “Services,” and easy to navigate subcategories for more than 450 cities worldwide. Almost fifteen years after its founding, the San Francisco-based website is the seventh most popular English-language webpage in the world, receiving over twenty billion page views per month. However, despite Craigslist’s popularity, it only employs about 30 employees.

Several recent crimes involving Craigslist drew the attention of law enforcement officials. In April 2009, Boston police officers arrested a twenty-two-year-old medical school student named Philip Markoff—better known as the “Craigslist killer”—in connection with several crimes. First, Markoff allegedly robbed a woman at gunpoint at a Westin hotel after he arranged to receive a massage from her through a Craigslist “Erotic Services” posting. The masseuse only escaped when her husband entered the room. According to police, four days later, Markoff murdered Julissa Brisman, another masseuse he had solicited through Craigslist’s “Erotic Services”

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1. Fair Hous. Council of San Fernando Valley v. Roommates.com, LLC, 521 F.3d 1157, 1164 (9th Cir. 2008) (en banc).
4. Id.
In the months following the crimes, both the media and law enforcement officials turned their attention to the high volume of crimes associated with classified services advertisements on Craigslist. Section 230 of the Communications Decency Act (“Section 230”) grants broad immunity to websites with user-generated content. In the past several years, two courts have limited the scope of Section 230 somewhat, but it continues to be a powerful safe harbor protecting websites from liability for their users’ torts and criminal activities. Still, perhaps motivated in part by judicial narrowing of Section 230, Craigslist elected to change the “Erotic Services” section of its website and assured law enforcement officials that its employees would monitor the section for illegal conduct.

This Note will examine the extent of Craigslist’s potential criminal liability for its users’ offenses. Part I looks at Section 230 and its judicial interpretation. Part II explores cases applying Section 230 and how plaintiffs have used unique legal theories to hold online service providers liable for the actions of third parties. Part III discusses how Craigslist’s “Erotic Services” forum has been a source of users’ criminal activity. Part IV weighs the possibility of holding Craigslist criminally liable through an exception to Section 230.

I. SECTION 230 OF THE CDA AND JUDICIAL INTERPRETATION

A. LEGISLATIVE BACKGROUND OF SECTION 230

In 1995, a New York state court held that an interactive computer service acted as a publisher and was, therefore, responsible for defamatory comments made by users on its virtual bulletin boards. To prevent a wave of tort-based lawsuits against then-novel internet services and the consequent chilling effect on free speech, Congress passed the Communications Decency

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8. See, e.g., Robert Mitchum & Monique Garcia, Craigslist Erotic Services: Legal Pressure Shuts Down Section Tied To Prostitution, CHI. TRIB., May 14, 2009, at 6; Brad Stone, Craigslist Agrees to Curb Sex Ads, N.Y. TIMES, Nov. 6, 2008, at B3;


Act in 1996 ("CDA"). The CDA sought to promote such policy objectives as “continued development of the Internet” and “development of technologies which maximize user control over what information is received by individuals.” The following year, the United States Supreme Court in *Reno v. ACLU* struck down the parts of the CDA addressing liability for indecent materials as unconstitutional under the First Amendment. However, Section 230 of the CDA remained in tact and still guarantees broad immunities to interactive computer services providers:

(c) Protection for ‘good samaritan’ blocking and screening of offensive material.

(1) Treatment of publisher or speaker

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.

(2) Civil liability

No provider or user of an interactive computer service shall be held liable on account of—

(A) any action voluntarily taken in good faith to restrict access to or availability of material that the provider or user considers to be obscene, lewd, lascivious, filthy, excessively violent, harassing, or otherwise objectionable, whether or not such material is constitutionally protected; or

(B) any action taken to enable or make available to information content providers or others the technical means to restrict access to material described in paragraph (1) [subparagraph (A)].

Congress also enacted limitations to Section 230:

(e) Effect on other laws

(1) No effect on criminal law

Nothing in this section shall be construed to impair the enforcement of section 223 or 231 of this title, chapter 71 (relating to obscenity) or 110 (relating to sexual exploitation of children) of Title 18, or any other Federal criminal statute.

...,

(3) State law

Nothing in this section shall be construed to prevent any State from enforcing any State law that is consistent with this section. No cause of action may be brought and no liability may be

13. *Id.* at § 230(b)(1),(3).
15. § 230(e).
imposed under any State or local law that is inconsistent with this section.\textsuperscript{16}

Thus, the statute shields providers of “interactive computer services” from the liability normally attributed to publishers as long as another “information content provider” provides the content.\textsuperscript{17} While the immunity granted by Section 230 is quite broad, it does not extend to federal criminal statutes.\textsuperscript{18}

**B. Judicial Interpretation**

In 1997, the Fourth Circuit Court of Appeals in \textit{Zeran v. America Online, Inc.} became the first appellate court to interpret the scope of immunity under Section 230.\textsuperscript{19} The plaintiff in \textit{Zeran} brought a negligence claim against America Online (“AOL”), for not promptly removing defamatory statements posted on an AOL bulletin board.\textsuperscript{20} First, the plaintiff argued that the defendant was a distributor rather than a publisher, and thus not protected by Section 230’s immunity for publisher liability.\textsuperscript{21} The court disagreed and held that AOL fell within the “traditional definition of publisher” and was therefore “clearly protected” by Section 230.\textsuperscript{22} Artful pleading did not take away from the fact that AOL assumed a role that Section 230 specifically protected.\textsuperscript{23}

Next, Zeran argued that imposing liability on service providers who have knowledge of defamatory statements was consistent with the framework of Section 230.\textsuperscript{24} The court, once again, rejected the plaintiff’s argument. The court reasoned that, unlike print publishers that publish limited content, interactive computer services receive large numbers of postings, and could not feasibly investigate allegations in a timely manner.\textsuperscript{25} The court determined that since liability upon notice would have a chilling effect on free speech and deter self-regulation, it was inconsistent with Section 230’s regime.\textsuperscript{26}

Lastly, the plaintiff urged the court to apply a statutory canon favoring retention of common law principles, and thereby hold distributors liable.\textsuperscript{27} The court rejected the plaintiff’s final argument because the application of

\textsuperscript{16} Id. at § 230(e).
\textsuperscript{17} Id. at § 230(c)(1).
\textsuperscript{18} Id. at § 230(e)(1).
\textsuperscript{19} Zeran v. America Online, Inc., 129 F.3d 327 (4th Cir. 1997).
\textsuperscript{20} Id. at 328.
\textsuperscript{21} Id. at 331.
\textsuperscript{22} Id. at 332.
\textsuperscript{23} Id. at 332–33.
\textsuperscript{24} Id. at 333.
\textsuperscript{25} Id.
\textsuperscript{26} Id.
\textsuperscript{27} Id. at 333–34.
such a canon would contravene the broad scope intended by Congress. The court found that Congress unequivocally addressed the issue by using the term “publisher,” which traditionally included both distributors and original publishers. The court’s decision in Zeran set the stage for over a decade of broad application of the provisions of Section 230.

II. ATTEMPTS TO CIRCUMVENT SECTION 230

Since the CDA’s inception, courts have overwhelmingly used Section 230 to grant immunity to online services providers. Many creative attempts to elude the act’s broad protection have failed. However, in the past two years, two plaintiffs successfully argued that Section 230 immunity did not apply to the online service providers against which they brought suit. This Part explores both the failures and successes and what impact they could have on future Craigslist litigation.

A. CASES GRANTING SECTION 230 PROTECTION

1. MySpace Cases

Two cases involving MySpace, an online social networking site, provide insight into how a court might apply Section 230 against Craigslist. In both cases, the plaintiffs ultimately failed to persuade a court that Section 230 protection should not apply.

a) Doe v. MySpace

In May 2008, the Fifth Circuit affirmed a district court’s ruling that the “Good Samaritan” provision of Section 230 barred the plaintiff, the mother of a thirteen-year-old that posed as an eighteen-year-old to gain access to the social networking site MySpace, from bringing a negligence action against MySpace for failing to protect her daughter from a predator. The plaintiff’s daughter had been sexually assaulted by a predator she met on the

28. Id. at 334.
29. Id.
30. See e.g., Doe v. MySpace, Inc., 528 F.3d 413, 417–18 (5th Cir. 2008) (holding that plaintiff’s claim that website had a common law duty to protect minors was barred by Section 230); see also Dart v. Craigslist, Inc., No. 09-C1385, 2009 U.S. Dist. LEXIS 97596, *18–*19 (N.D. Ill. Oct. 20, 2009) (rejecting plaintiff’s claim that website created a public nuisance).
32. Doe v. MySpace, Inc., 528 F.3d 413 (5th Cir. 2008).
defendant’s website. The plaintiff made three unsuccessful arguments as to why MySpace was not protected under Section 230’s broad reach.

First, the plaintiff argued that MySpace was not a protected “publisher” because it was partially responsible for creating the content of the information exchanged between the predator and her daughter. Second, the plaintiff argued that Section 230 did not immunize entities that failed to take reasonable steps to protect minors. Lastly, the plaintiff argued that the defendant had a common law duty to protect her daughter.

Citing cases from the Third, Fourth, Ninth, and Tenth Circuits, the court held that Section 230 should be construed liberally to protect publishers of user-generated comments. The court did not rule on the plaintiff’s first argument that MySpace created the content on its website because the argument was not raised at trial. Although the plaintiff tried to distinguish her case by showing that MySpace had taken no action to protect minors, the court reasoned that such “allegations are merely another way of claiming that MySpace was liable for publishing [the third party content].” Thus, the court held that the CDA barred the plaintiff’s claims for negligence and gross negligence.

b) Doe IX v. MySpace

In May 2009, a district court in Texas granted MySpace’s motion to dismiss a suit brought by a mother of a child assaulted by a sexual predator the child had met on MySpace. In addition to claiming negligence and gross negligence, like the plaintiff in Doe v. MySpace, the plaintiff also raised a strict products liability claim against the website.

The plaintiff made two principal arguments. First, she alleged that the defendant was not entitled to Section 230 immunity because it failed to take protective measures. Citing Doe v. MySpace, the court readily rejected the first argument. Second, the plaintiff argued that the defendant was an information content provider, not an interactive computer service, and,
therefore, not protected under Section 230. This was the same argument the Fifth Circuit refused to consider in Doe because the plaintiff had not raised the argument in the district court.

This time, however, the court did reach the merits of the argument that MySpace was partially responsible for creating information exchanged. The plaintiff argued that MySpace, like the defendant in Roommates.com, was an information content provider because it created the information exchanged between her daughter and the sexual predator. In Roommates.com, the court determined that the defendant was not immune under Section 230 because it required users to enter certain data, and therefore acted like an information content provider. The court rejected this argument and distinguished Roommates.com. It stated that MySpace users were not “required to provide any additional information to their profiles,” whereas the user agreement for Roommates.com required users to provide certain information. The court held that merely prompting users to provide more information did not qualify a website as an information content provider.

2. Craigslist Cases

During the course of the past two years, several plaintiffs have filed lawsuits against Craigslist based on different theories. Like MySpace, Craigslist used Section 230 to shield itself from liability.

a) Gibson v. Craigslist

In September 2008, Calvin Gibson filed an amended complaint against Craigslist, Inc. claiming that it breached its duty of care when a user-generated ad on its website facilitated the illegal purchase of a gun used to shoot the plaintiff. Craigslist filed a motion to dismiss claiming immunity under Section 230. The defendant argued that the “CDA provides an absolute bar to any cause of action that would make an interactive service

45. Id.
46. Doe v. MySpace, Inc., 528 F.3d 413, 422 (5th Cir. 2008).
47. Roommates.com, 521 F.3d 1157 (9th Cir. 2008) (en banc).
49. Roommates.com, 521 F.3d 1157, 1166 (9th Cir. 2008) (en banc).
50. Doe IX, 629 F. Supp. 2d at 665. See also Doe II v. MySpace, Inc., 96 Cal. Rptr. 3d 148 (Cal. Ct. App. 2009) (holding that MySpace was not an information content provider and, therefore, immune under Section 230).
53. Id. at *2.
provider, like [C]raigslist, liable for third-party content posted on the Internet through its service.”

In order to determine whether Section 230 immunized Craigslist, the court applied a three-pronged test. The court had to determine “[i] whether Defendant is a provider of an interactive computer service; [ii] if the postings at issue are information provided by another information content provider; and [iii] whether Plaintiff’s claims seek to treat Defendant as a publisher or speaker of third party content.” As to the first prong, the plaintiff did not contest the categorization of the defendant as an interactive computer service provider. Second, the amended complaint stated that an unknown individual posted the listing, suggesting the information was provided “by another information content provider.” Lastly, the court determined that the plaintiff was treating the defendant as a publisher because it sought to hold the defendant liable for not monitoring the postings on its website. The court consequently granted the defendant’s motion to dismiss.

b) Chicago Lawyers’ v. Craigslist

In 2008, the Seventh Circuit issued a decision in a case involving the Fair Housing Act and Craigslist. The Chicago Lawyers’ Committee for Civil Rights Under Law brought a suit against Craigslist claiming that its website violated the Fair Housing Act, which prohibits ads that state a preference with respect to race, religion, sex, or family status. The plaintiff argued that Section 230(c) did not grant Craigslist immunity because it did not apply to information content providers who did not filter content on their websites. It based its argument on the fact that the caption of Section 230(c) read: “Protection for ‘Good Samaritan’ blocking and screening of offensive material.” Craigslist, however, argued that Section 230 provided a general prohibition of civil liability for interactive services providers. The court asserted that neither the plaintiff nor defendant was correct; Section 230 did

54. Id.
55. Id. at *8-*9 (quoting Nemet Chevrolet, Ltd. v. Consumeraffairs.com, Inc., 564 F. Supp. 2d 544, 548 (E.D. Va. 2008)).
56. Id. at *10-11.
57. Id. at 12.
58. Id.
61. Id. at 668; 42 U.S.C. § 3604(a), (c).
62. Chicago Lawyers’, 519 F.3d at 669.
63. Id.; 47 U.S.C. 230(c).
64. Chicago Lawyers’, 519 F.3d at 669.
not exclude non-filtering internet services but neither did it constitute a complete grant of immunity in all civil liability cases.65

Judge Easterbrook discussed at length the problems that would arise if internet services providers were required to filter all material posted on their websites.66 The court stated that Craigslist had some of the characteristics of a newspaper’s classified section.67 However, since it did not produce or publish the material, Craigslist was also similar to a common carrier.68 The court stated that it would be cost prohibitive to increase the limited staff of the site to police the thirty million notices published every month.69 The court concluded by stating that Section 230 did not allow a party to “sue the messenger just because the message reveals a third party’s plan to engage in unlawful discrimination.”70

The court in Chicago Lawyers’ also held that while Craigslist played some causal role by providing a forum for discriminatory ads, it in no way caused the ad to be made.71 The court reasoned that “[n]othing in the service craigslist offers induces anyone to post any particular listing or express a preference for discrimination.”72 Craigslist could not be held more liable than the makers of the computers that enabled users to post the advertisements in the first place.73 Finally, the court held that while the plaintiff could target individuals who violate the Fair Housing Act, the plaintiff could not hold Craigslist responsible.74

B. SECTION 230 IMMUNITY NOT GRANTED

While plaintiffs often attempt to circumvent Section 230 by arguing that interactive services providers create the content on their website and have a duty to protect young users, both lines of reasoning have succumbed to the broad immunity court’s grant under Section 230. Recently, however, several signs suggest that courts will carve out future limitations on Section 230.

65. Id.
66. Id. at 668–69.
67. Id. at 668.
68. Id.
69. Id. at 668–69.
70. Id. at 672.
71. Id. at 671.
72. Id.
73. Id. at 672.
74. Id.
1. Roommates.com

Just one month after the Seventh Circuit reached its decision in *Chicago Lawyers’*, the Ninth Circuit reached a different conclusion in another case regarding the Fair Housing Act.\(^{75}\) Several local housing councils brought a case against Roommates.com, a roommate matching website.\(^{76}\) Before users could search the listings on the defendant’s website, the defendant required them to create profiles and disclose their sex, sexual orientation, and other personal information.\(^{77}\) The website also required users to describe their preferences in roommates and encouraged comments in an “Additional Comments” box.\(^{78}\) Plaintiffs alleged that the website violated the Fair Housing Act\(^ {79}\) and state housing discrimination laws by requiring its users to state their preferences in regards to roommates and to share protected characteristics.\(^ {80}\)

The court determined that Section 230 immunity did not apply because Roommates.com acted as an information content provider when it required website users to complete questionnaires it had created.\(^ {81}\) Unlike the limited role of Craigslist in *Chicago Lawyers’,* Roommates.com contributed to the content that was placed on its website. The court held that Section 230 did not shield online services providers from civil claims when they “materially contribut[e]” to the unlawfulness of the content.\(^ {82}\) The court reasoned that “the Communications Decency Act was not meant to create a lawless no-man’s-land on the Internet.”\(^ {83}\)

The court also determined that the “Additional Comments” feature was immunized because the defendant “does not provide any specific guidance . . . nor does it urge subscribers to input discriminatory preferences.”\(^ {84}\) Unlike with the questionnaire, Roommates.com did not require users to fill out “Additional Comments” nor did it provide informational categories or drop down menus for the users’ selection. The “Additional Comments” section was more analogous to the user-generated advertisement placed on Craigslist.org in *Chicago Lawyers’.* The decision in *Roommates.com* presented a

\(^{75}\) 42 U.S.C. § 3601.

\(^{76}\) Roommates.com, LLC, 521 F.3d 1157, 1161 (9th Cir. 2008) (en banc).

\(^{77}\) Id.

\(^{78}\) Id. at 1162.

\(^{79}\) Id. at 1165.

\(^{80}\) Roommates.com, 521 F.3d at 1162.

\(^{81}\) Id. at 1164.

\(^{82}\) Id. at 1167–68.

\(^{83}\) Id. at 1164.

\(^{84}\) Id. at 1173–74.
break from past CDA jurisprudence, in which courts had granted immunity to nearly all interactive computer service providers.

2. NPS, LLC v. StubHub, Inc.

Shortly after the Ninth Circuit decided Roommates, another court applied its Section 230 analysis in NPS, LLC v. StubHub, Inc.\footnote{NPS, LLC v. StubHub, Inc., No. 06-4874-BLS1, 2009 Mass. Super. LEXIS 97 (Mass. Super. Ct. Jan. 26, 2009).} The defendant in StubHub operated a website that helped users sell season tickets to sporting events.\footnote{Id. at *5.} The plaintiff, an issuer of tickets to the Patriots football games, brought several claims against the defendant for providing a venue for season ticket holders to illegally sell their tickets.\footnote{Id. at *1.}

The defendant moved for partial summary judgment with regards to the plaintiff’s claim for intentional interference with advantageous relations.\footnote{Id.} The defendant argued that it was immune under Section 230 because it was merely an interactive computer service provider.\footnote{Id. at *12.} However, the court disagreed and stated that there was evidence that StubHub “materially contributed” to the illegal scalping of season tickets.\footnote{Id. at *13; See Roommates.com, 521 F.3d at 1167–68 (holding that a website that materially contributes to the unlawful content on a website falls within the exception to Section 230 and is not granted immunity).} Citing Roommates.com, the court held that because StubHub helped to develop the unlawful content on its website, it fell outside the scope of Section 230 immunity.\footnote{StubHub, 2009 Mass. Super. LEXIS 97 at *13.}

The court offered two principal criteria to differentiate StubHub from websites hosting classified ads, such as Craigslist.org.\footnote{Id. at *33–*34.} First, it stated that while other websites charged a fixed rate, StubHub charged its users fees based on the price of the ticket sale.\footnote{Id. at *34.} Second, StubHub affirmatively sought to increase the prices others charge in their ads.\footnote{Id. at *34–*35.} Other classified ads did not encourage any particular content within an ad. After many years of courts liberally granting providers of interactive computer services immunity, two courts reevaluated Section 230 and placed limits on what it means to contribute content to a website.
III. “EROTIC SERVICES” UNDER ATTACK

A. AGREEMENTS WITH STATE ATTORNEY GENERALS

In November 2008, just one year prior to the well-publicized slaying of the masseuse hired through a Craigslist “Erotic Services” posting, Craigslist, along with forty state attorney generals and the National Center for Missing and Exploited Children, released a statement. The joint statement detailed the “measures that craigslist is taking to help combat unlawful activity and improve public safety on its web site” and announced that Craigslist would require erotic service providers to pay a fee and provide a valid form of identification in order to advertise on the website. Additionally, Craigslist, if subpoenaed, would provide that information to the relevant authorities. The goal of the agreement was to “allow legitimate escort and other services to continue advertising, while providing a strong disincentive to companies who are conducting illegal business.” However, critics later argued that efforts to curb illegal conduct on the website failed because advertisers used fake credit cards or untraceable debit cards.

Following the arrest of the “Craigslist killer,” Craigslist made further voluntary changes to its policy. In May 2009, without conferring with either state attorney generals or law enforcement officials, Craigslist stated that it would close its “Erotic Services” category and replace it with an “Adult Services” category. Postings to the new category would cost $10 and could be renewed for $5. Furthermore, Craigslist promised that its employees would review the postings for illegal content.

96. Id.
97. Id.
101. Id.
102. Id.
During the same time, South Carolina Attorney General Henry McMaster threatened to file criminal charges against Craigslist management if they did not within ten days remove portions of Craigslist.org enabling the solicitation of prostitution and dissemination of pornographic materials.\(^{104}\) Craigslist responded by filing a motion of declaratory and injunctive relief in a district court in South Carolina to “enjoin a threatened prosecution in violation of federal law and the U.S. Constitution.”\(^{105}\) Furthermore, Craigslist stated that it had voluntarily attempted to reduce the illicit use of its website and that its attempts failed because illicit posting had dropped dramatically.\(^{106}\) Craigslist alleged that Attorney General McMaster’s threat of prosecution would violate its First Amendment right to free speech.\(^{107}\) McMaster subsequently backed down and stated that he was happy that Craigslist was taking the matter seriously.\(^{108}\)

B. \textit{Dart v. Craigslist}

In March 2009, Thomas Dart, an Illinois county sheriff, filed a complaint in the Northern District of Illinois against Craigslist claiming that it “knowingly and intentionally facilitates prostitution”\(^{109}\) and that it “creates an ongoing nuisance” by enabling prostitution.\(^{110}\) The plaintiff alleged that in doing so Craigslist violated several municipal, state, and federal statutory laws.\(^{111}\) The complainant stated that his county spent over $100,000 monitoring Craigslist and arresting criminals based on their activity on the website.\(^{112}\) Dart stated that the changes made to Craigslist following the November 2008 agreement did not reduce the number of illicit posts on the


\(^{106}\) Id. at ¶ 5.

\(^{107}\) Id. at ¶ 69.


\(^{110}\) Id. at ¶ 129.

\(^{111}\) Id. at ¶ 5.

\(^{112}\) Id. at ¶ 141.
website because prostitutes “found ways to circumvent the less than onerous restrictions.”

In May 2009, Craigslist filed a motion for judgment on the pleadings. Craigslist argued that Section 230 immunized it from liability and that the plaintiff’s proposed remedies were barred as a matter of law. To support its Section 230 argument, Craigslist directed the court to *Chicago Lawyers’* from the Seventh Circuit and *Roommates.com* from the Ninth Circuit. Furthermore, Craigslist urged the court that it qualified for Section 230 immunity under the three-prong test for determining when a provider of online services is a publisher of unlawful third party content. Craigslist said that Dart could not “escape this conclusion through artful pleading—such as by trying to impose liability on craigslist as a ‘public nuisance.’” Lastly, Craigslist contended that if the court gave credence to Dart’s argument, it would circumvent Congress’s intent to encourage the development and self-regulation of the Internet.

In July 2009, Dart filed a reply to Craigslist’s motion. First, Dart argued that advertising prostitution was not constitutionally protected. He maintained that “Erotic Services” was a euphemism for “prostitution” on the defendant’s website and that advertising prostitution was not a constitutional right. Second, he argued that Section 230 immunity was inapplicable because Craigslist created the content on its website by displaying categories and enabling users to search by sexual proclivity. Lastly, Dart argued that even if Craigslist had immunity under Section 230, its actions constituted a nuisance because it knowingly facilitates illegal conduct.

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113. *Id.* at ¶ 46–53.
115. *Id.*
116. *Id.* at 11–13.
117. *Id.* at 13–17.
118. *Id.* at 16.
119. *Id.* at 17–19.
121. *Id.* at 3.
122. *Id.* at 4–5.
123. *Id.* at 7–8.
124. *Id.* at 15.
On October 20, 2009, the district court ruled in Craigslist’s favor and dismissed the suit. The court stated that Craigslist had Section 230 immunity because it provided interactive computer services and the ads on its website were “information provided by another information content provider.” Regarding the nuisance claims, the court held that Sherriff Dart “strained the ordinary meaning of the words ‘arrange’ and ‘direct’” when he accused Craigslist of knowingly arranging meetings for the purposes of prostitution. The court cited Chicago Lawyers’ to emphasize that Section 230 was enacted so that providers of interactive computer services would not be held liable for such crimes. The court extended this reasoning to the plaintiff’s allegation that Craigslist provided the contact information of prostitutes and brothels; Craigslist users, not Craigslist itself, provided that information. After a lengthy analysis, the court concluded that Craigslist was immune under Section 230(c)(1) of the CDA.

In the opinion, the court relied heavily on Chicago Lawyers’ and distinguished the case from Roommates.com. Contrary to Sherriff Dart’s claim, the court found that Craigslist’s “Erotic Services” section did not induce others to engage in unlawful conduct, unlike the mandatory questionnaire of Roommates.com. Furthermore, the court held that since not all of the listed services were sexual in nature, the subcategories were not merely synonyms for illegal sexual services and that Craigslist was not liable for users who disregarded the site’s guidelines. Judge Grady concluded that Sherriff Dart’s allegations were not different from those the Seventh Circuit rejected in Chicago Lawyers’. Craigslist, once again, was able to use Section 230 to shield itself from liability.

IV. POTENTIAL FOR LIABILITY UNDER § 230(E)

Although plaintiffs throughout the past decade have developed creative arguments to establish liability against online services providers, none have brought a successful claim based on the criminal law exceptions in § 230(e). However, the potential of such a threat from both federal and state prosecutors could drive many interactive computer service providers to

126. Id. at *13; See 47 U.S.C. § 230(f)(2)–(3).
128. Id. at *19–*20.
129. Id. at *27.
130. Id. at *22; See Chicago Lawyers’, 519 F.3d 666, 671-72 (7th Cir. 2008) (“Nothing in the service craigslist offers induces anyone to post any particular listings . . ..”).
132. Id. at *27.
change the way they operate. This Part will look to these possible exceptions to immunity under Section 230 and whether they could alter the behavior of providers of interactive computer services.

A. EXCEPTIONS

1. Section 230(e)(1)—Federal Criminal Statutes

Section 230(e)(1) states that “[n]othing in this section shall be construed to impair the enforcement of section 223 or 231 of this title, chapter 71 (relating to obscenity) or 110 (relating to sexual exploitation of children) of Title 18, or any other Federal criminal statute.” Although Section 230 preempts state criminal law, Section 230(e)(1) permits plaintiffs to allege federal criminal violations against internet service providers that would otherwise be shielded from liability. In addition to alleging that Craigslist violated state and city laws, Sherriff Dart alleged in Dart v. Craigslist that Craigslist violated 18 U.S.C. § 1952, which prohibited the facilitation of prostitution. When it granted the motion for judgment on the pleadings, the court glossed over this issue by stating in a footnote that 18 U.S.C. § 1952 “does not bring [Dart’s] public-nuisance suit within that [§ 230(e)(1)] exception.” The court cited Doe v. Bates, an unreported decision from a district court in Texas, to support its proposition that § 230(e)(1) did not enable private litigants to bring civil claims under the guise of federal criminal law. The court in Doe v. Bates reasoned that Congress intended to preserve the ability of law enforcement officials to do their job while granting online service providers immunity from civil claims. No other court has cited to Doe v. Bates to support a similar proposition.

This raises the question whether Craigslist, or any other provider of interactive computer services, could be held liable under the same federal criminal statutes if a prosecutor brought the claims as opposed to a private

citizen. According to Doe v. Bates, the answer to that question is yes.139 If a prosecutor successfully brought criminal charges under 18 U.S.C. § 1952, the statute cited by Sheriff Dart, Craigslist could be held liable for facilitating prostitution. While prosecutors have yet to bring federal criminal charges against Craigslist, this could be a successful means for holding Craigslist responsible for its users’ activities and could have contributed to Craigslist’s decision to implement changes to its website. Furthermore, prosecution does not have to be limited to crimes relating to prostitution. Prosecutors can look to any chapter of Title 18 of the United States Code to charge website operators with criminal activity.

2. Section 230(e)(3)—State Law

Section 230(e)(3) states that “nothing in this section shall be construed to prevent any State from enforcing any State law that is consistent with this section.”140 Dart argued that Craigslist’s actions violated a state law criminalizing the solicitation of a prostitute.141 However, the court determined that Sheriff Dart’s allegations “strain the ordinary meaning of the terms ‘arrange’ and ‘direct’” as the postings on Craigslist.org were not created by Craigslist itself.142 While this court did not agree that Craigslist violated state laws, it is possible for another court to reach the alternate conclusion based on a slightly different fact pattern.

The current design of Craigslist.org would likely place it outside of any state law violations. Unlike the website in Roommates.com, Craigslist.org has a simple user interface and no drop down menus.143 Therefore, it would be difficult to argue that the website played a role in any unlawful conduct that resulted from a posting. However, just as with the federal law exception provided in § 230(e)(1), it is imaginable that a fact pattern could emerge in which a provider of interactive computer services violated a state statute that is consistent with Section 230.

Over the past several years, states have tried to pass laws aimed at making the Internet a safer place.144 For example, New Jersey proposed the Social Networking Safety Act to prohibit the transmission of sexually

139. See id. (“section 230(e)(1) exemption permits law enforcement authorities to bring criminal charges against even interactive service providers in the event that they themselves actually violate federal criminal laws.”).
143. Roommates.com, 521 F.3d 1157, 1161 (9th Cir. 2008) (en banc).
offensive communication to a minor located in the state. Under this law, operators could be held liable if they do not provide a reporting link, enable users to block sexually offensive comments, or review reports regarding offensive material submitted by users or third parties. If passed and held to be constitutional and consistent with the CDA, such a law could pose a serious threat to interactive computer services providers.

B. SECTION 230(E) AS AN IMPETUS FOR CHANGE

Fears of prosecution under the exceptions provided in § 230(e) could result in changes to the way interactive computer services providers operate. In the past year, Craigslist has voluntarily implemented many changes to curb the use of its website for illicit purposes. In March 2009, Craigslist reported that as a result of the changes, its website saw a 90-95% decrease in monthly posts in the “Erotic Services” section. Less than two weeks after South Carolina Attorney General Henry McMaster threatened Craigslist, the website eliminated the “Erotic Services” category all together. It is possible that Craigslist was concerned about its potential criminal liability under the exceptions to Section 230 immunity.

While Craigslist circa early 2008 may have been vulnerable under the § 230(e)(1) exception, the current incarnation of its website attempts to do what it can to discourage users from committing illegal acts. However, it is unlikely that other websites with complex user interfaces can continue to use Section 230 as a bulletproof shield. During the past few years, Roommates.com and StubHub have demonstrated that courts are no longer interested in granting unfettered immunity to providers of interactive computer services. Therefore, courts might be receptive to using § 230(e) as a way to limit Section 230 immunity.

Prosecutors could use the exceptions provided in § 230(e) to further other congressional goals. Some have argued that while the law has accomplished its goal of promoting the Internet, the same cannot be said of its goal of curbing child pornography. Under the liberal application of...
Section 230, websites that knowingly facilitate the exploitation of children are immune. Prosecutors could employ the exception to Section 230 as a tool to limit an interactive computer services provider’s immunity if it violates federal criminal laws or state laws consistent with the CDA. Federal criminal statutes, such as 18 U.S.C. § 1466A, which prohibit the distribution of obscene visual representation of sexually abused children, could be used to hold websites that facilitate criminal activity accountable.

The exceptions in § 230(e) could serve as much needed limits on Section 230 immunity. Many critics have argued that courts have incorrectly broadened the scope of Section 230. Furthermore, critics argue that broad application of service provider immunity is no longer necessary because Congress has achieved its goal of fostering the growth of the Internet. Roommates.com and StubHub demonstrate a trend, albeit a minor one, towards curtailing the broad reach of Section 230. Moreover, the fact that Craigslist is succumbing to the demands of state attorney generals to make changes to its website could signal that providers of interactive computer services no longer view Section 230 as a source of blanket immunity.

V. CONCLUSION

During the past decade, interactive service providers have enjoyed broad immunity under Section 230 of the Communications Decency Act. Plaintiffs have unsuccessfully attempted to thwart the application of Section 230 to various providers of interactive computer services. To date, Craigslist has avoided every civil charge raised against it under Section 230 and has recently implemented many changes to its website in order to avoid future liability. However, two recent cases demonstrate that there are limits to Section 230 immunity. An interactive computer service provider with a slightly different fact pattern might not be as fortunate as Craigslist if prosecutors bring charges that fall within the § 230(e) exceptions.

150. Id. at 777.
152. Noeth, supra note 149.
Goodbye diary, hello blog! The proliferation of blogging has created new challenges for employers and workers. One common challenge is the tension between the free speech rights of employees to post online and the rights of employers to set and enforce workplace policies as well as to manage employees.

In Richerson v. Beckon, a school district demoted a teacher, who was responsible for mentoring other teachers, after she wrote about her coworkers, employer, and union representatives on her personal blog. The teacher's job description included providing her mentees with “honest, critical, and private feedback” and expressly required her to develop trusting and confidential relationships with them. The teacher criticized her coworkers on the blog and while she did not identify them by name, her descriptions of them and their work made them easily identifiable. The school district reassigned the teacher to a classroom position so she would no longer be in a mentoring role. The teacher sued, claiming constitutional protection for the personal speech on her blog.

The District Court for the Western District of Washington granted the school district’s motion for summary judgment, holding that the speech did not meet the “public concern” test from Connick v. Myers, which provided that public employees do not lose their rights as citizens to participate in public debate by virtue of their government employment so long as their speech addresses matters of "public concern." Here, the teacher's blog posting was not protected when it disrupted relationships between coworkers, interfered with the employee-speaker's performance of their duties, and undermined a close working relationship based upon personal loyalty and confidentiality.

The Ninth Circuit agreed, holding that the school district was correct in demoting the employee because of the “highly personal and vituperative comments” she made about other school employees on her blog. Here, the school district's legitimate administrative interests outweighed the employee’s First Amendment rights. The Ninth Circuit upheld the District Court's finding that the teacher's speech was not protected under the balancing test of Pickering v. Bd. of Educ., which assesses whether an employee’s free speech
rights are outweighed by an employer’s right to an efficient, disruptive-free workplace.

The Ninth Circuit’s opinion in *Richerson v. Beckon* is not published and is not precedent for future cases regarding whether employees can be disciplined for comments made on blogs or other internet venues such as Facebook, Twitter, and Google Buzz outside of 9th Cir. R. 36-3.

**Tenenbaum v. Sony BMG Music Entertainment**

*130 S. Ct. 126 (2009)*

On October 5, 2009, the United States Supreme Court denied a petition for writ of certiorari requesting appeal of the First Circuit’s decision in *Tennenbaum*, which denied the broadcasting of courtroom oral arguments via the Internet.

Several record companies, including Sony BMG, had brought copyright infringement suits against individuals who allegedly downloaded music without paying. Joel Tenenbaum, one of the defendants, moved to permit the webcast of some courtroom proceedings. The district court allowed the motion, rooting its ruling on public interest and Local Rule 83.3 of Massachusetts federal district court, which provided that “no person shall take any photograph, make any recording, or make any broadcast by radio, television, or other means, in the course of or in connection with any proceedings in this court, on any floor of any building on which proceedings of this court.”

On appeal, the First Circuit held that the district court misread Rule 83.3 and that the rule specifically prohibited the webcasting of civil proceedings. The appeals court reasoned that the intention of the rule was to “forbid all broadcasting of federal district proceedings in civil cases, except for the enumerated exceptions.” Tabling the issue of the constitutionality of prohibiting courtroom webcasting, the court emphasized that the was not a case about free speech or public access to courts but the correct interpretation of controlling Massachusetts law. In his Petition for Writ of Certiorari, Tenenbaum urged the Court to decide on the constitutional questions surrounding the use of the Internet and webcasting in federal civil courtroom proceedings. These included whether a total ban on the Internet broadcasting of open-court sessions of civil actions in federal courts violated the First and Fifth Amendments. Because the writ was denied, these questions remain unanswered.
CLOUD COMPUTING AND STORED COMMUNICATIONS: ANOTHER LOOK AT QUON V. ARCH WIRELESS

David S. Barnhill

I. INTRODUCTION

“[N]othing is better worthy of legal protection than private life, or, in other words, the right of every man to keep his affairs to himself, and to decide for himself to what extent they shall be the subject of public observation and discussion.”

As I write this Note, each draft is uploaded to a server on a network run by Dropbox, an internet-based service that syncs files across multiple computers, so that I can access drafts from any computer. When I email this Note for comments and suggestions from my Gmail account, copies of the emails will be saved on Google’s servers. When the Note is complete, I will upload it to a networked storage system run by Amazon so that other people with sufficient account privileges may access it.

This real-world example of cloud computing raises important Fourth Amendment issues. Average Americans regularly use web-based email and online storage systems to interact and communicate in the cloud. Which of these communications, if any, does the Fourth Amendment protect from unreasonable search and seizure? To put it another way, when do people have a reasonable expectation of privacy in data stored in the cloud?

In the recent Quon v. Arch Wireless Operating Co. decision, the Ninth Circuit held that there was a reasonable expectation of privacy in the contents of text messages. The Ninth Circuit broke with Supreme Court

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1. Edward L. Godkin, Libel and Its Legal Remedy, 12 J. SOC. SCI. 69, 80 (1880).

2. The National Institute of Standards and Technology provides the following definition of cloud computing: “Cloud computing is a model for enabling convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction.” Peter Mell and Tim Grance, The NIST Definition of Cloud Computing, NATIONAL INSTITUTE OF STANDARDS AND TECHNOLOGY, INFORMATION TECHNOLOGY LABORATORY (October 7, 2009), http://csrc.nist.gov/groups/SNS/cloud-computing. For more discussion on the definition of cloud computing, see Section IV.A, infra.

precedent that held information voluntarily revealed to third parties loses all privacy protection (the business records cases).

The decision in Quon is also notable because the protected text messages were sent from an employer-issued pager and the Ninth Circuit held that the “operational realities” of the workplace indicated that Quon’s messages would be private, even though his employer’s policy was that all pager communications would be subject to inspection. The court further ruled that Quon’s employer, the Ontario Police Department, violated his Fourth Amendment rights because the audit of his text messages constituted an excessively intrusive and therefore unreasonable search.

The Supreme Court granted certiorari, so it will decide whether the Ninth Circuit correctly found a reasonable expectation of privacy in the content of the text messages and correctly weighed the “operational realities” of the workplace to find that the search performed was excessively intrusive. This is an opportunity for the Court to speak directly on the privacy protections available for electronic communications delivered through third parties. By extending Fourth Amendment protections to text messages, the Supreme Court could recognize the growing importance of email and texting as a means of private communication and update privacy protections to accommodate current technology just as it did with telephones in the 1967 decision Katz v. United States. Additionally, the Court will likely attempt to give greater guidance to courts in analyzing the “operational realities” of a particular workplace. Because the current analysis of the Fourth Amendment in the workplace is case-specific, general guidance is desirable to

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4. See Smith v. Maryland, 442 U.S. 735 (1979) (holding that because dialed telephone numbers are voluntarily revealed to the phone company, the plaintiff did not have any reasonable expectation in the privacy in the numbers dialed); United States v. Miller, 425 U.S. 435 (1976) (holding that the plaintiff had no reasonable expectation of privacy in bank records that contained only information voluntarily given to the bank for use in their normal course of business); Couch v. United States, 409 U.S. 322 (1973) (holding that there was no reasonable expectation of privacy in tax records produced by an accountant where the plaintiff challenged a summons directing her accountant to produce her tax records).

5. Quon Circuit, 529 F.3d at 907.

6. Id. at 909 (“[T]he search was excessively intrusive in light of the noninvestigatory object of the search, and because Appellants had a reasonable expectation of privacy in those messages, the search violated their Fourth Amendment rights.”).

7. See Brief of Petitioners at i, City of Ontario v. Quon, No. 08-1332 (U.S. Feb. 5, 2010) (listing the questions presented to the Court).

8. Katz v. United States, 389 U.S. 347 (1967) (holding that electronically recording a phone call made from a phone booth violated the Fourth Amendment even though no physical intrusion occurred).

9. Brief of Petitioners at i, City of Ontario, No. 08-1332 (listing the questions presented to the Court).
provide more certainty for employers to establish effective workplace policies without incurring liability for violating an employee’s privacy protections.

The Note begins by discussing the Supreme Court Fourth Amendment precedent in Part I. Part II recounts the factual and procedural background of Quon, focusing on the Fourth Amendment and the workplace. Part III surveys cloud computing technology, including the motivations and concerns related to its use, and Fourth Amendment protections to cloud data. The Note concludes by proposing a method for analyzing privacy in cloud computing in the workplace.

II. THE FOURTH AMENDMENT

The Fourth Amendment to the Constitution provides in part: “The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated.”

The protection against unreasonable search and seizure in the Fourth Amendment applies only to state action, including government employers like those in Quon.

This section describes the Supreme Court’s Fourth Amendment jurisprudence, tracing its evolution and current status in the context of both electronic communication and the workplace. It particularly focuses on the third-party doctrine as it is applied in the business records cases because of its relevance to the discussion of Fourth Amendment protections for cloud data. The business records cases raised the possibility that emails and data stored on remote servers were “wholly without Fourth Amendment protection” because “individuals have no protected privacy interest in personal information and records voluntarily disclosed to businesses.”

A. Katz v. United States

The modern view of the Fourth Amendment must start with the Supreme Court’s decision in Katz v. United States. In Katz, the Court held that the government performed an unlawful search in violation of the Fourth

10. U.S. Const. amend. IV.
11. See O’Connor v. Ortega, 480 U.S. 709, 715 (1987) (“Searches and seizures by government employers or supervisors of the private property of their employees, therefore, are subject to the restraints of the Fourth Amendment.”); Burdeau v. McDowell, 256 U.S. 465, 475 (1921) (“The Fourth Amendment gives protection against unlawful searches and seizures, and ... its protection applies to governmental action.”).
12. See Section IV.C, infra.
Amendment when it electronically listened to and recorded Katz’s telephone conversation while he was in a phone booth.\(^{14}\) This was a departure from previous Fourth Amendment jurisprudence limiting illegal searches to physical intrusions;\(^{15}\) the Court stated that “the Fourth Amendment protects people—and not simply ‘areas.’”\(^{16}\) The Court recognized that Fourth Amendment protection for the telephone was necessary because “[t]o read the Constitution more narrowly is to ignore the vital role that the public telephone has come to play in private communication.”\(^{17}\)

The Court’s holding opened the door to broader privacy protection. Justice Harlan’s concurring opinion particularly focused the Court’s modern Fourth Amendment jurisprudence on people rather than property by articulating the need for a reasonable expectation of privacy.\(^{18}\) Justice Harlan’s concurrence identified two requirements to claim Fourth Amendment protection. First, a person must “exhibit[] an actual (subjective) expectation of privacy,” and second, “the expectation [must] be one that society is prepared to recognize as ‘reasonable.’”\(^{19}\) The first requirement is subjective, the second is objective. Following Supreme Court guidance, the Ninth Circuit has traditionally focused on the objective requirement, stating “the touchstone of the Fourth Amendment is reasonableness.”\(^{20}\)

B. \textbf{THE FOURTH AMENDMENT IN THE WORKPLACE, O’CONNOR V. ORTEGA}\n
Applying the reasonableness standard, the Supreme Court defined the scope of Fourth Amendment protection in the workplace in \textit{O’Connor v. Ortega}.\(^{21}\) In \textit{Ortega}, state hospital officials searched the office of a physician in

\begin{footnotesize}
\begin{enumerate}
\item[14.] 389 U.S. 347, 352 (1967) (“One who occupies [a telephone booth], shuts the door behind him, and pays the toll that permits him to place a call is surely entitled to assume that the words he utters into the mouthpiece will not be broadcast to the world.”).
\item[15.] \textit{Id.} at 352–53 (”[T]he absence of [physical] penetration was at one time thought to foreclose further Fourth Amendment inquiry, for that Amendment was thought to limit only searches and seizures of tangible property.”) (citing Goldman v. United States 316 U.S. 129, 134–36 (1942); Olmstead v. United States, 277 U.S. 438, 457, 464, 466 (1928)).
\item[16.] \textit{Id.} at 353.
\item[17.] \textit{Id.} at 352.
\item[19.] \textit{Katz}, 389 U.S. at 361 (Harlan, J., concurring).
\item[20.] Quon Circuit, 529 F.3d 892, 903 (9th Cir. 2008) (quoting United States v. Kriesel, 508 F.3d 941, 947 (9th Cir. 2007)); see Illinois v. McArthur, 531 U.S. 326, 330 (2001) (”[The Fourth Amendment’s] central requirement is one of reasonableness.”).
\item[21.] 480 U.S. 709 (1987).
\end{enumerate}
\end{footnotesize}
conjunction with a sexual harassment investigation. The hospital fired the physician, who subsequently filed suit claiming that the hospital violated his Fourth Amendment rights. The Supreme Court, in a plurality opinion, held that the physician had a reasonable expectation of privacy in his workplace and remanded to determine whether the hospital’s search was reasonable.

The first issue presented in *Ortega* was whether a public employee had a reasonable expectation of privacy “in his office, desk, and file cabinets at his place of work.” Assuming that the public employee established a reasonable expectation of privacy, the second issue concerned the “appropriate Fourth Amendment standard for a search conducted by a public employer.” Justice O’Connor, writing for the plurality, presented a contextual approach that weighed the privacy interests of the public employees against the interests of the employers in efficiently and effectively managing the workplace.

1. **Reasonable Expectation of Privacy of Employees**

The threshold question in *Ortega* asks whether a public employee has a reasonable expectation of privacy in the physical location or item of interest. The expectation of privacy must be one that society is willing to accept and is not nullified because a person works for the government.

But not all workplaces are equal. Once a court determines that there is a reasonable expectation of privacy in the location or item of interest, the inquiry must proceed on a fact-specific basis because, as the *Ortega* Court recognized, the “operational realities” vary from workplace to workplace. Some of the “operational realities” of a workplace affecting an employee’s reasonable expectation of privacy include the employer’s regulations and policies related to privacy and whether they are actively enforced. In *Ortega*, the Court found that the physician had a reasonable expectation of privacy in his desk and file cabinets considering the following factors: he did not share his desk, he kept personal material in his office, and the hospital had not

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22. *Id.* at 712–13.
23. *Id.* at 714.
24. *Id.* at 728–29.
25. *Id.* at 712.
26. *Id.*
27. *Id.* at 719–20.
28. *Id.* at 715.
29. *Id.* at 716–17.
30. *Id.* at 718.
31. *Id.* at 719.
established any policy discouraging employees from storing personal items in their offices.\(^{32}\)

This analysis did not satisfy Justice Scalia, however, who argued in a concurring opinion for a clearer rule: “I would object to the formulation of a standard so devoid of content that it produces rather than eliminates uncertainty in this field.”\(^{33}\)

\(^{32}\) Id. at 718–19.

\(^{33}\) Id. at 730 (Scalia, J., concurring). One way to analyze this statement is to look at the application of the standard as applied by the various circuits. Circuit courts applying Ortega have recognized several factors as important. See United States v. Taketa, 923 F.2d 665, 671 (9th Cir. 1991) (holding that an employee who used a coworker’s office where that coworker was granted exclusive use of the office, does not have a reasonable expectation of privacy); Am. Postal Workers Union, Columbus Areal Local AFL-CIO v. U.S. Postal Serv., 871 F.2d 556, 59–60 (6th Cir. 1989) (ruling that a waiver of privacy rights and notice to the employees as provided in collective bargaining agreement were enough to defeat an expectation of privacy even when employers had never previously searched the area in question); Schowengerdt v. Gen. Dynamics Corp., 823 F.2d 1328, 1335 (9th Cir. 1987) (concluding that the employee enjoyed a reasonable expectation of privacy in areas where he had exclusive use unless he was on notice from the employer that searches could be performed); McGregor v. Greer, 748 F. Supp. 881, 888 (D.D.C. 1990) (deciding that public access to an employee’s office, employer privacy policies, and history of searches by the employer are questions of fact to determine whether the employee had a reasonable expectation of privacy). Much of the analysis has turned on whether an employer has an anti-privacy policy. Compare United States v. Ziegler, 456 F.3d 1138, 1146 (9th Cir. 2006), superseded by United States v. Ziegler, 474 F.3d 1184 (9th Cir. 2007) (holding no objectively reasonable expectation of privacy existed where the employee’s workplace computer was routinely monitored and the employer’s privacy policy provided sufficient notice of such monitoring), and Biby v. Bd. of Regents, of the Univ. of Neb., 419 F.3d 845, 850–51 (8th Cir. 2005) (holding employment policy saying the employer could search employee computer enough to defeat a reasonable expectation of privacy), and United States v. Thorn, 375 F.3d 679, 683 (8th Cir. 2004) (holding that a policy reserving the right to audit computer use and a prohibition against downloading sexual images overcomes employee’s privacy rights), and United States v. Angevine, 281 F.3d 1130, 1134 (10th Cir. 2002) (stating because computer-use policy reserved the right to randomly audit internet use and to monitor specific individuals suspected of misusing computers, the employee is on notice, and therefore the expectation of privacy is unreasonable), and Muick v. Glenayre Elecs., 280 F.3d 741, 743 (7th Cir. 2002) (“Glenayre had announced that it could inspect the laptops that it furnished for the use of its employees, and this destroyed any reasonable expectation of privacy. . . .”), and United States v. Simons, 206 F.3d 392, 398 (4th Cir. 2000) (declaring that the company’s Internet use policy gave sufficient notice to the employee to render any expectation of privacy unreasonable), and Am. Postal Workers Union, 871 F.2d at 560 (holding no reasonable expectation of privacy in light of the clearly expressed provisions permitting random and unannounced locker inspections), and McGregor, 748 F. Supp. at 888 (holding that where the policy regarding privacy is unclear an employee may have a reasonable expectation of privacy), with Leventhal v. Knapek, 266 F.3d 64, 74 (2d Cir. 2001) (stating that because employer did not practice routine searches of workplace computers and did not have a general privacy policy, the employee had a reasonable expectation of privacy in contents of their work computer); see also United States v. Slanina, 283 F.3d 670, 677 (5th Cir. 2002).
2. Reasonable Search by Employers

If the employee's expectation of privacy was reasonable, then the employer must demonstrate that the search was reasonable "under all the circumstances" to avoid violating the Fourth Amendment. Because an employer may desire to search an employee's workplace for various work-related reasons (as opposed to criminal investigations), and because law enforcement is generally not involved in investigations into workplace misfeasance, the traditional requirement that the employer have probable cause before a search can be performed could prove too onerous.

Therefore, the plurality in *Ortega* concluded "that the 'special needs, beyond the normal need for law enforcement[,] make the . . . probable-cause requirement impracticable['] for legitimate work-related, noninvestigatory intrusions as well as investigations of work-related misconduct.' Thus, when balancing employees' privacy interests with the employers' special needs to manage the workplace, a standard of reasonableness will not permit arbitrary intrusions upon the former nor "unduly burden" the latter. The Court in *Ortega* did not rule on the search performed by the hospital and remanded the case to determine if it was reasonable.

C. THE THIRD-PARTY DOCTRINE AND THE BUSINESS RECORDS CASES

The third-party doctrine states that even where a person has a reasonable expectation of privacy in a particular item, once he voluntarily gives that item to a third party he surrenders his Fourth Amendment rights. The Court applied this doctrine in a trio of cases that have become known as the business records cases.

In *Couch v. United States*, the Court held that there was no reasonable expectation of privacy in tax records produced by an accountant. The plaintiff challenged a summons directing her accountant, an independent contractor, to produce her tax records as a violation of her Fourth Amendment rights. Given the absence of a policy placing [the employee] on notice that his computer usage would be monitored and the lack of any indication that other employees had routine access to his computer, we hold that [the employee's] expectation of privacy was reasonable.

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35. *Id.* at 725 (quoting New Jersey v. T.L.O., 469 U.S. 325, 351 (1985) (Blackmun, J., concurring)).
36. *Id.*
37. *Id.* at 729.
Amendment rights. The IRS attempted to get plaintiff’s tax records after noticing that there was a “substantial understatement of gross income” related to the plaintiff’s restaurant. The Court held that the plaintiff’s reasonable expectation of privacy vanished once she gave the records to the accountant, knowing that much of the information would be revealed in tax documents.

In United States v. Miller, the Court held that the plaintiff had no reasonable expectation of privacy in bank records arising from the normal course of business. The plaintiff was convicted of possessing an unregistered still and defrauding the government of various taxes. Before the case was tried, the plaintiff attempted to prevent his bank records from being produced. The Court found that the records contained only information voluntarily given to the bank for use in their normal course of business, thus destroying any reasonable expectation of privacy the plaintiff had in the records.

In Smith v. Maryland, the Court held that the disclosure of telephone numbers to the phone company when dialing prevented plaintiff from having a reasonable expectation of privacy in the numbers dialed. The plaintiff was arrested for robbery after the police discovered that he continued to call and harass the robbery victim. Investigators discovered this after installing a pen register, a device to record phone numbers, on the plaintiff’s phone line. The plaintiff claimed that the Fourth Amendment protected against discovery of the phone numbers he dialed. The Court disagreed, holding that because the phone company necessarily inspected the phone numbers to complete the telephone call and bill the plaintiff, he had no reasonable expectation of privacy in the telephone numbers he dialed. The Court found that “a pen register differs significantly from the listening device employed in Katz, for pen registers do not acquire the contents of communications.”

40. Couch, 409 U.S. at 323.
41. Id. at 324.
42. Id. at 335–36.
43. Miller, 425 U.S. at 436.
44. Id.
45. Id. at 442–43.
47. Id. at 737.
48. Id. at 737–38.
49. Id. at 742.
50. Id. at 741 (emphasis in original).
III. QUON V. ARCH WIRELESS

The Ninth Circuit in Quon v. Arch Wireless held that a person has a reasonable expectation of privacy in the content of text messages sent via, and stored with, third parties. The court also addressed whether certain practices in the workplace defeated that reasonable expectation. Section III.A explores the facts of the case. Section III.B follows with a discussion of the decision in the district court. The decision in the Ninth Circuit is presented in Section III.C. Section III.D discusses the denial for a rehearing en banc.

A. FACTS OF THE CASE

Sergeant Jeff Quon of the Ontario Police Department (OPD), husband to Jerilyn Quon of the OPD, had an affair with OPD dispatcher April Florio. Sergeant Quon routinely sent personal, sexually explicit text messages from his work-issued pager to both his wife and his mistress. He also sent personal text messages to Sergeant Steve Trujillo, a fellow member of the SWAT team at the OPD. The Chief of Police of the OPD discovered that Quon was using his pager for personal purposes when he audited transcripts of Quon’s text messages.

The City of Ontario contracted with Arch Wireless Operating Company in October of 2001 to provide two-way, alphanumeric pagers to the City’s employees. In the contract, Arch Wireless stipulated a limit of 25,000 characters per month for each pager and an extra fee for each character exceeding that limit. The City issued pagers to the OPD SWAT team because of OPD’s “refusal to pay overtime or stand-by pay to officers who must be available for SWAT call-outs.”

The pagers sent a text message by first sending the message via a radio-frequency (RF) transmission from the pager to a receiving station. The receiving station then relayed the message either via satellite or wired transmission to a computer network owned by Arch Wireless. The computer network stored the message for up to seventy-two hours, until the

52. Id. at 1126.
53. Id.
54. Id. at 1126–27.
55. Id. at 1122–23.
56. Id. at 1123.
57. Quon v. Arch Wireless, 554 F.3d 769, 770 (9th Cir. 2009) [hereinafter Quon En Banc].
58. Quon District, 445 F. Supp. 2d at 1123.
59. Id.
recipient pager was ready to receive the message. Arch Wireless also archived a copy of the message on their servers. When the recipient pager became ready to receive the message, Arch Wireless sent the message to the transmission station closest to the recipient pager where the station then sent the message via an RF transmission to the pager.

The OPD declared that the use of the pagers was covered by the City’s “Computer Usage, Internet and Email Policy” (Policy). The Policy stated that the City “reserves the right to monitor and log all [email use], with or without notice” and that the “[u]sers should have no expectation of privacy . . . when using these resources.” The Policy also stated that all information produced using the City’s resources was considered property of the City, and consequently, employees should not use the City’s email or Internet for personal communication. Finally, the Policy stated that “[t]he use of inappropriate, . . . obscene, suggestive, . . . or harassing language in the email system will not be tolerated.”

Sergeants Quon and Trujillo, members of the OPD SWAT team, reviewed and signed this Policy in 2000 but were not issued pagers until late 2001 or early 2002. The OPD issued the pagers to members of the SWAT team “to enable better coordination and a more rapid and effective response to emergencies by providing nearly instantaneous situational awareness to the team as to the other members [sic] whereabouts.” On April 18, 2002, Quon attended a meeting where Lieutenant Steven Duke (Duke), the pager administrator, informed all present that: “two-way pagers are considered email messages. This means that messages would fall under the City’s policy as public information and eligible for auditing.” Quon declared that he “vaguely recalled attending the meeting” and that he did not recall Duke extending the Policy to text messages. Both he and Trujillo, however, subsequently received a memorandum reiterating what Duke had said in the meeting: the OPD considered text messages as email communications covered by the City’s Policy.

60. Id.
61. Id.
62. Id.
63. Id.
64. Id.
65. Id.
66. Id. at 1124.
67. Quon Circuit, 529 F.3d 892, 895–96 (9th Cir. 2008).
68. Quon District, 445 F. Supp. 2d at 1123.
69. Id. at 1124.
70. Quon Circuit, 529 F.3d at 896 (internal quotations removed).
71. Quon District, 445 F. Supp. 2d at 1124.
Despite the statements made in that April meeting, Duke implemented an informal policy regarding the use of the pagers that contravened the City’s Policy. As the pager administrator, Duke informed personnel (including Quon) that messages would only be audited if an officer exceeded his monthly character limit and disputed the charges claiming that the messages were work-related. If an officer paid the overage charges himself, the messages would not be audited. Quon exceeded his limit three or four times, but paid the charges each time without incident.

In August of 2002, however, Duke grew weary of collecting the overage charges from the officers and informed Chief Lloyd Scharf of the problem. Chief Scharf told Duke to audit the messages to see if they were work-related to determine if the character limit should be increased. Chief Scharf ordered Duke to review the transcripts of Quon’s sent messages over a two-month period.

The transcripts of Quon’s text-messages over the two-month period covered forty-six pages and of the 450 text-messages sent, only fifty-seven were for business-related purposes. After reading Duke’s report on the matter, Chief Scharf and Quon’s supervisor reviewed the contents of the messages. Subsequently, the matter was turned over to Internal Affairs to investigate Quon’s alleged misconduct. When asked why Chief Scharf and the Internal Affairs officer read all of Quon’s messages, the Internal Affairs officer stated: “Sgt. Quon was asked and indicated that he could not state how much time he spent on the pager during work hours. Therefore, reviewing and redacting the transcripts was the only reasonable method to obtain this information.”

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72. Id.
73. Id.
74. Id.
75. Quon Circuit, 529 F.3d at 897.
76. Quon District, 445 F. Supp. 2d at 1125.
77. Id. at 1125–26. Chief Scharf requested that Duke review the text message transcripts of the two officers with the most severe overages, not specifying any particular officer. Id. at 1125. Quon satisfied this criteria. Id.
78. Quon En Banc, 554 F.3d 769, 775 (9th Cir. 2009).
79. Quon District, 445 F. Supp. 2d at 1126.
80. Id. at 1127 ("Chief Scharf thereafter made a determination that Quon’s pager was being misused in that too much duty time was used for personal pages not associated with duty on duty time.").
B. The District Court Decision

Quon and several others filed suit against the City of Ontario and the Ontario Police Department in the Central District of California alleging, inter alia, violations of their Fourth Amendment rights. After a jury determined the purpose of the police department’s search into the content of Quon’s text messages, the district court found all defendants free from liability for the search.

Relying on Ortega, the court held that the City’s search was not unreasonable notwithstanding the plaintiffs’ reasonable expectation of privacy in the content of the text messages based on the informal policy instituted by Duke. The court concluded that the intent of the search determined its reasonableness—if the intent was to uncover misconduct then it was unreasonable, but if the intent was to determine the efficacy of the character limit then it was reasonable. A jury decided that the purpose of the search was to determine the efficacy of the character limit. Thus, the court returned a verdict in favor of the defendants.

The court held that Quon (and the rest of the plaintiffs by extension) had a reasonable expectation of privacy in the content of the text messages. Applying the first prong of the Ortega test, the court stated that if the City’s formal Policy (as applied to text messages) was the only factor considered, Quon would have no reasonable expectation of privacy. However, the court held that Duke’s informal policy of not auditing text messages if overage charges were paid “eroded any attempt on defendants’ part to lessen the expectation of privacy its employees had in the use of the pagers issued to

82. Quon District, 445 F. Supp. 2d at 1128. Jeff and Jerilyn Quon, April Florio, Steve Trujillo, and Doreen Klein filed claims against Arch Wireless, the City of Ontario, Chief of Police Lloyd Scharf, and Sergeant Glenn were for violating the Stored Communications Act, the Fourth Amendment, the California Constitution, C.P.C. § 629.86, invasion of privacy and defamation. The government defendants (all defendants except Arch) were granted summary judgment on the SCA claims because they provide no service (no cause of action under § 2702) and the investigation was not a criminal one (no cause of action under § 2703). Id. at 1129. Likewise, Arch was granted summary judgment on the Fourth Amendment (and related California Constitution claims) because these claims are preempted by the allowances in the SCA. Id. at 1138. The claims for invasion of privacy and defamation along with violations of C.P.C. § 629.86 will not be discussed in this Note. Also, Doreen Klein was not part of the appeal to the Ninth Circuit, so this Note will not discuss her case.
83. Id. at 1138, 1149.
84. Id. at 1149.
85. Id. at 1146.
86. Quon Circuit, 529 F.3d 892, 908 (9th Cir. 2008).
87. Id.
88. Quon District, 445 F. Supp. 2d at 1141–43.
89. Id. at 1140.
them; indeed, [Duke’s] actions could be said to have encouraged employees to use the pagers for personal matters.”

To determine the reasonableness of a search, a court must decide whether the search was justified at its inception and whether it was “reasonably related in scope to the circumstances which justified the interference in the first place.” Regarding the reasonableness of the search performed, the court reasoned that “[t]he dispute in question concerns the actual purpose or objective Chief Scharf sought to achieve in having Duke perform the audit of Quon's pager.” If Scharf ordered the search to determine the efficacy of the character limit, then the search was reasonable at its inception. Otherwise, if it were designed to uncover misconduct the search would be unreasonable at its inception. The court declared if a jury found that the true purpose of the audit was to determine the percentage of text messages that were work-related, then it would be reasonable in scope. The court concluded “if the purpose for the audit was to determine the efficacy of the existing character limits to ensure that officers were not paying hidden work-related costs, then the Court finds that no constitutional violation occurred.”

C. THE NINTH CIRCUIT’S DECISION

Quon appealed the case to the Ninth Circuit where the court reversed the district court’s decision. It held that OPD’s search was unreasonable in scope. The Ninth Circuit agreed with the district court that Quon and the other appellants had a reasonable expectation of privacy in the content of their text messages, but the court disagreed as to the scope of the search ruling, finding that the search was excessively intrusive and violated the appellants’ Fourth Amendment rights.

90. Id. at 1142 (emphasis original).
92. Quon District, 445 F. Supp. 2d at 1144 (emphasis original).
93. Id. at 1146.
94. Id. at 1144. The court stated that the applicable misconduct was “playing games on City time” according to the defendants. Id. Since Duke’s informal policy allowed officers to use the pagers for personal use, the misconduct at issue here did not exist and hence could not be uncovered by the search making the search unreasonable at its inception. Id.
95. Id. at 1145.
96. Id. at 1146.
97. Quon Circuit, 529 F.3d 892, 910–11 (9th Cir. 2008). The court affirmed the district court’s holding that the search was reasonable at its inception. Id. at 908. The claims against Arch Wireless for violating the Stored Communications Act will not be discussed in this Note.
98. Id. at 909.
1. Fourth Amendment Protection for Text Messages

The Ninth Circuit held that the search in question violated their Fourth Amendment rights because Quon and the other appellants had a reasonable expectation of privacy in the content of the text messages and the scope of the search conducted by the OPD was unreasonable.99

The Ninth Circuit has declared that the “touchstone of the Fourth Amendment is reasonableness,” both in the expectation of privacy and the search in question.100 Because the extent of Fourth Amendment protection for modern electronic communication is an “open question,” the Ninth Circuit looked to comparable communications for guidance on the privacy expectations.101 In addition, employment circumstances often affect whether an expectation of privacy is reasonable.102 To evaluate the reasonableness of a search, the court must determine whether it is “justified at its inception” and whether it is “reasonably related in scope to circumstances which justified interference in the first place.”103

a) Reasonable Expectation of Privacy

In determining whether the Appellants had a reasonable expectation of privacy in stored text messages, the Ninth Circuit looked to other technologies for guidance.104 First, the Ninth Circuit looked to cases involving phones and determined that tapping a telephone violates a reasonable expectation of privacy while a device that records phone numbers dialed does not because it does not capture the contents of the communication.105 Next, the court reviewed cases involving letters where the Supreme Court and the Ninth Circuit determined that there is a reasonable expectation of privacy as to the contents but not the address.106 Finally, the

99. Id.
100. United States v. Kriesel, 508 F.3d 941, 947 (9th Cir. 2007).
101. Quon Circuit, 529 F.3d at 904.
103. Id. at 726.
104. Quon Circuit, 529 F.3d at 904–06. For a critique on this method of analysis, see Amanda Yellon, Comment, The Fourth Amendment’s New Frontier: Judicial Reasoning Applying the Fourth Amendment to Electronic Communications, 4 J. BUS. & TECH. L. 411 (2009).
105. Quon Circuit, 529 F.3d at 904 (looking to previous Supreme Court cases, Smith v. Maryland, 442 U.S. 735 (1979) and Katz v. United States, 389 U.S. 347 (1967), for guidance regarding Fourth Amendment protection for electronic communication). For more discussion on Smith and Katz, see Part II, supra.
106. Quon Circuit, 529 F.3d at 905 (looking to previous Supreme Court and Ninth Circuit cases, United States v. Jacobsen, 466 U.S. 109, 114 (1984), United States v. Hernandez, 313 F.3d 1206, 1209–10 (9th Cir. 2002), and United States v. Choate, 576 F.2d 165, 174 (9th Cir. 1978), about the privacy of letters).
court drew upon its email privacy jurisprudence that ruled that there is no privacy in the information indicating the sender and recipient of emails. The court concluded that the privacy interests in letters and email were identical, and extended that protection to text messages by declaring “no meaningful difference between . . . emails . . . and the text messages at issue here.” For the recipients of text messages, the Ninth Circuit held that as a matter of law there is a reasonable expectation of privacy that the content of the messages will not be revealed without the sender’s consent.

For the sender of the text messages in this case, Quon, the Ninth Circuit ruled that the informal policy of the Department, stating that text messages would not be audited if the officers paid their overage charges, rendered the expectation of privacy reasonable. The court affirmed the district court’s finding that if the OPD followed the formal Policy of the City there would be no reasonable expectation of privacy for the employees. However, because the informal policy instituted by Duke was the “operational reality” of the OPD and because officers relied on the informal rather than the formal policy, Quon had a reasonable expectation of privacy in the contents of his messages.

b) Reasonableness of the Search

The court in Quon found that when the OPD audited Quon’s text messages they violated the appellants’ Fourth Amendment rights. The court affirmed the finding of the jury, that Chief Scharf’s purpose in searching Quon’s text messages was to determine the efficacy of the character limit, and consequently held the search reasonable at its inception. However, the court determined that the scope of the search intruded upon the Appellants’ reasonable expectation of privacy in such a

107. Id. (reviewing a Ninth Circuit opinion, United States v. Forrester, 512 F.3d 500, 510 (9th Cir. 2008), about the privacy of email). The Court points out that there has been no ruling as to whether there is a reasonable expectation of privacy in the content of emails. Id.
108. Id. (citing Forrester, 512 F.3d at 511).
109. Id.
110. Id. This ruling applied to Appellants Jerilyn Quon, Steve Trujillo, and April Florio, the recipients of Jeff Quon’s text messages. Id. at 905 n.6. Jeff Quon’s reasonable expectations were additionally affected by the OPD’s policies. Id.
111. Id. at 907.
112. Id.
113. Id.
114. Id. at 909.
115. Id. at 908.
manner as to be deemed unreasonable as a matter of law in light of the non-investigatory purpose of the search.\textsuperscript{116}

D. \textbf{PETITION FOR REHEARING EN BANC DENIED}

Judge Ikuta wrote a vigorous dissent to the denial of the petition for rehearing the case en banc, criticizing the panel’s decision regarding the Fourth Amendment and accusing them of ignoring Supreme Court precedent.\textsuperscript{117} Judge Wardlaw, the author of the Ninth Circuit’s opinion, wrote a concurrence to the denial of hearing demonstrating that the decision comported with the Court’s prior rulings.\textsuperscript{118}

The dissent criticized the Ninth Circuit’s ruling that the OPD violated the Fourth Amendment when it audited Quon’s messages for two reasons. First, the dissent asserted that a finding of a reasonable expectation of privacy in messages sent with company pagers undermined the rule set forth in \textit{Ortega} and “hobbles government employers.”\textsuperscript{119} Second, the dissent argued the opinion in \textit{Quon} failed to follow Supreme Court precedent and seven other Circuits regarding the reasonableness of searches.\textsuperscript{120}

As to the first point, the dissent argued that finding a reasonable expectation of privacy in the content of the text messages ignored the operational realities of the workplace. The dissent pointed to several factors militating against a reasonable expectation of privacy in the text messages, such as: (1) the written and oral policy of the City communicated to Quon, (2) the issuance of the pager Quon for SWAT-related work, (3) the lack of privacy expectations in the content of SWAT-related communications, and (4) the diminished expectation of any privacy under the California Public Records Act.\textsuperscript{121} The dissent insisted that ignoring these operational realities and allowing one man’s informal policy to override all other factors “departs from the practical approach of \textit{O’Connor} and effectively precludes a public employer from undertaking investigations reasonably necessary to conduct its business.”\textsuperscript{122}

Additionally, Judge Ikuta declared that the court erred in holding that the OPD’s search was excessively intrusive.\textsuperscript{123} The dissent argued that the court

\begin{itemize}
    \item \textsuperscript{116} Id. at 909 (reasoning that the search was excessively intrusive in light of the purpose of the search, noting a “host of simple ways” to achieve the same goal).
    \item \textsuperscript{117} Quon En Banc, 554 F.3d 769, 774–79 (9th Cir. 2009).
    \item \textsuperscript{118} Id. at 769–74.
    \item \textsuperscript{119} Id. at 774.
    \item \textsuperscript{120} Id.
    \item \textsuperscript{121} Id. at 776.
    \item \textsuperscript{122} Id. at 777.
    \item \textsuperscript{123} Id.
\end{itemize}
relied on a test from Schowengerdt v. General Dynamics Corp., the “least intrusive means” test, that the Supreme Court has superseded three times and that was no longer considered good law.124 The dissent explained that to determine the reasonableness of the search, the court erroneously looked at what the OPD could have done rather than analyzing what it actually did.125 Again, the dissent suggested this result would unfairly burden government employers and restrict their ability to reasonably monitor their workplace.126

Judge Wardlaw began the concurring opinion by saying that “[n]o poet ever interpreted nature as freely as Judge Ikuta interprets the record on this appeal.”127 The concurrence declared that the court’s decision in Quon follows Ortega and that the dissent misinterprets several key facts,128 including: (1) there was no official policy regarding the pagers, (2) Quon did not recall Duke extending the City’s computer policy to the pagers, (3) Duke’s informal policy carried “a great deal of weight” as the administrator of the pagers, (4) Quon’s reliance on the informal policy was reasonable, (5) the practices of the OPD were consistent with the informal policy, and (6) both the District Court and Ninth Circuit panel found that Quon had a reasonable expectation of privacy in the messages.129

Judge Wardlaw then explained how the court followed the Supreme Court’s rule in Ortega, rebutting the dissent’s claim that the panel applied the superseded “least intrusive means” test. The concurrence emphasized that the rule in Ortega dictates that a court must consider the operational realities of the particular workplace and determine reasonableness “under all the circumstances.”130 The alternate methods the court discussed in the opinion were to illustrate that the method adopted by the OPD was unreasonable in light of the purpose of the search.131 The concurrence concluded that the dissent’s fact-blind interpretation of the law would “strip[] public employees of all rights to privacy regardless of the actual operational realities of each workplace,” and “create a far broader rule than Supreme Court precedent allows.”132

124. Id.; see Schowengerdt v. Gen. Dynamics Corp., 823 F.2d 1328 (9th Cir. 1987) (holding that a search was unreasonable where less intrusive means were feasible that could accomplish the purpose of the search).
125. Id. at 778.
126. Id. at 779.
127. Id. at 769.
128. Id. at 769–70.
129. Id. at 770–71.
130. Id. at 772 (citing O’Connor v. Ortega, 480 U.S. 709, 725–26 (1987)).
131. Id. at 773.
132. Id. at 774 (emphasis in original).
IV. THE INTERSECTION OF STORED COMMUNICATIONS, THE WORKPLACE, AND THE CLOUD

Quon confronts the problem of privacy in stored electronic communications and the workplace’s effect on it. Similar problems in a workplace setting in the near future will likely involve cloud computing.133 What can Quon teach us about the inevitable conflicts that will arise when privacy in data stored in the cloud is breached? This Part will focus on the expectation of privacy in data for personal use and in a workplace setting to see to what degree the decision in Quon affects Fourth Amendment protections for data that is migrating to the cloud.134

A. DEFINING CLOUD COMPUTING

Attempting to define cloud computing can prove to be as elusive as attempting to capture a genuine cloud with one’s hands.135 Many scholars’ attempts to define cloud computing have not yielded a universally agreed-upon definition.136 The working definition of cloud computing as provided by the National Institute of Standards and Technology will serve as a starting point: “Cloud computing is a model for enabling convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service

133. See, e.g., Clash of the Clouds, THE ECONOMIST, Oct 15th 2009, available at http://www.economist.com/displaystory.cfm?story_id=14637206 (arguing that cloud computing is pushing computing power to central hubs, contrary to previous trends in the industry); Posting of Erick Schonfeld to TechCrunch, “IBM’s Blue Cloud Is Web Computing By Another Name,” http://techcrunch.com/2007/11/15/ (Nov. 15, 2007) (defining cloud computing as massive server farms are used for online storage and applications by companies such as Amazon, Google, Yahoo, and IBM).

134. For an interesting take on this, see David A. Couillard, Note, Defogging the Cloud: Applying Fourth Amendment Principles to Evolving Privacy Expectations in Cloud Computing, 93 MINN. L. REV. 2205, 2205–06 (2009) (“Despite the shift in Internet usage, users expect their information to be treated the same on this virtual cloud as it would be if it were stored on their own computer, phone, or iPod.”).

135. For an explanation of the origin of the term cloud and its association with the Internet, see Jessie Holliday Scanlon and Brad Wiener, The Internet Cloud, THE INDUSTRY STANDARD, July 9, 1999, http://www.thestandard.com/article/0,1902,5466,00.html#page=0,0.

This Part will attempt to present a general overview of the cloud computing model as previously defined that is accessible yet sufficiently detailed to motivate the discussions regarding privacy presented in Section IV.C.

First, it is helpful to identify the three primary actors involved in cloud computing: the Service Users (SUs), the Service Providers (SPs), and the Infrastructure Providers (IPs). SPs provide software services available to SUs. SP services are made available to SUs through the Internet via interfaces designed for the particular service. SUs employ client applications that run on SUs’ devices, such as a laptop, PDA, or cellular phone. These client applications may be specific to an SP’s service, like an online backup service running on a computer, or may be a general web browser, like Mozilla Firefox or Internet Explorer. The infrastructure is provided to the SPs by other entities, IPs. IPs provide and maintain the computing resources that allow SPs to scale their services flexibly and reduce their costs.

The next step is to identify the cloud service models. The cloud services can be grouped into three categories: Software as a Service (SaaS), Platform as a Service (PaaS), and Infrastructure as a Service (IaaS). SaaS is the most familiar to most internet users, and web-based email falls into this category. SaaS provides users applications through the Internet that behave as the provider intends and over which users have little control outside of configuration settings. PaaS is a platform for application development that gives customers tools and a computing environment to develop and run their own applications. The PaaS company provides the platform on remote servers to run these applications, and the customers need not maintain the

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137. Mell, supra note 2; cf. Luis M. Vaquero et al., A Break in the Clouds: Toward a Cloud Definition, ACM SIGCOMM COMPUTER COMMUNICATION REVIEW, Volume 39, Issue 1, at 51 (January 2009), ISSN:0146-4833, available at http://portal.acm.org/citation.cfm?id=1496091.1496100 (“Clouds are a large pool of easily usable and accessible virtualized resources (such as hardware, development platforms and/or services). These resources can be dynamically reconfigured to adjust to a variable load (scale), allowing also for an optimum resource utilization.”).

138. See Vaquero, supra note 137, at 50.

139. Id.

140. Id.

141. Id.

142. See Mell, supra note 2; Vaquero, supra note 137, at 51.

143. See Mell, supra note 2; Vaquero, supra note 137, at 51. Examples of SaaS include online office applications (e.g., Google Docs), email applications (e.g., Hotmail), Flickr (online photo storage), and Pixlr (online photo editor).
underlying software infrastructure that allows the applications to function.\(^{144}\) IaaS companies provide the hardware infrastructure (such as servers and storage) for a customer to use remotely, allowing the customer to install and maintain whatever operating system, software, and applications they desire.\(^{145}\)

The final step in this overview is to identify how these clouds are deployed. The three main deployment models are private clouds, public clouds, and hybrid clouds.\(^{146}\) A private cloud is one where the cloud infrastructure is uniquely provided to a single customer.\(^{147}\) A public cloud is one provided to the general public.\(^{148}\) A hybrid cloud mixes private and public clouds, maintaining them as unique entities but tying the clouds together with technology allowing for data and application portability between them.\(^{149}\)

To illustrate how these categories interact, I will provide a hypothetical example. Imagine that Company A designed a web application that allows users to upload a number of photographs to create a collage. Company A pays Company B to provide a suitable number of web servers and storage so that internet users may access Company A’s application. Company A installs the necessary operating systems and software libraries on Company B’s servers so that Company A’s application is functional and available on the Internet. In this scenario, Company A is providing Software as a Service and acts as Service Provider to any internet user making a collage with their application, the internet users being the Service Users. For these Service Users, the collage application is in a public cloud. Company B provides Infrastructure as a Service to Company A, so Company B is the Infrastructure Provider. If Company B provides the servers and storage only for Company A, the infrastructure is a private cloud, but if this service is open to the public it is a public cloud.

B. Motivations and Considerations When Moving to the Cloud

Many motivations exist for migrating to cloud-based services. Consumers benefit when ad-supported applications in the cloud are free and viable options to costly non-cloud software. In addition, possible customers need

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\(^{144}\) See Mell, supra note 2; Vaquero, supra note 137, at 51. Examples of PaaS include Google Apps Engine, BungeeConnect, and Yahoo! Pipes.

\(^{145}\) See Mell, supra note 2; Vaquero, supra note 137, at 51. Examples of IaaS are Amazon Web Services and Flexiscale.

\(^{146}\) See Mell, supra note 2.

\(^{147}\) Id.

\(^{148}\) Id.

\(^{149}\) Id.
not install resource intensive applications on their computers because the hardware in the cloud provides the computing power and storage. All that the potential customer needs is a simple client application or a web browser and an internet connection. Many cloud-based services are available to any device that can connect to the Internet, which provides increased mobility and freedom from device tie-in. Finally, data stored in the cloud serves as a useful backup for important information that could be lost due to hardware failures.

Significant economic benefits exist for migrating to the cloud for businesses as well. As a practical matter for businesses, providing a service that does not require a customer to have a particular operating system or minimum hardware capabilities broadens a company’s possible consumer base. In addition, as server-side storage and processing power costs decline relative to those of client-side storage and processing, a business realizes an economic advantage from moving their data and processing to the cloud.¹⁵⁰

However, these may not be the most compelling economic reasons to migrate to cloud computing because they ultimately waste resources.¹⁵¹ In the cloud, multiple copies of data may be stored and bandwidth is needed to interact with the various applications and to access the online storage.¹⁵² Ed Felten, in a post on the blog Freedom to Tinker, presents an alternative economic motivation:

Why, then, are we moving into the cloud? The key issue is the cost of management. Thus far we focused only on computing resources such as storage, computation, and data transfer; but the cost of managing all of this – making sure the right software version is installed, that data is backed up, that spam filters are updated, and so on – is a significant part of the picture. Indeed, as the cost of computing resources, on both client and server sides, continues to fall rapidly, management becomes a bigger and bigger fraction of the total cost. And so we move toward an approach that minimizes management cost, even if that approach is relatively wasteful of computing resources. The key is not that we’re moving computation from client to server, but that we’re moving management to the server, where a team of experts can manage matters for many users.¹⁵³

¹⁵¹ Id.
¹⁵² Id.
¹⁵³ Id. (emphasis in original).
Thus, the move to the cloud may present many advantages. But before a person or company chooses to migrate to the cloud, they should consider the privacy implications of such a move.

C. CLOUD COMPUTING, PRIVACY, AND THE WORKPLACE

The Ninth Circuit in *Quon* held that the sender and recipients of text messages had a reasonable expectation of privacy in the content of their messages, even where the service provider had access to the contents of those messages. The court reached this conclusion by analogizing text messages to phone calls, letters, and emails. Only after finding a reasonable expectation of privacy in the content of the text messages did the court proceed to consider the employee’s workplace environment to determine whether that environment rendered the expectation unreasonable. The analysis in *Quon* guides the discussion in this Section. Privacy in the cloud first hinges on whether there exists a reasonable expectation of privacy in the content of certain data, and then whether a public employee’s expectation may be rendered unreasonable by various workplace practices and policies.

1. Reasonable Expectation of Privacy in the Cloud

The first step is to determine whether there is a reasonable expectation of privacy in the data stored in the cloud. Because of the nature of cloud computing, data must be stored with third parties. Thus, courts must consider the broad implications of Fourth Amendment doctrine that “a person has no legitimate expectation of privacy in information he voluntarily turns over to third parties” to the cloud.

Two recent cases illustrate the current divergence over whether the third-party doctrine applies to cloud-based email services. A district court judge

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154. See Section III.C, supra.
155. *Quon Circuit*, 529 F.3d 892, 904–05 (9th Cir. 2008). Note, however, that the court recognized that there was no case explicitly holding that there is a reasonable expectation of privacy in the content of emails, but they cited a case where the Ninth Circuit declared that the privacy interests in letters and emails were identical. *Id.* at 905.
156. *Id.* at 906.
157. Fourth Amendment conflicts between employers and employees in the workplace necessarily require that the employer be a public employer. Burdeau v. McDowell, 256 U.S. 465, 475 (1921). States may have privacy laws affecting private sector employees in a similar fashion, see e.g., Laura B. Pincus & Clayton Trotter, *The Disparity Between Public and Private Sector Employee Privacy Protections: A Call for Legitimate Privacy Rights for Private Sector Workers*, 33 AM. BUS. L.J. 51 (1995) (“As the Constitution applies only to state action, private sector employees must rely on common law protections or state statutory protection, both of which vary wildly from state to state.”).
159. For a discussion of the third-party doctrine, see *supra* Section II.C.
in Oregon wrote about the privacy of email stored in the cloud in *In re United States*, a case deciding whether the government must notify an individual when they have obtained a search warrant for their personal email account.160 He explained that Google's Privacy Policy indicated that Google can access any information stored on their servers and will share such information about its subscribers when it has a “good faith belief that access, use, preservation or disclosure of such information is reasonably necessary to . . . satisfy any applicable law, regulation, legal process or enforceable governmental request.”161 The court looked to the Supreme Court’s third-party doctrine to inform their opinion on the privacy of email in the cloud.162 Apparently contradicting the Ninth Circuit’s decision in *Quon*, the District Court of Oregon reasoned that:

[S]ubscribers are, or should be, aware that their personal information and the contents of their online communications are accessible to the ISP and its employees and can be shared with the government under the appropriate circumstances. Much of the reluctance to apply traditional notions of third party disclosure to the email context seems to stem from a fundamental misunderstanding of the lack of privacy we all have in our emails. Some people seem to think that they are as private as letters, phone calls, or journal entries. The blunt fact is, they are not.163

The court stated that email that is stored on a remote computer with a third party has no Fourth Amendment protection. This statement cannot be squared with the holding in *Quon* that there is a reasonable expectation of privacy in the content of text messages even though the service provider can access that information.164 However, the court did not hold that email was per se without Fourth Amendment protection. It assumed without deciding that email was protected, but the language cited above indicates a lack of unanimity whether there is any constitutional protection for email stored in the cloud.165

In a similar case involving a Bear Stearns hedge fund manager prosecuted for securities fraud, the state attempted to enter the manager’s personal email

161. *Id.* at *13 (quoting Google Privacy Policy, http://www.google.com/privacypolicy.html (last visited May 13, 2009)).
162. *Id.* at *11–13.
163. *Id.* at *15.
164. *Quon* Circuit, 529 F.3d at 905.
sent via Gmail into evidence.\(^\text{166}\) The defendant successfully moved to suppress the evidence, and the court in \textit{United States v. Cioffi} stated that the defendant had a reasonable expectation of privacy in the contents of his personal email account.\(^\text{167}\)

This case is also interesting because it highlights some of the privacy pitfalls inherent in cloud computing. The defendant had deleted his Gmail account before the government served Google with the search warrant.\(^\text{168}\) Google originally responded to the search warrant by stating that the emails were gone because the defendant had deleted the account.\(^\text{169}\) “On the eve of trial,” however, Google located a version of the defendant’s account as it existed nearly two years prior to the date of the warrant and promptly sent the contents to the government.\(^\text{170}\) This illustrates the concern that once data is in the cloud, a person loses the ability to completely control access to it.\(^\text{171}\)

As described in Section III.A., data that is stored in the cloud comprises more than simple communications like text messages or emails. The possible information stored with third parties in the cloud includes personal identification data, photos, videos, recordings, documents, software source and object code, and financial information. Furthermore, the Supreme Court has stated that information voluntarily revealed to third parties loses privacy protection, the third-party doctrine.\(^\text{172}\) Thus the question becomes whether


\(^{167}\) \textit{Id.} at *3 n.7, *12 (“The government does not dispute that [the defendant] had a reasonable expectation of privacy in the contents of his personal email account.”).

\(^{168}\) \textit{Id.} at *2.

\(^{169}\) \textit{Id.}

\(^{170}\) \textit{Id.}


\begin{quote}
Once this information is located in one or more databases “in the cloud”, it may be accessed and used in ways that individuals never envisioned or intended, and with little oversight. . . . And with the lengthy data retention periods and ineffective deletion procedures of many companies, we may find it very difficult to remove their data once it is uploaded.
\end{quote}

\textit{Id.; see also} Brian Kane & Brett T. Delange, \textit{A Tale of Two Internets: Web 2.0 Slides, Dies, and is Privacy Resistant}, 45 Idaho L. Rev. 317, 346 (2009) (“But the stark reality is that users have to understand that each piece of their lives uploaded onto the Internet becomes a lost piece of privacy.”).

\(^{172}\) \textit{See} David A. Couillard, \textit{supra} note 134 at 2207–08 (“However, when the object of a search–tangible or not–is voluntarily turned over to a third party, the Supreme Court has held that a person loses their reasonable expectation of privacy in that object.”); Orin S. Kerr, \textit{supra} note 38 at 563 (indicating that Supreme Court precedent holds that information
the reasoning that the Ninth Circuit employed in Quon, concluding that text messages and emails are protected under the Fourth Amendment, renders the third-party doctrine inapplicable to information stored in a cloud.  

As explained in Section I.C., the three principal cases espousing the third-party doctrine in the context of tangible communications are Smith, Couch, and Miller, also known as the business records cases. The common thread in these cases is that the information was revealed to a third party to accomplish a task commissioned by the revealer. Thus, the third party necessarily used the communicated information, and it is the third party’s active use that exhausted any reasonable expectation of privacy in the communication. Privacy law should distinguish between cloud-based communications that convey information to the service provider (or infrastructure provider) for the provider’s use and those that convey information to the provider for mere reception and storage. There is a reasonable expectation of privacy in the latter, and the cloud service

voluntarily revealed to third parties eliminates Fourth Amendment protection for that information). For more information on the third-party doctrine, see supra Section II.C.  

173. That this information may be “communicated” only to the person who put the information in the cloud in the first place does not alter this analysis. If a person stores data in the cloud that only he or she uses, it does not cease to be a communication in this analysis. One of the primary emails of concern in Cioffi was an email the defendant sent to himself containing a running diary of some thoughts, and the fact that it was sent to himself and to no one else did not alter the conclusion that there was a reasonable expectation of privacy in the content of the communication. See Cioffi, 2009 WL 3738314 at *2–3.  

174. Smith v. Maryland, 442 U.S. 735 (1979) (concluding that there was no reasonable expectation of privacy in the telephone numbers a person dialed); United States v. Miller, 425 U.S. 435 (1976) (stating that there was no reasonable expectation of privacy in financial records turned over to a bank); Couch v. United States, 409 U.S. 322 (1973) (holding that tax records given to an accountant were not protected by the Fourth Amendment because they were given to a third party). See supra Section II.C.  

175. For a more lengthy discussion of various forms of communication, such as telegrams, and their Fourth Amendment protections, see Alexander Scolnick, Note, Protections for Electronic Communications: The Stored Communications Act and the Fourth Amendment, 78 FORDHAM L. REV. 349 (2009).  

176. See Alyssa H. DaCunha, Note, TXTS R SAFE 4 2DAY: Quon v. Arch Wireless and the Fourth Amendment Applied to Text Messages, 17 GEO. MASON L. REV. 295, 326–27 (2009) (“The significant factor distinguishing the business records cases from a case such as Quon is that, unlike stored text messages, each of the documents at issue in the business records cases was of ‘independent interest’ to the business that received the documents from the individual.”).  

provider's ability to review the information should not diminish this expectation.

2. Cloud Computing Privacy in the Public Sector Workplace

Turning to cloud computing in the public sector employment context, another factor must enter into the equation in calculating privacy expectations in cloud data. The “operational realities” of the workplace may diminish an expectation of privacy in data stored with third parties to the point of making it unreasonable. This is a fact-intensive inquiry dependent on the specific details of each public sector workplace, but Quon provides a sample analysis. The Supreme Court has the opportunity to provide further guidance when it reviews Quon, which will provide a clearer framework for privacy policies in the workplace.

In Quon, the OPD issued pagers to SWAT officers and paid for the base contract, but officers paid for the overages they incurred. The City had a policy that governed the use of the pagers, but the administrator of the pagers instituted a practice that contravened it. These factual scenarios are subject to a myriad of variations in different public employment contexts, and it may not be clear from the outset how a court would decide a particular situation. With the disagreement over how to weight each factor in the analysis, the Supreme Court will have the opportunity to help employers and employees by providing some clarity.

The guidance from Quon directs public sector employers to take affirmative steps to control employee conduct. From an employer’s perspective, the lesson to be learned from Quon is to be ever-vigilant in overseeing privacy policies because courts may find them nullified due to lack of enforcement or contrary policies informally introduced by management. Employers migrating to cloud computing must establish business practices that control data, including which employees can access

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178. A result that would be consistent with the holding of Quon. See Quon Circuit, 529 F.3d 892, 905–06 (9th Cir. 2008).
179. See id. at 906–07.
180. See Brief of Petitioners at i, City of Ontario v. Quon, No. 08-1332 (U.S. Feb. 5, 2010) (listing the questions presented to the Court).
181. Id. at 895, 897.
182. Id. at 897.
183. See Brief of Petitioners at i, City of Ontario v. Quon, No. 08-1332 (U.S. Feb. 5, 2010) (listing the questions presented to the Court). Compare Quon En Banc, 554 F.3d 769, 770–71 (9th Cir. 2009) (concurring opinion) with Id. at 776–77 (dissenting opinion).
184. See Quon Circuit, 529 F.3d at 907.
the cloud computing service, procedures for removing employee access, and policies regarding personal use of cloud resources.

For the courts, the analysis of privacy interests in the public sector workplace should not differ in principle from the analysis to determine whether there is a reasonable expectation of privacy in the first place. For data stored with third parties, once the court establishes that an employee has a subjective expectation of privacy, the court should proceed to analyze the workplace environment to decide whether the expectation is objectively reasonable. This is accomplished by inquiring whether the public sector employer has access to the employee’s data, notwithstanding the third party’s ability to access the data. An employer can demonstrate access by showing that its policies and monitoring practices establish an open door for investigating an employee’s data stored in the cloud. In this way, the employer is analogous to a third party and the analysis proceeds along the lines of the third-party doctrine, requiring a court to decide whether the communication is directed to the third party or provided to them (the employer in this case) to accomplish an agreed upon task. In the employment context, the agreed upon task is the efficient and effective monitoring of the workplace. Any data stored in the cloud that affects how an employer manages the workplace would then lose any privacy protection. Data that does not fall in this category, such as personal email sent from a work email account as permitted by the public sector employer, would enjoy Fourth Amendment protection.185

Analyzing the facts in Quon using the proposed framework, the result would remain largely unchanged with one exception. The informal policy would serve to eliminate the OPD as a possible third party with access to Quon’s text messages because it destroys the employer’s access to the text messages. Quon would then have an objectively reasonable expectation of privacy in the contents of his messages even after considering the “operational realities” of the workplace.

V. CONCLUSION

When the Supreme Court reviews Quon it will be in a similar position as it was when it decided Katz. Prior to Katz, Fourth Amendment jurisprudence did not indicate that there was a reasonable expectation of privacy in

185. See Scolnik, supra note 175, at 393–97. Of course, even where there is a reasonable expectation of privacy, an employer may show that the search was reasonable and would not run afoul of the Fourth Amendment or similar state-provided privacy protections. See Quon Circuit, 529 F.3d at 906.
telephone calls because there was no physical intrusion, but the Supreme Court held that a caller who entered a phone booth had a reasonable expectation that the contents of his telephone call would not be “broadcast to the world.”186 The Court recognized that the Fourth Amendment should provide protection for telephone conversations because “[t]o read the Constitution more narrowly is to ignore the vital role that the public telephone has come to play in private communication.”187 By granting certiorari in *Quon*, the Supreme Court is poised to reinforce *Katz*’s interpretation of the Constitution by recognizing that text messaging and email have also come to play a “vital role” in private communication. Failing to recognize a reasonable expectation of privacy in communications such as text messages and emails stored with third parties would be a step backwards in Fourth Amendment jurisprudence. Affirming the Ninth Circuit’s holding in *Quon* will bring Fourth Amendment protection into the twenty-first century and protect the information that will inevitably migrate to the cloud.

The Supreme Court could also provide more guidance for courts in analyzing privacy for electronic communication in the workplace. By extending the third-party doctrine and its logical implications to the employment context, the Supreme Court could provide more certainty for employers rather than allowing for various, but undefined, “operational realities” to affect a court’s analysis.

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187. *Id.*
IMS Health v. Ayotte: A New Direction on Commercial Speech Cases

Alexander D. Baxter

I. INTRODUCTION

The constant call of the pharmaceutical ad has become commonplace on radio and television. With less than twenty years to exploit a patent on a new drug or treatment, pharmaceutical companies are locked in an endless battle with their own past successes, forever trying to convince consumers that the latest patent-protected and profitable formulation is superior to older drugs that have lost patent protection. Although consumers can ignore drug ads at their own discretion in private venues, they are significantly less able to do so in their doctor’s office. Therefore, physicians are primary targets for pharmaceutical advertising. Company marketers ply them with free samples of the latest drug along with pens and paperweights, bagels and coffee, even reimbursement checks for travel expenses to educational conferences—all to convince the physicians to prescribe the company’s brand instead of a generic or a competitor’s product.

Pharmaceutical marketers are known as “detailers” because they provide doctors details on new medications. Detailers have access to a doctor’s prescription history, a valuable tool for pitching a drug to the physician and tracking the doctor’s decision to actually prescribe the marketed drug. Data mining companies, working closely with the pharmaceutical companies, collect, process, and sell these histories. To promote competition by curbing detailers’ success promoting brand-name drugs over generics, New Hampshire passed a law prohibiting the sale of prescription histories for commercial purposes in 2006, and other states have subsequently adopted similar legislation. Litigation against the New Hampshire Act, IMS Health v. Ayotte, arose quickly as the data mining companies challenged the Act on constitutional free speech grounds. In an unusual decision, the First Circuit Court of Appeals deemed the sale of prescription history information to be conduct rather than speech and therefore unprotected by the First Amendment.

Part I of the Note explains the background that prompted the New Hampshire law. Part II discusses the legislative response in New Hampshire
and nearby states. Part III provides a brief overview of the relevant Supreme Court decisions regarding commercial speech. Part IV discusses the recent holdings in the Ayotte case as well as its counterpart cases in Maine and Vermont. Finally, Part V focuses on the court ruling in Ayotte and predicts that future courts handling commercial speech cases will not follow the First Circuit’s departure from precedent.

II. DETAILING: A PART OF EVERY PHYSICIAN’S DAILY ROUTINE

Marketers of brand-name pharmaceuticals use a variety of methods to maximize their drugs’ market share. Along with marketing to consumers, pharmaceutical companies spend vast amounts of money selling brand-name drugs directly to physicians. Marketers use the direct-to-physician approach, known as “detailing,” to encourage physicians to prescribe a particular brand-name drug over generic or competitor-brand drugs, or to maintain brand loyalty after a patent expires. Pharmaceutical companies spend almost $16 billion a year advertising their products, $4 billion of which is used for direct-to-physician marketing. By purchasing data from “data mining” companies, detailers acquire a detailed knowledge of the prescription history of the physicians they advertise to.

Pharmacies store certain information when they fill a prescription: the name of the patient and physician, the drug, dosage, and quantity dispensed. Data mining companies purchase this information from the pharmacies to package for sale. They organize and cross-reference this information in a variety of ways, including combining it with reference information about prescribers from the American Medical Association’s Physician Masterfile. Data miners such as IMS Health Inc. (IMS) and Verispan, LLC (Verispan), the plaintiffs in the IMS Health cases, sell access to their information databases to pharmaceutical companies. Although IMS and Verispan have other customers and provide some information at little or no cost to researchers, pharmaceutical companies comprise up to ninety-five percent of

2. Id.
4. Ayotte II, 550 F.3d at 45.
5. Ayotte I, 490 F. Supp. 2d at 166.
6. Id.
7. See infra Part V.
their total business. IMS dominates the health care information market, and Verispan is approximately one-tenth IMS’s size.

In compliance with patient privacy laws, IMS and Verispan install programs on pharmacy computers to encrypt the identity of the patient in each prescription record before the information is transferred from the pharmacy. However, after masking the patient’s identity, the data miners assign a placeholder number to each patient in order correlate multiple prescriptions for the same patient.

Armed with a dataset describing various physicians, their specialties, and prescription histories, detailers have several marketing advantages. First, they can more accurately target drugs to the right audience. For instance, prescription information allows detailers to discover which physicians tend to adopt new drugs quickly. Such “early adopters” are more profitable advertising targets. Second, advertisers can tailor their pitches more accurately to individual physicians, improving the likelihood of success. Finally, the pharmaceutical companies can determine their advertising’s success by tracking changes in a physician’s prescription history and adjust their marketing strategies accordingly.

Almost all physicians report having some kind of relationship with pharmaceutical representatives. Usually this relationship includes small gifts to the office, free lunches or coffee, or samples of prescription drugs. Many physicians also report accepting compensation for attending medical conferences and continuing education programs, as well as payments for

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9. Id. at 166.
10. Id. at 165.
13. Id. Importantly, the privacy of patients receiving and filling prescriptions was not a critical issue in the IMS Health cases because of IMS and Verispan’s policies protecting their privacy. The litigation in the IMS Health cases thus focused instead on the effect that detailers have on health care costs as a result of their acquisition and use of prescription information linked to physicians. See infra, Part V.
15. Id.
16. Id.
17. Id.
19. Id. 83% of physicians reported being brought food or drink, while 78% reported receiving prescription samples. The free samples are of particular note, since they are often used for patients who are unable to afford the prescription drugs any other way.
consulting or speaking at conferences. Detailers utilize these gifts and reimbursements to influence physicians’ prescription practices. Although most physicians deny being influenced by detailers, the vast amount of money that pharmaceutical companies spend on direct-to-physician marketing speaks to its efficacy.

Prescription drug costs, including increased costs from detailing, are an increasing portion of the similarly increasing cost of health care in the United States. Nationally, current estimates see health care costs rising from twelve percent of GDP in 2007 (itself nearly $1.8 trillion) to twenty-five percent in 2025, and almost fifty percent in 2082. The growth rate of medical costs far outstrips the growth rate of GDP. This relationship is present at the state level as well. Prescription drugs make up approximately fourteen percent of the total expenditure on medical services nationally, but drug expenditure is a strong growth area. The growth rate of brand-name prescription drug costs is between two and three times that of the inflation-tracking consumer price index, keeping total drug costs high despite the presence of cheaper

20. Id.
21. See IMS Health Inc. v. Ayotte (Ayotte II), 550 F.3d 42, 72 n.23 (1st Cir. 2008) (Lipez, J., concurring and dissenting). In one anecdote that Judge Lipez cites, a pharmaceutical marketing manager sent an email to her employees saying:

Our goal is 50 more [prescriptions] per week for each territory. If you are not achieving this goal, ask yourself if those doctors that you have such great relationships with are being fair to you. Hold them accountable for all of the time, samples, lunches, dinners, programs and past [consulting engagements] that you have provided or paid for and get the business!! You can do it!!


22. See Natasha Singer, No More Goodies for Doctors from Drug Makers, N.Y. TIMES, Dec. 30, 2008, at A1 (“Dr. Phillip Freeman . . . said that physicians who contended the giveaways were benign might be suffering from denial. ‘The need to deny influence is damaging to the soul,’ Dr. Freeman said.”).

24. Congressional Budget Office, The Long-Term Outlook for Health Care Spending 8 (2007). Excess cost growth in medical expenditure—the amount of cost growth in excess of GDP growth—was 2.1% in the 1975–2005 period; with a 2.2% annualized GDP growth, medical costs grew at nearly twice the rate of the national economy. Id.
27. See, e.g., Delay & Norton, supra note 25, at 5. But cf. PricewaterhouseCoopers, supra note 26, at 13 (noting that the acceleration in prescription drug cost growth has declined).
generic alternatives. With Medicare and Medicaid accounting for over forty percent of health care expenditures, rising drug prices have a serious effect on federal and state budgets.

Combined with these rising drug costs and pressures on state budgets, the pervasiveness of detailing makes the practice a common target for legislation. States have passed various laws attempting to restrict the effectiveness of detailing attempting to relieve some of the pressure on Medicare and Medicaid, hoping to contain at least one input to drug costs.

III. LEGISLATIVE AND PRIVATE RESPONSES TO DETAILING

A. INEFFECTIVE NON-LEGISLATIVE RESPONSES

In response to the effects of detailing on prescription practices, the American Medical Association (AMA) established the Prescribing Data Restriction Program (PDRP) in 2006. This program allowed doctors to opt in to prevent pharmaceutical companies from accessing their prescription records. If a physician registers, data mining companies may still collect and sell her prescription history information to pharmaceutical companies, but pharmaceutical companies are prohibited from giving the data to marketers for three years. Very few physicians signed up for the PDRP when it was first announced. The AMA also developed guidelines for the use of prescription data in order “to provide ethical guidance to the healthcare industry.”

In addition to the AMA’s efforts, many drug companies have voluntarily stopped providing small gifts such as pens and coffee mugs to physicians. However, because of the voluntary nature of the PDRP, the necessity to re-register every three years, and the commercial advantages of detailing, some

29. Id. at 13–14 (noting generics cost about 70% less than brand name drugs).
31. See infra Section III.B.
32. Id.
34. Ayotte II, 550 F.3d at 74 (Lipez, J., concurring and dissenting).
35. Herskovits, supra note 33.
36. Id.
37. Natasha Singer, No Mug? Drug Makers Cut Out Goodies for Doctors, N.Y. TIMES, Dec. 31, 2008, at A1. Given the small value of such gifts, the voluntary restrictions should have minimal effect on the total marketing effectiveness of detailing.
states deemed these efforts ineffectual and turned to legislation to regulate drug marketing and detailing in particular.  

B. LEGISLATIVE RESPONSES

Considering the PDRP to be ineffectual in light of the high economic incentive for pharmaceutical marketing, several states placed restrictions on pharmaceutical advertisers, citing patient privacy, improved care, or reduction of costs associated with prescription drugs. Some states restricted the number, value, and quality of gifts that detailers could give to physicians. Others, including New Hampshire, Vermont, and Maine, passed laws prohibiting the use of prescriber-specific information in detailing, which spawned the litigation discussed, infra, in Part V.

In 2006, the New Hampshire legislature passed the Prescription Information Confidentiality Act to restrict detailers’ access to physicians’ prescription histories and tendencies. The Act prohibits the licensing, transfer, use, or sale of patient-identifiable and prescriber-identifiable prescription records for most commercial purposes, and provides civil and criminal penalties for violations. This legislation has the practical effect of cutting data miners off from their primary source of revenue. Although data miners may still collect and analyze prescription data, any sale of such data to a pharmaceutical company for marketing purposes violates the law.

In 2007, two states followed New Hampshire’s example. Maine passed “An Act to Amend the Prescription Privacy Law,” which requires physicians to opt-in to have their records covered by the law. Vermont passed a similar

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39. Id.
44. Id. Data organized by less specific factors than prescriber, such as zip code, are explicitly permitted. Id.
45. Sales to pharmaceutical companies comprise approximately 95% of the data miners’ businesses. IMS Health, Inc. v. Ayotte (Ayotte I), 490 F. Supp. 2d 163, 166 (D.N.H. 2007).
law that protects physician records by default, but has an opt-out procedure to allow physicians to provide their records for collection.47

Table 1: Summary of state statute opt in/out provisions

<table>
<thead>
<tr>
<th>State passing law</th>
<th>New Hampshire</th>
<th>Maine</th>
<th>Vermont</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date passed</td>
<td>2006</td>
<td>2007</td>
<td>2007</td>
</tr>
<tr>
<td>Physicians included by default</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Physicians may opt in</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Physicians may opt out</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

The legislation in New Hampshire had an immediate impact on co-plaintiffs IMS and Verispan.48 Both companies instituted procedures to remove New Hampshire records from their databases for sale.49 They also responded by challenging each of the laws on constitutional grounds, bringing *IMS Health v. Ayotte* in New Hampshire, *IMS Health v. Rowe* in Maine, and *IMS Health v. Sorrell* in Vermont (herein collectively referred to as “IMS Health cases”). All three cases challenged the respective state laws as overly restrictive of commercial speech in violation of the First Amendment. Before describing the court decisions in detail,50 Part IV provides a general legal background of the commercial speech doctrine.

IV. HISTORY OF THE COMMERCIAL SPEECH DOCTRINE

A. COMMERCIAL SPEECH DENIED PROTECTION IN FIRST HALF OF TWENTIETH CENTURY

The most common definition of commercial speech is speech proposing that the listener enter into a commercial transaction.51 Prior to 1976, commercial speech lacked clear constitutional protection and was occasionally denied First Amendment protection entirely by the Supreme Court.52 In 1946, the Court in *Valentine v. Chrestensen* upheld a New York law that prohibited the distribution of handbills and other advertisements on

48. See supra Part II.
50. See infra Part V.
public city streets. The Court determined that, while it would violate the First Amendment to ban the distribution of all handbills on the street, there was “no such restraint on government as respects purely commercial advertising.” The Court later maintained that commercial speech was unprotected in *Breard v. Alexandria*, upholding a Louisiana law prohibiting door-to-door solicitation of magazine subscriptions. The Court distinguished *Breard* from a previous case striking down a conviction for door-to-door solicitation of a religious meeting, noting that the religious solicitation involved “no element of the commercial.” Over the next two decades, however, the Court tended to soften its approach to cases involving commercial speech, either avoiding the issue or limiting the holding in *Valentine*.

**B. COMMERCIAL SPEECH FIRST GRANTED PROTECTION IN VIRGINIA BOARD**

In 1976, the Supreme Court swept away any previous notion that commercial speech was entirely unprotected by the First Amendment. In *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, the Court confronted a Virginia law declaring a pharmacist guilty of unprofessional conduct if she published or otherwise advertised the price of her drugs or any other commercial information related to their sale. After noting its past denials to extend First Amendment protection to commercial speech, the Court identified the pharmacists’ speech as a communication of the idea: “I will sell you the X prescription drug at the Y price.” This situation is similar to that surrounding the IMS Health cases, though in *Virginia Board*, the pharmacist advertised to the public at large, while in the IMS Health cases, the pharmaceutical companies advertise to physicians, a step removed from the public.

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54. *Id.* at 54–55.
56. *Id.* at 642–43.
57. See, e.g., *Bigelow v. Virginia*, 421 U.S. 809, 819 (1975) (nothing that speech is not unprotected simply because it is part of a paid advertisement); Pittsburgh Press Co. v. Human Relations Comm’n, 413 U.S. 376, 385–86 (1973) (recognizing free expression interest in editorial decisions in newspaper advertising).
58. *Va. Bd. of Pharm. v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 748, 750 (1976). The restriction in *Virginia Board* was intended to buttress the public support and confidence in pharmacists, which might be damaged by the sense that they were excessively competing over price instead of focusing on patient health. *Id.* at 761.
59. *Id.* at 761.
60. See infra Part V.
The Court then noted that speech does not lose First Amendment protection because money is spent disseminating it, because the speech itself is in a form intended to make a profit, or because it involves a solicitation to purchase other things or contribute money. Therefore, if commercial speech were to be unprotected under the First Amendment, something about the content of the speech must make it unworthy. Because the public is, and should be, very much interested in the state of the commercial market, and because the free flow of information is likely to improve the public’s decisions, the Court held that commercial speech “is not in itself harmful,” and should not be denied constitutional protection. However, the Court noted that commercial speech had “commonsense differences” distinguishing it from other varieties of speech, and thus may be subject to regulation that the Constitution would not permit for non-commercial speech.

C. THE COURT PROVIDES THE COMMERCIAL SPEECH TEST IN CENTRAL HUDSON

In 1980, the Supreme Court clarified the differences between commercial and non-commercial speech and established a test for permissible regulation of commercial speech. The Court in *Central Hudson Gas & Electric Co. v. Public Service Commission of New York* reviewed a New York restriction on the advertisement of electricity usage, which the state had initially adopted as a response to the inadequate fuel stock in the winter of 1973–74. The state continued to enforce the ban after the pressure on fuel had eased, and *Central Hudson Gas & Electric Co.* challenged the law on First Amendment grounds.

The Court identified two content-neutral features of commercial speech that allowed its regulation: the commercial speakers’ ability to control the accuracy and lawfulness of their messages, and a profit motive that makes commercial speech “hardy” and less likely to be suppressed completely by regulation. The Court accorded commercial speech First Amendment protection, but the protection is somewhat limited. Thus the Court reviews commercial speech cases under a type of intermediate scrutiny.

62. *Id.* at 761–62.
63. *Id.* at 770.
64. *Id.* at 771 n.24.
66. *Id.*
67. *Id.* at 564 n.6.
68. *Id.* at 563–64.
The *Central Hudson* rule for reviewing commercial speech restrictions proceeds in two stages. First, because commercial speech is afforded less protection than regular speech, the government may proscribe misleading or illegal commercial speech, such as speech proposing an illegal transaction. 69 If the government regulation does not address illegal or misleading speech, then the government must prove that it passes a three part test: (1) the government must show a substantial interest in regulating the speech, (2) the regulation must directly advance the substantial interest, and (3) the regulation must not be more restrictive than it needs to be to serve the substantial government interest. 70 The Court in *Central Hudson* found the New York law to be unconstitutionally broad. Although New York’s interest in conservation that prompted the ban on electricity advertising was substantial and the ban advanced that interest, the Court concluded that the law failed the final aspect of the test because it was overly restrictive. 71

Although the *Central Hudson* three part test has provided guidance for how courts structure their analyses of commercial free speech, it has by no means provided a bright line rule on the constitutionality of commercial speech restrictions. 72 Many commercial speech cases hinge on whether or not the government regulation is overly restrictive, the third factor in the three-part test. While lower court rulings tend to be very fact-intensive and difficult to predict, Supreme Court precedents offer a few benchmark cases that provide a sliding scale of constitutional scrutiny. Thus, the more restrictive of speech a law is, the more compelling a state interest it must serve in order to pass constitutional muster. First, a law entirely suppressing the dissemination to the public of truthful, non-misleading commercial speech faces exacting (though not *strict*) scrutiny, and “rarely survive[s] constitutional review.” 73 These types of bans are nearly always found to be overbroad and more restrictive than necessary. Second, a ban that is less complete, such as prohibiting the in-person solicitation of business by lawyers or accountants, faces more relaxed scrutiny. These bans often target a certain form or venue

69. *Id.* at 578–79.
70. *Id.* at 561–66.
71. *Id.* at 570–71.
73. 44 Liquormart, Inc. v. Rhode Island, 517 U.S. 484, 502–03 (1996). The Court in *Liquormart* did carve out a small space where such a blanket ban may be acceptable, when such bans are enacted to preserve a fair bargaining process. *Id.* at 502. Though the First Circuit in *Ayotte II* did not hold so, this line of reasoning parallels the court’s “felt sense” argument about which types of speech are denied First Amendment protection. See IMS Health, Inc. v. Ayotte (*Ayotte II*), 550 F.3d 42, 52 (1st Cir. 2008).
of advertising, so-called “time and place” restrictions. Such bans “need only be tailored in a reasonable manner to serve a substantial state interest.”

Third, speech that is related solely to the commercial interests of the speaker and its specific business audience warrants the most relaxed constitutional scrutiny, because the public has the smallest interest in the particular information. Restrictions on the transfer of a person’s credit history, when used to compile an advertising list, fall into this final category.

The Court has noted that when it strikes down a restriction of commercial speech, it is almost always because the restrictions are substantially excessive. In contrast, a regulation need not be the least restrictive option to be upheld; the Court requires only a “reasonable fit” between the restriction of commercial speech and the legislative goal, and will defer somewhat to legislative findings. Whether the New Hampshire law transgresses the First Amendment, assuming it regulates speech, depends heavily on the category into which the restriction of detailing falls.

V. THE IMS HEALTH CASES

IMS and Verispan filed a civil action seeking declaratory and injunctive relief in the District Court of New Hampshire against the Attorney General of New Hampshire Kelly Ayotte. Their constitutional challenge alleged that the Prescription Information Confidentiality Act (the New Hampshire Act) “transgressed the Free Speech clause of the First Amendment, was void for vagueness, and offended the Commerce Clause.” This Note only addresses the plaintiffs’ First Amendment challenge.

75. Compare id. (striking down a law prohibiting in-person solicitation by professional accountants) with Ohralik v. Ohio State Bar Ass’n, 436 U.S. 447, 465–66 (1978) (upholding a ban on solicitation of injury clients by attorneys, because of the heightened stress placed on the lay audience of the solicitation by “a professional trained in the art of persuasion”).
77. Id. at 789.
79. Fox, 492 U.S. at 480. The Court notes that the “reasonable fit” doctrine is still substantially more strict than the “rational basis” doctrine applied to some Fourteenth Amendment equal protection cases. Id. at 480–81.
80. See infra Part VI.
82. IMS Health Inc. v. Ayotte (Ayotte II), 550 F.3d 42, 48 (1st Cir. 2008).
A. THE LOWER COURT DECISION IN AYOTTE

The Ayotte district court first considered whether IMS Health and Verispan’s actions constituted speech at all. Ayotte advanced two arguments that the New Hampshire Act prohibiting the sale or use of prescription data for commercial purposes did not regulate speech: (1) it regulated factual rather than expressive information, and (2) it regulated the use of the information rather than its disclosure. The court rejected both arguments: the first by noting that the Supreme Court in Va. Board protected purely factual information, and the second by observing that the New Hampshire Act expressly prohibited the transmission, and thus disclosure, of prescriber records. The court added that even if it did not prohibit transmission of records directly, it still regulated speech because it affected the downstream speech of pharmaceutical marketers.

After establishing that the plaintiffs’ actions constituted speech, the court characterized the restricted speech as commercial under the Central Hudson formulation. The court held that the law specifically prohibited the use and transmission of prescriber information for commercial purposes but did not regulate non-commercial disclosures. The district court proceeded to evaluate the constitutionality of the New Hampshire Act based on the Central Hudson test: whether it concerned a substantial state interest, effectively promoted that interest, and was no more restrictive than necessary in light of the state interests it promoted.

The state asserted that the New Hampshire Act advanced two substantial interests: the protection of prescriber privacy and the reduction of state health care costs. The state argued the first interest on very narrow grounds. The state argued that detailers invaded the privacy of prescribers not by acquiring the prescription information (professional information which the physicians likely did not have a right to keep private), but by intruding into the physician’s decision-making process. The court rejected this argument because the detailer-prescriber relationship did not meet the level of

84. Id.
85. Id. at 176.
86. That is, the pharmaceutical companies’ ability to speak would be affected by the lack of prescription history information. Id.
87. Id.
88. Id. at 177–83.
89. Id. at 179.
90. Id. at 179 n.13.
91. Id. at 179.
intrusiveness required to invoke a privacy interest. The court found that preventing detailers from using prescription data to persuade doctors to make “inadvisable prescribing decisions” was not a compelling state interest.

On the other hand, the court held that the state’s interest in reducing health care costs was clearly substantial. However, the court ultimately determined that the New Hampshire Act failed the second and third parts of the Central Hudson test. The state argued that detailing would become less effective without access to prescription records, thereby causing physicians to prescribe more generic drugs, which in turn would cut the state’s Medicare and Medicaid expenses. The court rejected this argument. Citing cases wherein patients had to be treated with brand-name drugs due to negative physical reactions to generics, the court reasoned that less expensive generic drugs are not always as medically efficacious as their brand-name counterparts. Thus, the initial savings in state expenditures might come at the cost of health care quality, leading to more treatments and more expense. Unwilling to balance the cost savings with the chance of losing care quality, the court held that the state had not met its burden in proving that the New Hampshire Act effectively advanced the goal of cost savings.

Finally, the district court held that the law was more restrictive than necessary. In doing so, the court appeared to use a “least restrictive means” test for this analysis instead of the “reasonable fit analysis” that the Supreme Court has advanced. The court presented three alternatives that the state could employ to reduce health care costs related to prescribing brand name drugs that did not involve restricting speech: (1) restricting detailers’ gift giving, as in other states, (2) instituting a state-sponsored advertising campaign for generic drugs, and (3) requiring prescription of generic rather than brand-name drugs to Medicaid patients unless the prescriber determines

92. The state argued by analogy to previous cases, showing that there was a substantial state interest in: (1) preserving the tranquility of the home, Carey v. Brown, 447 U.S. 455, 471 (1980); (2) preventing harassment or intimidation in advertising services, Edenfield v. Fane, 507 U.S. 761, 769 (1993); and (3) preventing the willing affront to the tranquility of bereaved individuals, Fla. Bar v. Went For It, Inc, 515 U.S. 618, 630 (1995).
94. Id. at 178–80.
95. Id. at 180.
96. Id.
97. Id.
98. Id. at 181.
99. Id. at 181–83.
100. See supra Section IV.C.
the brand-name drug to be medically necessary. However, the court did not directly consider whether the restriction on prescription information was a “reasonable fit” to the state interest.

The court thus determined the state could not justify the New Hampshire law under either of the interests that it advanced. The first interest of prescriber privacy, preventing the “intrusion” of detailers into the doctor-patient relationship, was not a substantial state interest. The second interest in cost reduction was a substantial interest, but the court held that the law did not successfully advance it and was overly restrictive of speech. After dismissing both justifications, the court struck the New Hampshire Act as unconstitutional and issued an injunction preventing its enforcement.

B. **Ayotte on Appeal**

In 2008, Ayotte appealed on behalf of New Hampshire to the Court of Appeals for the First Circuit. The court of appeals overturned the district court in a split decision. The court’s analysis differed significantly from the district court’s, eventually determining that the New Hampshire law did not regulate speech. However, the court first identified three information transactions that occur before a detailer makes her marketing pitch: (1) the plaintiffs’ acquisition of prescriber-specific information, (2) the sale of processed information to pharmaceutical companies for use in detailing, and (3) the use of that information by detailers to promote products. The court then established that it would consider only the rights of the plaintiffs, the data miners, and not those of detailers or pharmaceutical companies. This restricted the court’s analysis to “whether . . . the acquisition, aggregation, and sale of prescriber-identifiable data [] constitute[s] speech or conduct and whether New Hampshire’s legitimate governmental interests are sufficient to counterbalance any speech rights inherent therein.” The following Sections consider the court’s holdings that (1) the data miners’ activity constituted conduct, not speech, and (2) even if it was speech, the state had sufficient justification for restricting it.

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102. *Id.* at 183.
103. IMS Health v. Ayotte (*Ayotte II*), 550 F.3d 42 (1st Cir. 2008).
104. *Id.* at 48–49.
105. *Id.* at 49. Judge Lipez noted in his concurring and dissenting opinion that the pharmaceutical companies were intimately involved in the overall IMS Health litigation, and that because the law squarely targeted their practices, their rights should not be ignored in adjudicating the case. *Id.* at 65–69 (Lipez, C.J., concurring and dissenting).
106. *Id.* at 50 (majority opinion).
1. The Act Constitutes Regulation of Conduct

The court began its analysis with the observation that making a course of conduct illegal does not necessarily abridge freedom of speech simply because that conduct is carried out through language, whether spoken or written.107 The court then noted that there were categories of speech to which the Supreme Court had not granted First Amendment protection.108 The unprotected categories included lewd and profane speech, libel, “fighting words,” agreements restraining trade, speech furthering crime, and speech such as sexual harassment that creates hostile work environments.109 While noting that no doctrinal aggregation and explanation of these exceptions exists, the court identified a “felt sense” that laws proscribing such categories primarily regulated conduct rather than speech, or that the speech they regulated was of little to no societal value.110

Turning to the New Hampshire Act, the court determined that it primarily regulated conduct: information that the data miners used was more akin to a commodity that was purchased, processed, and re-sold, and the law only restricted to whom and for what purpose the data miners could sell it.111 The court also noted that the law did not exist to protect particular businesses,112 and that the free development (through collection and processing) of prescription history information was still legal—only sale for use in detailing was proscribed.113 Actors in the information market were still free to create and disseminate the underlying information for other purposes,

107. Id. at 51.
108. Id. at 51–52. (noting examples of the categories of speech).
110. Ayotte II, 550 F.3d at 52 (1st Cir. 2008).
111. Id. at 53 (“The plaintiffs . . . ask us in essence to rule that because their product is information instead of, say, beef jerky, any regulation constitutes a restriction of speech. We think that such an interpretation stretches the fabric of the First Amendment beyond any rational measure.”).
112. Id. (“[T]he First amendment [sic] does not safeguard against changes in commercial regulation that render previously profitable information valueless.”) (quoting Wine & Spirits Retailers, Inc. v. Rhode Island, 418 F.3d 36, 49 (1st. Cir. 2005)).
113. Id. The New Hampshire Act targets the conduct of detailers, but the information they use to convince doctors to purchase their drugs can also be used for more laudatory research activities. Id.
such as research.\textsuperscript{114} The court thus held that the New Hampshire Act did not violate the Free Speech Clause and that the law was constitutional.

Circuit Judge Lipez, though ultimately concurring that the law was constitutionally permitted, penned a forceful dissent on the speech or conduct issue.\textsuperscript{115} Lipez reasoned that the law had to be a regulation of speech because of it affected how pharmaceutical companies are allowed to advertise.\textsuperscript{116} Lipez further noted that even if the “upstream” conduct of data mining companies and pharmacies was not speech, the New Hampshire Act targeted the “downstream” speech of pharmaceutical companies advertising to physicians.\textsuperscript{117} Since the law was designed to limit speech, Lipez concluded, it had to be analyzed as a restriction on speech under the \textit{Central Hudson} test.\textsuperscript{118}

2. \textit{The Act Would Meet Free Speech Scrutiny}

Although the court held that the New Hampshire Act did not regulate First Amendment-protected speech, it assumed \textit{arguendo} that it did to analyze the law as a commercial speech restriction subject to \textit{Central Hudson}.\textsuperscript{119} As the district court had done below, the court first found that health care cost containment satisfied the first prong of the test as a substantial government interest.\textsuperscript{120}

The court then analyzed the connection between regulating detailing and the stated interest of containing health care costs by looking at the evidence the state presented: (1) detailing increases the cost of prescription drugs, (2) prescriber history information increases the success of detailing, and (3) detailing does not contribute to improved patient health.\textsuperscript{121} The court concluded that the evidence, while not iron-clad, was “competent,” and that it was unreasonable to require more concrete evidence where New Hampshire was the first state to restrict detailing in this manner.\textsuperscript{122} Thus, the New Hampshire Act was “reasonably calculated to advance [the state’s] substantial interest in reducing overall health care costs within New Hampshire.”\textsuperscript{123}

\begin{itemize}
\item \textsuperscript{114} \textit{Id.}
\item \textsuperscript{115} \textit{Id.} at 68–69 (Lipez, C.J., concurring and dissenting).
\item \textsuperscript{116} \textit{Id.}
\item \textsuperscript{117} \textit{Id.}
\item \textsuperscript{118} \textit{Id.}
\item \textsuperscript{119} \textit{Id.} at 54 (majority opinion).
\item \textsuperscript{120} \textit{Id.} at 55.
\item \textsuperscript{121} \textit{Id.} at 55–58.
\item \textsuperscript{122} \textit{Id.} at 58.
\item \textsuperscript{123} \textit{Id.} at 59.
\end{itemize}
Finally, the court turned to whether the New Hampshire law was no more extensive than necessary to serve the state’s interest. The Court of Appeals considered the district court’s three alternatives to restricting the use of prescription histories: restricting gifts to physicians, providing competing advertising for cheaper methods, and re-tooling the state Medicaid program to aggressively promote generic drugs and make it more difficult to prescribe brand-name drugs. The court dismissed each in turn, finding that there was little efficacy in restricting gifts (and that gifts of drugs were gratefully used to treat patients unable to pay for their prescriptions), that it was unfeasible for the state to compete with the huge advertising budget of the pharmaceutical industry, and that the Medicaid proposal was impractical, incomplete, and improperly placed in the prescription process. The court thus held that there was no identifiable alternative to achieving the goals of the New Hampshire Act without restricting speech and that it was no more restrictive than it had to be. With this conclusion, the state had met its burden under all three parts of the *Central Hudson* test, and the Court of Appeals therefore upheld the New Hampshire Act as constitutionally permissible.

The majority on the Court of Appeals took two different approaches to arrive at the same conclusion. While its decision ultimately rested on the determination that the New Hampshire Act regulated conduct and not speech, the court also provided *Central Hudson* analysis to conclude that even if it did regulate speech, it would nevertheless be permitted under First Amendment jurisprudence. This dual structure is a new wrinkle in commercial speech cases, and the First Circuit is currently the only court to declare that an information-regulating law like New Hampshire’s regulates conduct rather than speech.

C. LITIGATION IN MAINE AND VERMONT

Maine and Vermont passed legislation similar to the New Hampshire Act concerning physician records, but the laws differ regarding the presence of opt-out and opt-in provisions. In Maine, a physician must request that his or her records not be used for commercial purposes. This request is made when applying for a medical license. In Vermont, as in New Hampshire, the

124. *Id.* at 59–60.
125. *Id.*
126. *Id.* at 60.
127. *Id.* at 64.
law covers prescriber data by default, but prescribers may opt out of coverage.\footnote{129. See 18 Vt. Stat. Ann. § 4631 (2008).}

There was litigation in both states paralleling the case in New Hampshire. IMS Health v. Rowe, in Maine, was decided after the district court issued its decision in Ayotte, but before the Court of Appeals had reviewed the case. As such, the Rowe court cited the Ayotte district court decision approvingly and only discussed whether the opt-in provision in the Maine law made enough of a difference to save the law from constitutional violation.\footnote{130. IMS Health Corp v. Rowe, 532 F. Supp. 2d 153 (D.Me. 2007).} The court concluded that, though the opt-in provision made it a closer case, the law still violated the First Amendment.\footnote{131. Id.}

The case in Vermont, IMS Health v. Sorrell, was decided after the Ayotte appeal came down. Though not bound by Ayotte’s First Circuit precedent, the Sorrell court cited the Ayotte appeal approvingly and followed its commercial speech analysis.\footnote{132. See IMS Health Inc. v. Sorrell, 631 F. Supp. 2d 434 (D.Vt. 2009).} Noticeably lacking in the Sorrell court’s analysis, though, was any discussion of Ayotte’s distinction between conduct and speech. The Sorrell court held that the Vermont law squarely targeted speech and proceeded accordingly, upholding the law on Central Hudson grounds.\footnote{133. Id. at 446–47.}

VI. ANALYSIS: THE NEW HAMPSHIRE LAW REGULATES SPEECH, NOT CONDUCT, BUT IN A CONSTITUTIONALLY PERMISSIBLE MANNER

The litigation in Ayotte invoked two competing interests: the right to speak freely and disseminate information, and the need to contain drug expenditures and preserve the sanctity of the doctor-patient relationship. Although both are important, the First Circuit made the correct decision—even if for an unexpected reason—to allow for regulation of selling prescription information in light of the massive drain on public finance that drug prices and drug detailing cause. Section V.A is a critical examination of the court’s finding that the Prescription Information Law regulated conduct, not speech.\footnote{134. See N.H. Rev. Stat. Ann. § 318:47-f (2006). For a description of the court’s opinion, see supra Section V.B.} The Section concludes that the First Circuit’s finding is unsustainable and that plaintiff’s conduct should have been categorized as speech. Section V.B explores the options of how data mining can be regulated if it is considered speech.
A. THE COURT’S ODD DECISION: CONDUCT, NOT SPEECH

The Ayotte court’s primary basis for upholding the New Hampshire Act was that it regulated the conduct of the plaintiffs, not their speech.\(^{135}\) However, this determination jumps over a few important gaps. First, the first stage of the commercial speech regulation test the Supreme Court set out in Central Hudson reasonably covers the categories that the court identified as exempt from First Amendment protection—“fighting words” and agreements in restraint of trade, for example. These are categories of speech that facilitate or promote otherwise illegal activity, permissible under the test. The “downstream” speech that the New Hampshire law targets—pharmaceutical marketing to physicians by detailers—is not made illegal by the law. It is only weakened. Because the data mining does not facilitate an illegal activity, it is strange to deem the data mining without First Amendment protection.

Furthermore, the existence of a market for the manipulated data belies the court’s supposition that it is only of “nugatory informational value.”\(^{136}\) Though the court notes that drying up a market is not a reason to strike down a regulation of speech,\(^ {137}\) the market (which ranges from encouraged research to disfavored marketing) for IMS’s services differentiates their commercial activities from non-protected speech-like agreements to restrain trade or “fighting words.” Finally, the court recognizes that there is a public interest in disseminating the prescription information, but that research rather than detailing serves that interest.\(^ {138}\) Nevertheless, the information itself has value, both social and economic. The court’s determination that the transfer of information for one purpose (research) is permissible conduct but transfer for a different purpose (pharmaceutical marketing) is of little or no value is difficult to reconcile in a stable framework.

Ultimately, it is unlikely that Ayotte’s characterization will be widely adopted by other courts. Perhaps recognizing the disconnect between its holding and First Amendment precedent, the Ayotte court offered an alternative explanation for upholding the New Hampshire Act.\(^ {139}\) The Sorrell district court, not bound by the First Circuit precedent, characterized the prescriber-identifiable information as “plainly commercial [and] possessing a degree, however debatable, of social importance,” and held that the Vermont

\(^{135}\) See supra Section V.A.
\(^{136}\) See IMS Health v. Ayotte (Ayotte II), 550 F.3d 42, 52 (1st Cir. 2008).
\(^{137}\) Id. at 53.
\(^{138}\) Id.
\(^{139}\) Id. at 54.
law regulated speech and not conduct. If more states seek to curb pharmaceutical detailing, it is likely that the other federal circuits will analyze those laws as regulating speech as well.

**B. WHAT KIND OF SPEECH IS REGULATED, AND AT WHAT LEVEL OF SCRUTINITY?**

Assuming that data collection, analysis, and resale should fall under the limited constitutional protection offered by the commercial speech doctrine, the next question is at what level of scrutiny a court should examine data regulations. As discussed previously, the Supreme Court has drawn out three rough categories of commercial speech and three corresponding levels of intermediate scrutiny: (1) complete bans on the dissemination of commercial information which rarely survive constitutional review, (2) less than complete restrictions that must reasonably comport with their legislative goal, and (3) restrictions of information of little public interest that are examined in a more relaxed manner.

The New Hampshire Act and its counterparts do not appear to fit into the first category of restrictions—complete bans on the spread of commercial information. As the First Circuit Court of Appeals noted, nothing prohibits data mining companies from collecting and analyzing prescription histories, as long as they do not sell them to those who use them for a commercial purpose. However, there is some danger to this line of reasoning. Given that sales to pharmaceutical companies account for the vast majority of revenue for data mining companies, a country-wide replication of the New Hampshire Act would threaten to force companies like IMS and Verispan out of business. Although preservation of business models is not normally a factor in First Amendment analysis, the same data miners who sell to pharmaceutical companies also distribute their databases to researchers without a profit expectation. Consequently, making data mining companies unprofitable by criminalizing their most important revenue stream could effectively cripple dissemination of prescription information for useful research purposes and thus harm the public interest.

Though the New Hampshire Act is not a complete ban on a type of commercial information, it might fit under either of the two remaining categories: (1) restrictions on time, place, or manner of spreading information, or (2) restrictions on information relevant only to the speaker.

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141. See supra Section IV.C.
142. Ayotte II, 550 F.3d at 53.
143. Id. at 74.
and its specific business audience. If a less than complete restriction on the spread of commercial information (the second category), the New Hampshire Act meets the “reasonable fit” analysis used to evaluate the level of speech restriction and the governmental interest behind it. The district court in Ayotte seemed to apply a test more like the “least restrictive means” test for restrictions on expressive speech, offering several alternatives that might further the New Hampshire state legislature’s goal of restricting the effectiveness of detailing while causing less harm to the dissemination of information. The court of appeals was correct to reject that framework. The existence of less restrictive alternatives does not mean that the New Hampshire law was unreasonable. The legislature’s goal, restraining rapidly growing health care costs based in part on the expense of brand-name drugs,144 is substantial enough to sustain a restriction on the commercial use of certain information. The court of appeals was correct to offer New Hampshire some leeway in charting a course that may reduce state medical expenses at the cost of some dissemination of commercial information.145

Finally, the New Hampshire law likely meets the most relaxed test for restraints on commercial speech: if prescription histories are commercial information of importance only to the speaker and its specific business audience, then their transfer warrants reduced constitutional protection. The cases that federal courts have decided on these grounds are similar to the Ayotte case—in Dun & Bradstreet v. Greenmoss, the Supreme Court found that credit histories delivered by credit reporting companies to a business audience were this type of information.146 Similarly, the Court of Appeals for the District of Columbia held that a marketing list based on credit reports, which helped buyers target consumers for advertising, was a matter of no public concern.147 The sale of prescription histories seems to fit this general category. Certainly most arguments that prescription histories are matters of public concern—that they are subject to research, are needed for professional review, and are useful for measuring various aspects of the economy—could also apply to credit reports. Under this more relaxed framework, the New Hampshire Act and others like it easily pass constitutional muster.

Thus, the New Hampshire Act does not fit into the strictest category of commercial speech restrictions but would survive the lower constitutional

144. Prescription drugs make up 14% of health care expenditures, and brand-name drugs are increasing in price at nearly three times the rate of inflation. See supra Part II.
145. See Ayotte II, 550 F.3d at 58.
scrutiny if it fit into either of the other two categories. Because of its reasonably limited scope (prohibiting only one type of informational transaction) and the strong legislative goal behind it, the New Hampshire Act is a “reasonable fit” as an attempt to control health care costs, despite the as-yet unknown ultimate effect. Despite the implication for free speech, New Hampshire and the other states enacting laws like New Hampshire’s should be able to attempt to control health care costs in this manner.

VII. CONCLUSION

The New Hampshire legislature faced a difficult problem prevalent throughout the United States—rising drug prices impacting the state budget through Medicare and Medicaid—and came up with an imperfect solution. Although the New Hampshire Act regulates protected speech and impinges upon the free flow of information (commercial or not), ultimately the substantial state interest in reducing medical costs is paramount. The First Circuit Court of Appeals, in a break from every other court handling this type of issue, deemed the sale of prescription information conduct and not speech. It is unlikely that this idea will be carried forward for long. At least one district court has already decided the exact same issue under a speech analysis, and similar decisions will surely come if more states pass laws similar to the New Hampshire Act.
Imagine that you are an executive at Sears Holdings Corporation (Sears), one of the nation’s largest retailers.¹ You want to launch a website that allows customers to leave feedback on products and allows you to track their online and offline activities. Legally speaking, what information must you provide to those customers? How explicit must your disclosures be? Is a privacy policy enough or would you have to include other notification measures as well?

When Sears launched its online “My SHC Community” (Community) site in April 2007,² the company intended the Community to be an interactive website through which Sears could send participants product information and marketing surveys as well as collect consumer data and usage information through a tracking application.³ The Privacy Statement and User License Agreement (PSULA) accompanying the Community site stated explicitly that the tracking software would collect information from participants’ secure transactions, including personal financial and health data.⁴ Sears also paid ten dollars to participants who retained the tracking application for at least thirty days.⁵

In June 2009, the Federal Trade Commission (FTC or Commission) indicated that Sears’s privacy disclosure was not enough. Observing that the application collected consumers’ information from online banking statements, video rental transactions, library borrowing histories, and online

⁵ Exhibit B, supra note 3.
drug prescription records,\textsuperscript{6} the Commission charged that Sears's characterization of the scope of tracking as “online browsing” was deceptive and in violation of the Federal Trade Commission Act,\textsuperscript{7} suggesting that a privacy policy that explicitly states a company’s information collection practices may no longer be adequate to comply with FTC privacy disclosure standards. Sears agreed that month to settle with the Commission over charges that it inadequately disclosed the extent to which its software tracked consumers’ personal information.\textsuperscript{8}

Both the Commission’s allegations and Sears’s agreement to settle surprised attorneys.\textsuperscript{9} According to one lawyer, Sears’s conduct was not “egregious” in light of the company’s disclosures in the PSULA: “One imagines that the reasonable expectations of consumers who chose to be paid to have their online activities tracked is that they would have their online activities tracked.”\textsuperscript{10} That commentator took particular issue with the Commission’s analysis of Sears’s actions as “deceptive,” arguing that previous FTC orders finding deception involved express misrepresentations in companies’ privacy policies about information collection practices.\textsuperscript{11}

This Note argues that the Commission’s finding of Sears’s practices as “deceptive” comports with the agency’s three-part framework for analyzing

\textsuperscript{6} In re Sears Holdings Mgmt. Corp., Docket No. C-4264 (released June 4, 2009) (draft complaint), available at http://www.ftc.gov/os/caselist/0823099/090604 searscomplaint.pdf. When Sears settled by accepting the terms of a consent agreement, the FTC had only provided the company with a draft complaint. In the FTC administrative action and settlement process, a complaint is not issued formally until after a period of public comment and subsequent approval by the FTC Commissioners. See infra Section I.A explaining the draft complaint process.

\textsuperscript{7} Complaint, supra note 2.


\textsuperscript{9} See, e.g., Alan Charles Raul et al., \textit{End of the Notice Paradigm?: FTC’s Proposed Sears Settlement Casts Doubt On the Sufficiency of Disclosures in Privacy Policies and User Agreements}, 8 PRIVACY & SECURITY L. REP. (BNA) No. 1070, at 2 (July 20, 2009); see also Susan E. Gindin, \textit{Nobody Reads Your Privacy Policy or Online Contract? Lessons Learned and Questions Raised by the FTC’s Action Against Sears}, 8 NW. J. TECH. & INTELL. PROP. 1, 2–3 (2009) (noting that the Sears action may be considered “alarming” in light of precedents upholding online contracts); Amy E. Bivins and Barbara Yuill, \textit{Attorneys, FTC Discuss Proposed Settlement Involving Tracking of Online Activity}, 8 PRIVACY & SECURITY L. REP. (BNA) No. 869, at 1–2 (June 15, 2009) (comparing private firm attorney Alan Raul’s reaction that the Sears settlement could have far-reaching implications and FTC attorney Rick Quaresima’s view that the case did not move the FTC’s enforcement standard); Howie Perlman, \textit{Sears Settles FTC Claims of Consumer Data Collection Without Proper Disclosure}, 8 PRIVACY & SECURITY L. REP. (BNA) No. 824, at 1 (June 8, 2009) (noting that the FTC may be signaling the inadequacy of material privacy disclosures made in a privacy policy or end user license agreement alone).

\textsuperscript{10} Raul, supra note 9, at 2.

\textsuperscript{11} Id. at 10.
deception under 15 U.S.C. § 45, more commonly known as Section 5 of the Federal Trade Commission Act. Given the extensive scope and sensitive nature of the information that Sears tracked, this Note agrees with the Commission that Sears’s initial use of the broad term “online browsing” to describe its tracking practices, even if later supplemented by a complete disclosure in the PSULA, was deceptive. This Note concludes, however, that Commission’s finding does not signal the end of privacy policies. Instead, the decision signals that a privacy policy alone may no longer be sufficient for disclosing material information about a company’s data-tracking practices.

This Note also recommends five measures for effective privacy disclosures after In re Sears. In particular, it explains how the FTC’s order gives additional guidance for compliance with the privacy disclosure principles issued by the FTC in its February 2009 staff report, SELF-REGULATORY PRINCIPLES FOR ONLINE BEHAVIORAL ADVERTISING. Behavioral advertising is the practice of tracking an individual’s online activities in order to deliver advertising tailored to that person’s interests. Although Sears was not tracking information specifically to deliver targeted ads, the company’s use of a privacy statement and user license is a common practice among companies engaged in behavioral advertising. As such, identifying what the Commission found deceptive about Sears’s practices offers additional guidance on how companies may comply with the FTC’s principles for behavioral advertising.

Part I of this Note discusses the FTC’s enforcement authority to take action against privacy violations and explains the three-part inquiry that the agency applies to determine whether a business practice is deceptive. Part II discusses the Commission’s complaint and order in the Sears matter. Part III explains why Sears’s conduct is appropriately analyzed as a deceptive practice. Part IV recommends privacy disclosure measures that companies can adopt to avoid engaging in deceptive information-tracking practices.

I. THE FEDERAL TRADE COMMISSION AND PRIVACY

The FTC was created in 1914 through the passage of the Federal Trade Commission Act (FTCA). Its mission is to promote competition among

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13. Id. at 2.
businesses and to protect consumers from unfair and deceptive trade practices. Although the FTC initially had authority only to restrict “unfair methods of competition in or affecting commerce” between businesses, the Wheeler-Lea Amendment in 1938 broadened the agency’s authority to protect consumers under Section 5 of the FTCA. This amendment gave the FTC general authority to police “unfair or deceptive acts or practices.” Under this broad power, the agency currently investigates and seeks sanctions for privacy violations, including monetary equitable relief as well as preliminary and permanent injunctions.

The FTC is headed by five Commissioners who are nominated by the President and confirmed by the Senate. The Commissioners vote to accept, reject, or concur in enforcement actions brought by the agency’s bureaus; they also vote on reports issued by the FTC staff. Today, the agency serves its consumer protection mission through the Bureau of Consumer Protection (BCP), which enforces consumer protection laws enacted by Congress and trade regulation rules issued by the Commission. The BCP primarily investigates business practices, undertakes administrative and judicial actions, engages in rulemaking proceedings, and promotes consumer and business education. The BCP’s Division of Privacy and Identity Protection enforces privacy violations by investigating and bringing actions against businesses,

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15. FTC, A GUIDE TO THE FTC, supra note 14.
16. Id.
18. Id. § 45(a)(1).
19. The FTC also has privacy enforcement authority under the Children’s Online Privacy Protection Act, the Gramm-Leach-Bliley Act, the Telemarketing and Consumer Fraud Abuse and Prevention Act, and the Fair Credit Reporting Act. In addition, the agency enforces specific consumer protection statutes such as the Telemarketing Sales Rule, the Pay-Per-Call Rule, the Truth-in-Lending Act, the Cigarette Labeling Act, and the Do-Not-Call Implementation Act. For a list of statutes related to the FTC’s consumer protection mission, see Fed. Trade Comm’n, Legal Resources - Statutes Relating to Consumer Protection Mission, http://www.ftc.gov/ogc/stat3.shtm (last visited Mar. 22, 2010).
22. The FTC’s bureaus include the Bureau of Consumer Protection, the Bureau of Competition, and the Bureau of Economics. FTC, A GUIDE TO THE FTC, supra note 14.
23. Id.
24. FTC, A BRIEF OVERVIEW, supra note 20, § II(A).
organizations, or individuals that use deceptive or unfair practices to collect, use, share, or secure consumers’ personal data.\textsuperscript{25}

Sections I.A and I.B below describe how the FTC brings enforcement actions and how the agency distinguishes unfair practices from deceptive ones. Section I.C then highlights cases in which deceptive analysis has been applied. Lastly, Section I.D discusses an FTC report that provides additional guidance on how and when an information collection practice is deceptive.

A. HOW THE FTC BRINGS AN ACTION

The FTC may initiate a consumer protection investigation independently or in response to consumer complaints, Congressional inquiries, or other impetuses, such as an article on a consumer subject.\textsuperscript{26} Following an investigation, the FTC may initiate an enforcement action through either an administrative or a judicial process.\textsuperscript{27} In the administrative enforcement process, one of the agency’s Bureaus drafts a complaint stating its charges, which it presents to the respondent company and to the FTC Commissioners.\textsuperscript{28}

If the company disputes the charges, the Commission may officially issue an administrative complaint.\textsuperscript{29} If the company settles, it signs a consent agreement in which it accepts the terms of a consent order resolving allegations in the draft complaint.\textsuperscript{30} In agreeing to the consent order, the

\begin{footnotesize}
\begin{enumerate}
\item FTC, A GUIDE TO THE FTC, supra note 14. FTC investigations generally are not publicly disclosed in order to protect the investigations and the companies under investigation. FTC, A BRIEF OVERVIEW, supra note 20, § I(A).
\item FTC, A BRIEF OVERVIEW, supra note 20, § II(A)1.
\item Id., § II(A)1. The Commission initiates an administrative or judicial action if it has “reason to believe” that the law has been or is being violated. 15 U.S.C. § 45(b); 15 U.S.C. § 53(b). The FTC’s administrative complaint initiates a formal proceeding that is like a federal court trial but before an administrative law judge. Initial decisions by an administrative law judge may be appealed to the full Commission. Final decisions issued by the Commission may be appealed to the U.S. Court of Appeals and to the U.S. Supreme Court. FTC, A BRIEF OVERVIEW, supra note 20, § II(A)1(a).
\item Id., § II(A)1; see also In re Sears Holdings Mgmt. Corp., Docket No. C-4264 (released June 4, 2009) (agreement containing consent order), available at http://www.ftc.gov/os/caselist/0823099/090604searsagreement.pdf [hereinafter Consent Agreement] (explaining the consent agreement process).
\end{enumerate}
\end{footnotesize}
company does not admit to any violations of the law;\textsuperscript{31} it does, however, waive the right to judicial review.\textsuperscript{32} The consent agreement and draft complaint are then placed on public record for thirty days for public comment.\textsuperscript{33} After considering the comments received during the comment period, if a majority of the Commissioners approves the consent agreement, the Commission officially issues the complaint as well as a final order resolving the allegations in the issued complaint.\textsuperscript{34} The Commission has resolved the majority of its privacy actions through this administrative complaint and consent agreement process.\textsuperscript{35}

Alternatively, the FTC may pursue a judicial action by filing a complaint in federal district court, which allows the agency to simultaneously seek injunctive relief as well as monetary equitable relief.\textsuperscript{36} In addition, a court’s order becomes effective immediately, whereas the Commission’s administrative order does not take effect until sixty days after service.\textsuperscript{37} Generally, the FTC favors administrative action in cases involving novel legal issues or fact patterns; this gives the Commission the first opportunity to make factual findings and articulate the relevant legal standards.\textsuperscript{38} If a court later reviews the administrative decision, the court must give substantial deference to the Commission’s factual findings and interpretations of the FTCA.\textsuperscript{39}

B. \textbf{Unfair vs. Deceptive Analysis}

Under the FTCA, the FTC has general authority to police “unfair or deceptive acts or practices.”\textsuperscript{40} A practice may violate the FTCA if it is either unfair, deceptive, or both.\textsuperscript{41} An act or practice is unfair if (1) it causes or is likely to cause substantial injury to consumers (2) that is not outweighed by countervailing benefits to consumers or to competition and (3) that cannot

\begin{itemize}
  \item \textsuperscript{31} FTC, A Brief Overview, \textit{supra} note 20, § II(A)1(a); see also Consent Agreement, \textit{supra} note 30.
  \item \textsuperscript{32} FTC, A Brief Overview, \textit{supra} note 20, § II(A)1(a).
  \item \textsuperscript{33} 15 U.S.C. § 45(b) (2006); FTC, A Brief Overview, \textit{supra} note 20, § II(A)1(a).
  \item \textsuperscript{34} FTC, A Brief Overview, \textit{supra} note 20, § II(A)1(a).
  \item \textsuperscript{36} 15 U.S.C. § 53(b); FTC, A Brief Overview, \textit{supra} note 20, § II(A)2. Through the administrative process, the FTC may only obtain injunctive relief. \textit{Id.}, § II(A)2.
  \item \textsuperscript{37} 15 U.S.C. § 45(b); FTC, A Brief Overview, \textit{supra} note 20, § II(A)2.
  \item \textsuperscript{38} FTC, A Brief Overview, \textit{supra} note 20, § II(A)2.
  \item \textsuperscript{39} \textit{Id.}
  \item \textsuperscript{40} 15 U.S.C. § 45(a)(1).
  \item \textsuperscript{41} \textit{See id.}
\end{itemize}
be reasonably avoided by consumers.\footnote{Id. \S 45(n).} The first factor—the extent of consumer injury—is most important in unfairness analysis.\footnote{Id.} Although monetary harm and unnecessary health or safety risk typically satisfy the substantial injury factor,\footnote{Id.\S III.} a small degree of harm to a large number of consumers may also suffice.\footnote{Id.\, § III.}

In contrast, an act or practice is deceptive if it involves (1) a representation, omission, or practice that misleads or is likely to mislead (2) a consumer acting reasonably under the circumstances and (3) the representation, omission, or practice is material.\footnote{Letter from Fed. Trade Comm’n to Hon. John D. Dingell, Chairman, H. Comm. on Energy and Commerce, FTC Policy Statement on Deception, \S V (Oct. 14, 1983), available at http://www.ftc.gov/bcp/policystmt/ad-decept.htm [hereinafter FTC, Deception Policy].} Here, the FTC evaluates the entire transaction or course of dealing; this means that if the initial contact between a seller and a buyer is deceptive and creates a misleading impression, that entire transaction is deceptive even if the truth is subsequently disclosed to the consumer.\footnote{Id., \S III.}

C. Deceptive Analysis in Depth

Since 2000, the FTC has brought more than thirty privacy actions against various companies,\footnote{The majority of these cases are listed at Fed. Trade Comm’n, Privacy Initiatives, Enforcement Cases, http://www.ftc.gov/privacy/privacyinitiatives/promises_enf.html (last visited Mar. 22, 2010).} most of which it has settled through the administrative complaint and settlement process.\footnote{See Hofmann, supra note 35, at 14.} Substantively, the FTC has sought to enforce companies’ promises about how they would collect, store, use, or secure consumers’ personal information. Sections I.C.1 and I.C.2 below describe the Commission’s deception analysis and discuss how that analysis has been applied in online privacy cases.

1. The FTC Policy Statement on Deception

In 1983, the FTC issued a Policy Statement on Deception (Deception Policy) in response to a Congressional request for clarification on what constitutes a deceptive act or practice under Section 5 of the FTCA.\(^{50}\) The Policy laid out a three-factor inquiry that the Commission continues to use in determining whether a practice is deceptive. This inquiry asks (1) whether the act or practice involves a representation, omission, or practice that misleads or is likely to mislead; (2) whether the consumer acted reasonably under the circumstances; and (3) whether the representation, omission, or practice was material to the consumer’s conduct or decision with respect to the product or services.\(^{51}\)

Under this inquiry, the Commission first considers whether the act or practice “misleads” or is “likely to mislead” rather than whether it causes actual deception.\(^{52}\) For a written representation, for example, the Commission determines its likelihood to mislead by comparing phrases in the document, the nature of the claim, and the nature of the transactions.\(^{53}\) For omissions, the Commission may either presume that reasonable consumers are likely to be misled or require evidence establishing that likelihood.\(^{54}\)

Next, the Commission assesses whether the consumer’s interpretation or reaction is reasonable by considering the practice from the perspective of a reasonable consumer.\(^{55}\) This inquiry is fact-specific and presumes that a consumer’s interpretation of an act or omission is reasonable if that interpretation is intended by the seller.\(^{56}\) If the seller’s representation conveys multiple meanings to a reasonable consumer, and at least one meaning is false, the act or omission is deemed deceptive.\(^{57}\) If the practice targets a particular group of consumers, such as children or the elderly, the FTC also considers the practice from the perspective of an ordinary, reasonable member of that group.\(^{58}\) When assessing this second factor, the Commission has emphasized that “written disclosures or fine print may be insufficient to

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\(^{51}\) FTC, Deception Policy, supra note 46, § V.

\(^{52}\) Id., § II.

\(^{53}\) Id.

\(^{54}\) Id.

\(^{55}\) Id., § III.

\(^{56}\) Id.

\(^{57}\) Id.

\(^{58}\) Id.
correct a misleading representation.” Thus, “when the first contact between a seller and a buyer occurs through a deceptive practice, the law may be violated even if the truth is subsequently made known to the purchaser.”

Third, the Commission determines whether the deception is material. A “material” misrepresentation or omission is one that is “likely to affect a consumer’s choice of or conduct regarding a product.” It is information that is “important” to consumers, and if inaccurate or omitted, would likely cause injury to consumers. The Commission considers certain categories of information presumptively material, including express and implied claims. The Commission is also likely to infer materiality when the seller’s claims involve health, safety, or other main characteristics of a product or service, such as price, purpose, efficacy, or durability.

2. Deception Cases

As companies have established online presences, the FTC has used its three-part deception analysis to determine whether a company’s privacy practices have been deceptive. Although the FTC often finds companies’ practices to be “unfair or deceptive” without indicating whether the practice was specifically deceptive or unfair, findings of deception often involve companies’ per se violations of their own privacy policies. As such, FTC complaints generally discuss whether a practice is false, misleading, or likely to mislead (first factor), but tend to presume consumer reasonableness (second factor) and materiality (third factor).

In Federal Trade Commission v. Toysmart.com, LLC, for example, the FTC charged that an online toy seller violated Section 5 of the FTCA when it offered to sell customers’ personal information in contradiction to its original policy stating that such information would “never” be shared with a third

59. Id.
60. Id.
61. Id., § IV.
62. Id.
63. Id.
64. Id.
66. In the following cases, the FTC alleged that the company’s failure to implement reasonable and appropriate security measures to protect sensitive consumer information violated the company’s online privacy policies and “constituted unfair or deceptive acts or practices.” In re Petco Animal Supplies, Inc., 139 F.T.C. 102 (2005); In re MTS, Inc., 137 F.T.C. 444 (2004); In re Guess?, Inc., 136 F.T.C. 507 (2003); In re Microsoft Corp., 134 F.T.C. 709 (2002); In re Eli Lilly & Co., 133 F.T.C. 20 (2002); see also In re Liberty Fin. Co. Inc., 128 F.T.C. 240 (1999) (alleging that an investor website’s failure to maintain consumer survey responses anonymous despite initial survey description that responses would be anonymous was unfair or deceptive under Section 5).
party. In its course of business, Toysmart collected personal information from customers, such as names, addresses, billing information, shopping preferences, and family profiles. When the company ran into financial difficulty and initiated bankruptcy proceedings, however, it offered to sell its customer lists. Although the Commission did not explicitly analyze Toysmart’s actions under each deception factor, it alleged that Toysmart misrepresented its actions, which addresses the first factor requiring that practices be misleading or be likely to mislead. For the second factor, the Commission likely presumed that a reasonable consumer would not expect Toysmart to sell his or her information. Here, the Commission presumes that a consumer’s interpretation of an act or omission is reasonable if the seller intended that interpretation. Since Toysmart expressly stated that it would never share customers’ information with third parties, the company likely intended for customers to believe that it would never share this information. For the third factor, the Commission likely presumed that Toysmart’s claims were material because the company made express claims about never selling consumer information.

In the matter of Gateway Learning Corp., the Commission similarly found Gateway’s failure to notify consumers of changes to the company’s privacy policy to be deceptive. Beginning in 2000, Gateway marketed its Hooked on Phonics products under a privacy policy that promised not to sell, rent, or loan consumers’ personal identification information to third parties without express consumer consent. The policy also provided that if any changes were made to the policy, Gateway would notify customers and allow them to opt out of the new practices. In 2003, however, Gateway began to rent consumers’ information to marketers without their consent. A few months later, Gateway revised its online privacy policy to state that it would provide consumers’ personal information to third parties “from time to time.”

69. Id.
70. See supra note 56 and accompanying text; FTC, Deception Policy, § III.
71. The Commission presumes that a company’s express and implied claims are material. See supra note 63 and accompanying text.
73. Id. at 444.
74. Id. at 445.
75. Id. at 446.
76. Id.
Gateway did not, however, notify consumers of the change or give them the option to opt out, as was promised in the initial policy.\footnote{77} The Commission charged that Gateway’s failure to notify consumers of changes to its privacy policy was deceptive,\footnote{78} emphasizing that Gateway made “false or misleading” representations (first factor). Although the Commission did not specifically address its analysis under the other factors, it likely presumed that a reasonable consumer would not expect Gateway to change its policy without notification because Gateway expressly stated that it would notify consumers of changes to its privacy policy (second factor). The Commission likely also presumed that the claim was material because the claim was express (third factor).\footnote{79}

The FTC has also found omissions to be deceptive in adware cases.\footnote{80} In the matters of \textit{Zango, Inc.} and \textit{DirectRevenue LLC}, online companies offered consumers free content and software, such as screensavers, peer-to-peer file sharing software, games, or utilities, without adequately disclosing that downloading the free materials would install adware on users’ computers.\footnote{81} Although neither company violated any privacy policies, the Commission charged that the two businesses acted-deceptively in not disclosing that

\footnote{77. Id.}
\footnote{78. Id. at 450. The Commission also charged that Gateway’s retroactive application of a materially changed privacy policy to previously collected information was unfair. Id. at 449.}
\footnote{79. The FTC has also found a company’s failure to encrypt and secure users’ information despite representations otherwise to be deceptive. See Complaint, FTC v. Rennert, No. CV-S-00-0861-JBR (D. Nev. 1999) (alleging that an online pharmacy’s failure to encrypt user data or to transmit information using a Secure Sockets Layer, despite representations otherwise, was deceptive), available at http://www.ftc.gov/os/2000/07/iogcomp.htm; Complaint, United States v. ValueClick, Inc., No. CV-08-01711-MMM (C.D. Cal. 2008) (alleging that defendant companies’ failure to encrypt sensitive information or implement other “reasonable and appropriate measures” to protect against unauthorized access to consumers’ sensitive personal information was deceptive), available at http://www.ftc.gov/os/caselist/0723111/080317complaint.pdf.}
\footnote{80. Because the \textit{Sears} matter involved the downloading of tracking software that is arguably spyware (Sears did not adequately disclose the scope of the software’s tracking), it is helpful to see what kinds of practices the FTC has found to be deceptive in the adware and spyware context. Although an exact definitional difference between spyware and adware remains elusive, the Commission has described spyware as “software that aids in gathering information about a person or organization without their knowledge and which may send such information to another entity without the consumer’s consent, or asserts control over a computer without the consumer’s knowledge.” Fed. Trade Comm’n, Spyware Workshop, Monitoring Software on Your PC: Spyware, Adware, and Other Software, http://www.ftc.gov/bcp/workshops/spyware/ (last visited Mar. 22, 2010).}
adware would be installed along with the free materials. 82 “[Defendants] failed to disclose, or failed to disclose adequately, that such software is bundled with [] adware, which tracks and stores information regarding consumers’ Internet use and displays pop-up[s].” 83 Again, the Commission did not explain how the companies’ practices met each of the three deception factors. Because the companies’ practices involved omissions of information, however, the Commission likely presumed that a consumer would be misled under the first factor. The Commission likely also presumed that a consumer’s interpretation of the “lureware” to be free of adware was reasonable because the companies likely intended for consumers to believe that only the advertised freeware would be downloaded. 84 For the third factor, however, the Commission did specify that the bundling would be material to consumers in their initial decision to install the freeware. 85

In the cases above, the Commission generally required companies to pay monetary equitable relief. 86 In Gateway, for example, the settlement order required that Gateway give up the $4,608 it earned from renting the data. 87 In Zango and DirectRevenue, the post-settlement final orders required that the defendant companies disgorge $3 million and $1.5 million respectively. 88

D. PRIVACY AND BEHAVIORAL ADVERTISING

In addition to bringing administrative and judicial actions, the FTC undertakes other activities to evaluate and provide guidance on when a privacy practice is deceptive. The Commission, for example, often issues staff reports and hosts town halls, roundtables, and workshops to examine and solicit public opinion on privacy concerns. 89 The reports and workshops

82. Zango Complaint, supra note 81; DirectRevenue Complaint, supra note 81.
83. DirectRevenue Complaint, supra note 81.
84. Zango Complaint, supra note 81.
86. Since Toysmart was in bankruptcy proceedings, the Commission’s settlement did not require the company to pay a specific amount. Rather, it prohibited Toysmart from selling its customer list as a stand-alone asset and allowed the sales of lists only as a part of a package including the entire website. In addition, any lists could only be sold to a “Qualified Buyer,” defined as an entity in the “family commerce market” that expressly agreed to be Toysmart’s successor-in-interest as to the customer information. Toysmart Trial Order, supra note 67.
88. Zango Decision and Order, supra note 85; DirectRevenue Decision and Order, supra note 85.
89. FTC, Privacy Initiatives, supra note 25.
do not necessarily bind industry participants, but do establish informal standards for assessing a company’s privacy practices. In 2007, for example, the FTC held a two-day public town hall to discuss privacy concerns raised by behavioral advertising, such as consumers’ unawareness of data collection processes and the inadequacies of existing disclosures. Following the Town Hall, the FTC staff released for public comment a set of proposed principles for behavioral advertising designed to incite industry self-regulation. After receiving and reviewing sixty-three comments on the proposed principles, the FTC issued a final report, Self-Regulatory Principles for Online Behavioral Advertising (BAPs).

The BAPs emphasized the need for “transparency and consumer control” with respect to disclosure: “[C]ompanies that collect information for behavioral advertising should provide meaningful disclosures to consumers about the practice and choice about whether to allow the practice.” The FTC recommended that companies provide consumers notice and choice if the data reasonably could be associated with a particular consumer or with a particular computer or device, regardless of whether the data is personally identifying.

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92. FTC, BAPs, supra note 12, at 30. The Commissioners voted to approve the staff report 4–0. Commissioners Jon Leibowitz and Pamela Harbour also filed concurring statements. Chairman Leibowitz emphasized that the report’s endorsement of self-regulation “is viewed neither as a regulatory retreat by the Agency nor an imprimatur for current business practice”:

Industry needs to do a better job of meaningful, rigorous self-regulation or it will certainly invite legislation by Congress and a more regulatory approach by our Commission. Put simply, this could be the last clear chance to show that self-regulation can—and will—effectively protect consumers’ privacy in a dynamic online marketplace.


93. FTC, BAPs, supra note 12, at 11. The other BAPs are outside the scope of this Note, but include reasonable security and limited data retention, id. at 37–39, affirmative consent from consumers for material changes to privacy policies, id. at 39–41, and affirmative consent from consumers for use of sensitive data. Id. at 42–44.
94. Id. at 11.
95. Id. at 25.
Notably, the BAPs encouraged companies to “design innovative ways—
outside of the privacy policy—to provide behavioral advertising disclosures and
choice options to consumers.”96 The report noted possibilities such as:

(i) providing “just-in-time” notice at the point at which a
consumer’s action triggers data collection;
(ii) placing a text prompt next to, or imbedded in, the
advertisement; and
(iii) placing a prominent disclosure on the website that links to the
relevant area within the site’s privacy policy for a more detailed
description.97

The FTC’s report highlighted the possibility of placing near an
advertisement a linked disclosure such as “why did I get this ad?” that would
open to the pertinent section of a privacy policy explaining how and why the
data would be collected.98 According to the agency, such a disclosure “is
likely to be far more effective than a discussion (even a clear one) that is
buried within a company’s privacy policy.”99 Despite these possible disclosure
mechanisms, the BAPs did not endorse one specific way in which companies
should disclose tracking to consumers outside the privacy policy. The FTC’s
order in Sears, which requires Sears to disclose any tracking prior to and on a
separate screen from any privacy policy, thus exemplifies the BAPs’
recommendation that companies notify consumers outside of the privacy
policy.100

II. IN RE SEARS COMPLAINT AND ORDER

When Sears launched its My SHC Community website, it intended the
Community to be an interactive site through which Sears could send product
information and market surveys to participants. To join the Community,
consumers were required to download tracking software that would collect
their personal data and computer usage information. Before consumers
consented, Sears provided a Privacy Statement and User License Agreement
(PSULA) listing the types of data that the application would collect, such as

96. Id. at 35 (emphasis added).
97. Id. at 33.
98. Id. at 35–36.
99. Id. at 36.
100. See In re Sears Holdings Mgmt. Corp., Docket No. C-4264 (issued Aug. 31, 2009)
decision and order), available at http://www.ftc.gov/os/caselist/0823099/090604
searsdo.pdf.
Despite Sears’s PSULA, however, the FTC alleged that Sears’s actions in promoting the My SHC Community were deceptive. It emphasized that (1) the company’s initial invitation email stating that the software would track “online browsing” was inadequate, (2) the full disclosure of the scope of tracking was buried in the 75th line of the PSULA, (3) the installation box did not disclose the scope of the tracking application, and (4) the company failed to provide any desktop tray icons or other signs to indicate the running of the application on computers. In so doing, the FTC signaled to businesses that privacy policies may no longer be adequate for disclosing material information about a company’s information-tracking practices. In particular, if a company advertises or promotes a tracking application to consumers, it must disclose the types of data that the application tracks as well as how the data is to be used. Sections II.A and II.B below review the My SHC Community sign-up process as described in the Commission’s complaint and summarize the requirements of the final order.

A. THE SIGN-UP PROCESS

From April 2007 until January 2008, Sears implemented a market research program that invited users of sears.com and kmart.com to join Sears’s My SHC Community. In order to participate, customers needed to download a software application that would track their behavior online and offline. The sign-up process involved a series of interactions with and messages from Sears, including an email invitation that the FTC found particularly deceptive because it did not disclose the scope of the Community application’s tracking.

1. The Pop-Up Box Invitation

For a period of less than a year, fifteen out of every hundred visitors to the sears.com and kmart.com websites were presented with a My SHC Community pop-up box. The pop-up box asked, “Ever wish you could talk directly to a retailer? Tell them about the products, services and offers that would really be right for you?” It then invited visitors to become

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101. Exhibit E, supra note 4.
102. See Complaint, supra note 2.
103. Id.
105. Id.
members of the My SHC Community and to provide an email address to receive a follow-up email from Sears. The FTC noted that neither the pop-up box nor the privacy policy accessed via a hyperlink in the pop-up box mentioned the tracking software application.

2. The Email Invitation

To users who entered their addresses in the pop-up box, Sears emailed invitations to join the My SHC Community. The email described the Community as a “dynamic and highly interactive” online community sponsored by Sears where “your voice is heard and your opinion matters, and what you want and need counts!” As community members, consumers could “help shape the future by sharing and receiving information about the products, services and offers that would really be right for you.” Participation was also “always on your terms and always by your choice.”

The email stated:

To become a member of My SHC Community, we simply ask you to complete the registration process which includes providing us with your contact information as well as answering a series of profile questions that will help us get to know you better. You’ll also be asked to take a few minutes to download software that is powered by (VoiceFive). This research software will confidentially track your online browsing.

In the subsequent paragraph, the email continued:

We’ll ask you to journal your shopping and purchasing behavior. Again, this will be when you want and how you want to record it—always on your terms and always by your choice. We’ll also collect information on your internet usage. Community engagements are always fun and always voluntary!

In exchange for participation, members received ten dollars and registration in a sweepstakes. Consumers who wished to join needed to click the “Join Today!” button located at the bottom of the invitation.

106. Id.
107. Id.
108. Id.
109. Id.
110. Id.
112. Id.
113. Id.
email. If they retained the software on their computer for at least thirty days, they would receive the ten dollars.

3. The Landing Page

Consumers who clicked on the “Join Today!” button were directed to a landing page that again highlighted the benefits of membership. The landing page also noted that “community functions are fun and always voluntary.” The landing page featured a “Join Today!” button, above which Sears stated, “My SHC Community does NOT sell personal information.”

4. The Registration Page

Consumers who clicked on the “Join Today!” button in the landing page were directed to a registration page where they had to complete a user profile by submitting their name, address, age, and email address. Below the entry fields, the registration page presented the My SHC Community PSULA in a scroll box that displayed ten lines of the document at a time. A link to a printable version of the PSULA appeared below the scroll box.

This PSULA described (1) the requirements for participation in the program; (2) the types of information collected, which included demographic information, survey response information, internet usage information, and computer hardware, software, and other configuration information; (3) how the information would be collected; (4) how the collected information would be used; (5) how the information would be secured; (6) whether cookies would be used; (7) how the consumer could stop participating; (8) how children were regarded; and (9) how changes to the PSULA would be communicated.

The PSULA presented the scope of the tracking application on approximately the 75th line of the scroll box or the 35th line of the printable

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114. Id.
115. Id.
117. Id.
118. Id.
120. Id.
121. Id.
122. Exhibit E, supra note 4. The PSULA also sets out participants’ obligations to Sears and vice versa, as well as the other legal terms and conditions for participation. Id.
The section on “Internet usage information” provided that the application would monitor all of the Internet behavior that occurs on the computer on which you install the application, including both your normal web browsing and the activity that you undertake during secure sessions, such as filling a shopping basket, completing an application form or checking your online accounts, which may include personal financial or health information. The application would also track the pace and style with which you enter information online (for example, whether you click on links, type in webpage names, or use shortcut keys), the usage of cookies, and statistics about your use of online applications. The PSULA also provided that the application did “not examine the text of... instant messages or e-mail messages,” but could “review select e-mail header information from web-based e-mails as a way to verify... contact information and... online usage information.”

The section on “Computer hardware, software, and other configuration information” provided that the application may collect certain basic hardware, software, computer configuration and application usage information about the computer on which you install our application, including such data as the speed of the computer processor, its memory capacities and Internet connection speed. In addition, our application may report on devices connected to your computer, such as the type of printer or router you may be using. The PSULA also stated that Sears would make “commercially viable efforts to automatically filter confidential, personally identifiable information such as UserID, password, credit card numbers, and account numbers.” If it inadvertently collected such information, Sears promised to make “commercially viable efforts to purge [its] database of such information.” The PSULA also described how consumers could stop participating in the online community and remove the application from their computers, but

123. Id.
124. Id.
125. Id.
126. Id.
127. Id.
128. Id.
129. Id.
Sears reserved the right to continue to use any information collected prior to the consumer’s “resignation.”

A blank checkbox appeared below the scroll box PSULA and next to the statement: “I am the authorized user of this computer and I have read, agreed to, and have obtained the agreement of all computer users to the terms and conditions of the Privacy Statement and User License Agreement.” To continue with the registration process, consumers needed to check the box and click the “Next” button.

5. The Installation Page

Once consumers submitted the requisite information, checked the box, and clicked “Next,” they were directed to an installation page explaining the steps for downloading and installing the software. Consumers had to click on the “Yes” or the “Install” button in the “Security Warning” dialogue box to install the application. The FTC’s complaint noted that the installation page did not provide information on the scope of the information the software would track.

6. Desktop and System Tray Icons

Once installed, the tracking application ran continuously on consumers’ computers and transmitted consumer data to Sears’s servers. The application did not display on the desktop or system tray area any visible indications that it was running.

B. The Order

The Commission’s order did not require Sears to pay any monetary equitable relief. Rather, it prevented Sears from engaging in further deceptive acts and practices by requiring that the company disclose its

130. Id.
131. Id.
132. Exhibit D, supra note 119.
134. Id.
135. Complaint, supra note 2.
136. Id.
137. The application was listed, however, as “My SHC Community” in the “All Programs” menu and the “Add/Remove” utilities; its executable file name was also listed as a running process in the Windows Task Manager. Id.
138. In contrast, the FTC ordered Gateway to pay $4,608, Zango to pay $3 million, and DirectRevenue to pay $1.5 million for similar deceptive practices. See supra text accompanying notes 87–88.
consumer data collection practices on a separate screen prior to the display of any end user license agreement, privacy policy, or terms of use. 139 This notice must “clearly and prominently” disclose potential uses of the tracked data, whether third parties may use the data, and what types of data may be tracked.140 It must also disclose any tracking that includes (1) information from consumers’ interactions with a specific set of websites or from a broader range of Internet interactions; (2) transactions or information exchanged with third parties in secure sessions; (3) interactions with shopping baskets, application forms, or online accounts; or (4) personal financial or health information.141

The order also required that Sears obtain consumers’ express consent to download or install the tracking application and have their information collected.142 Consumers must indicate their assent by clicking on a button that would not be “pre-selected as the default option” and would be “clearly labeled . . . to convey that the action would initiate the [download, installation, or collection] processes . . . .”143

III. TOO LITTLE TOO LATE: WHY SEARS'S PRACTICE WAS DECEPTIVE

In its complaint, the FTC acknowledged that Sears’s application complied technically with its PSULA. Nevertheless, it concluded that Sears's practices were deceptive because the company’s initial communications with consumers failed to disclose adequately the scope of Sears’s information-tracking, which included data submitted during secure transactions. Under the Commission’s three-factor analysis for deception, an act or practice is deceptive if it involves a representation, omission, or practice that misleads, or is likely to mislead, a consumer acting reasonably under the circumstances.

139. Order, supra note 100, § I.A.
140. Id.
141. Id.
142. Id.
143. Id., § I.B. The order also requires Sears (1) to notify affected consumers that they have installed the tracking application and that the application collects and transmits to Sears and others the data described in the PSULA; (2) to notify consumers on how to uninstall the tracking application by (a) posting a clear and prominent notice on www.myshecommunity.com for two years and (b) informing affected consumers who complain or inquire about any tracking application; (3) to provide prompt, toll-free, telephonic, and email support to help affected consumers uninstall any tracking application. Id., § II. Section III of the order also required that Sears (1) stop collecting data from the consumers who downloaded the software and (2) destroy any data it had collected from customers. Id., § III.
and that representation, omission, or practice is material. 144 Because facts about the scope of tracking would be “material to consumers in deciding to install the software,” the Commission charged that Sears’s “failure to disclose these facts, in light of the representations made, was, and is, a deceptive practice.”145

Although neither the FTC’s complaint nor its order explicitly explains how Sears’s actions met each factor of the agency’s three-part deception analysis, this Part argues that the agency correctly found Sears’s actions to be deceptive. Specifically, it argues that Sears’s initial email describing its scope of tracking as “online browsing” was a material omission likely to mislead a reasonable consumer and that the misleading impression created by the email was not undone by Sears’s later PSULA. Sections III.A, III.B, and III.C below explain how the FTC likely applied the three factors to reach its charges against Sears.

A. REPRESENTATION OR OMISSION LIKELY TO MISLEAD

The FTC likely found “a representation or omission likely to mislead” in Sears’s initial invitation email to consumers. This initial email referred to the application’s scope of tracking twice. First, at the end of the fourth paragraph, Sears stated that the customer would be asked to download “research software” that would “confidentially track [the customer’s] online browsing.”146 Second, in the middle of a subsequent paragraph, Sears stated, “We’ll also collect information on your internet usage.”147

Given the extensive scope and sensitive nature of Sears’s tracking, the use of the term “online browsing,” even if supplemented by the second disclosure that Sears would “also collect information on your internet usage,” was an inadequate representation or omission. First, Sears used the software to collect information on nearly “all of the [consumers’] Internet behavior,” including secure transactions.148 The application also collected information from the headers of emails.149 As one public comment to the Sears consent agreement noted, a “wide continuum of information collection practices” exists on the Internet, ranging from tracking transactions on a company’s own site to improve the site’s navigation, to tracking passwords, account

144. See supra Section I.C.
145. Complaint, supra note 2.
146. Exhibit B, supra note 3.
147. Id.
148. Exhibit E, supra note 4.
149. Id.
In using a broad term such as “online browsing,” which could describe practices falling on either end of the continuum mentioned in the public comment, this Note agrees with the Commission’s finding that Sears failed to describe adequately the extent of its tracking. More specifically, this Note argues that Sears failed to describe up front its most extensive type of tracking. Because the invitation email did not specifically disclose the scope of Sears’s tracking, the email allowed consumers to believe that the tracking was on the minimal rather than the extensive end of the invasiveness continuum. As such, this omission or representation was likely to mislead a consumer.

Second, Sears’s initial email failed to disclose that the software would track consumers’ offline behavior. The email identified “online browsing” and “internet usage” as the types of information that the tracking application would collect. Neither phrase suggested, however, that the application would also harvest information about computer hardware and software configuration, the speed of the computer processor, the memory capacities, the type of printer or router, or the pace at which consumers clicked links, typed webpage names, and used shortcut keys. The failure of the initial email to state that offline behavior would be tracked was another omission likely to mislead.

B. CONSUMER ACTING REASONABLY UNDER THE CIRCUMSTANCES

Under deception analysis, the second factor that the Commission considers is what a reasonable consumer under the circumstances would have believed about the scope of Sears’s tracking. Although the Commission’s complaint did not explicitly address this factor, the FTC has previously stated that “to be considered reasonable, the interpretation or reaction does not have to be the only one. When a seller’s representation conveys more than one meaning to reasonable consumers, one of which is false, the seller is liable for the misleading interpretation.” Correspondingly, “when the first contact between a seller and a buyer occurs through a deceptive practice, the law may be violated even if the truth is subsequently
made known to the purchaser. Pro forma statements or disclaimers may not cure otherwise deceptive messages or practices."

Applying these standards, this Note argues that a reasonable consumer would not have believed that the scope of Sears’s monitoring would be so great as to include information submitted in secure transactions or activities undertaken offline. Sears’s initial communications assured consumers that they would have choice and control over their participation. The first pop-up box asked, “Ever wish you could talk directly to a retailer? Tell them about the products, services and offers that would really be right for you?” The subsequent invitation email described the My SHC Community as a “dynamic and highly interactive” online community where “your voice is heard and your opinion matters, and what you want and need counts!” Sears also repeatedly emphasized that participation was “always on your terms and always by your choice.”

In contrast to these exuberant claims about user participation being “always on your terms and always by your choice,” the initial email used the general term “online browsing” to describe the scope of consumer data tracking. This term allowed reasonable consumers to believe that the scope of tracking would be minimal when it was actually extensive. Because a seller is liable for a misleading representation when the representation conveys more than one meaning to reasonable consumers, this Note concludes that the FTC correctly held Sears responsible for creating the misleading interpretation that its tracking would be minimal.

Sears did eventually disclose the full scope of tracking of online and offline behavior in the PSULA. However, as the complaint pointed out, this disclosure did not appear in the PSULA until the 75th line. In addition, Sears’s suggestion in the invitation email that its application tracked “online browsing” or “internet usage” created a misleading impression that the PSULA disclosure could not cure. That Sears is a longstanding brick and

155. Id.
156. Exhibit A, supra note 104.
157. Exhibit B, supra note 3.
158. Id.
159. See Exhibit B, supra note 3.
160. See supra Section III.A.
161. See FTC, Deception Policy, supra note 46, § III.
162. See Exhibit E, supra note 4.
163. See Complaint, supra note 2 (observing that the description began on about the 75th line of the PSULA scroll box); Exhibit E, supra note 4.
164. See FTC, Deception Policy, supra note 46, § III (providing that “when the first contact between a seller and a buyer occurs through a deceptive practice, the law may be violated even if the truth is subsequently made known to the purchaser”).
mortar company may also have weighed against it; because consumers are more likely to trust a website run by Sears than one run by an unknown vendor, consumers are less likely to expect Sears to track their personal data so pervasively. As such, this Note concludes that a reasonable consumer would not have believed that Sears would monitor information submitted in secure transactions or activities undertaken offline.

C. MATERIALITY OF REPRESENTATION OR OMISSION

Under the third factor, the Commission considers whether the representation or omission was material. Although the Commission did not describe exactly how Sears’s omissions about the scope of its tracking were material, the complaint suggests that the tracking was so extensive that consumers likely would not have joined the community had they been initially informed of the scope. Such a conclusion may be supported by a 2009 study on Americans’ attitudes toward behavioral advertising conducted by the University of California, Berkeley, School of Law and the University of Pennsylvania’s Annenberg School for Communication. The researchers found that 66% of Americans objected to online tracking by advertisers. When told how advertisers tracked their online information, participants’ opposition to behavioral advertising increased: 84% opposed tracking that would monitor their activities on third-party sites, and 86% opposed tracking that would monitor their offline activities. Since Sears collected consumers’ data from third-party sites and offline activities, this study seems to support a conclusion that knowledge of Sears’s tracking practices would have affected consumers’ decisions to participate in the My SHC Community. As such, this Note concludes that Sears’s failure to disclose the scope of its tracking in the initial email constitutes a material omission.

165. See Gindin, supra note 9, at 29 (observing that the Sears matter is the FTC’s first enforcement action for behavioral tracking against a prominent brick and mortar company).
166. The Commission presumes materiality in cases where the seller knew, or should have known, that an ordinary consumer would need the omitted information to evaluate the product or service. See supra Section I.C.1; FTC, Deception Policy, supra note 46, § IV.
167. A “material” misrepresentation or omission is one that is “likely to affect a consumer’s choice of or conduct regarding a product.” See supra Section I.C.1; FTC, Deception Policy, supra note 46, § IV.
169. Id., Table 2, at 15.
170. Id., Tables 2 and 3, at 15.
D. Sears’s Liability for Deceptive Practices

As noted in Section II.B, the Commission did not require Sears to pay monetary equitable relief, as was the case in the matters of Gateway Learning Corp., Zango, Inc., and DirectRevenue LLC. This may be because the Sears matter is the first in which the Commission charged that a privacy policy disclosing a company’s collection and usage practices failed to undo the company’s earlier deceptive practice. Moreover, Sears did not violate its privacy policy (as Gateway had) or fail to disclose that software would be installed (as the Zango and DirectRevenue defendants had). As FTC Chairman Jon Leibowitz commented about the Sears matter, “Nobody argues that the folks at Sears are bad people who wanted to do bad things with the information they gleaned from these consumers. To the contrary, I don’t think they even knew exactly what they expected to learn from the data.”

Now that the FTC has signaled that detailed privacy policies do not immunize a company from liability for deceptive privacy practices, however, companies may face heavier consequences in the future.

IV. Recommendations for Privacy Disclosures After In Re Sears

Given that privacy policies may no longer be adequate in effectively disclosing a company’s privacy practices, the Sears order provides useful guidelines for companies on how data-tracking practices should be disclosed. In particular, Sears provides a concrete example of how the FTC may enforce privacy protection under its behavioral advertising principles. The rest of this Note recommends measures that companies can adopt to comply with Sears’s disclosure standards and identifies how these measures fit alongside the FTC’s principles for behavioral advertising. These recommendations include pre-privacy policy disclosures, multiple disclosures, disclosures in initial communications, disclosure of the most extensive tracking, and disclosure in system tray icons.

171. See supra text accompanying notes 87–88.
172. See id.
174. See Gindin, supra note 9, at 5–8 (identifying seven lessons to be learned from the Sears matter, including clear and prominent presentation of terms that are likely material to consumers, enhanced notice for “sensitive” personal information, and advertising materials that clearly and conspicuously disclose material information).
A. Disclosure Prior to the Privacy Policy

First, companies should disclose material information about their tracking practices on a separate screen prior to the privacy policy. The Sears order requires that a separate disclosure clearly and prominently describing the scope of monitoring be displayed prior to the display of any privacy policy, end user license agreement, or terms of use.175 This requirement reflects the Commission’s finding that a privacy policy may be inadequate if a company’s other communications with consumers create a misleading impression.176 It also reflects the Commission’s recognition that consumers often do not read privacy policies and would miss material information about a product or service if that information were only disclosed in the middle of a long privacy policy or agreement, as was the case with Sears’s PSULA.177 By requiring that disclosure about the scope of tracking be made before an end user license agreement or privacy policy, the Commission seeks to increase the chances that consumers will receive such material information.

This requirement also exemplifies the FTC’s first principle for behavioral advertising, which provides that disclosures about behavioral advertising be made “outside of the privacy policy.”178 Although the Commission recognized that it has become customary for companies to include most privacy disclosures in an online privacy policy and that alternative mechanisms for disclosure may confuse consumers, it also recognized that long and difficult-to-understand privacy policies are not effective in communicating information to consumers.179

B. Disclosure in Multiple Places

Second, companies should display pre-privacy policy disclosures in multiple locations on its website. The Sears complaint suggests that prior to its PSULA display, Sears could have disclosed the scope of its tracking in several locations, including the pop-up box invitation, the email invitation, and the landing page.180 The BAPs suggest options such as “just-in-time” notices that are provided when a consumer’s action triggers data collection or prominent disclosures that link to relevant areas within a more detailed privacy policy.181 The BAPs further suggest placing a linked question such as

175. Order, supra note 100, § I.A.
176. See FTC, Deception Policy, supra note 46, § III.
177. See Complaint, supra note 2.
178. FTC, BAPs, supra note 12, at 35 (emphasis added).
179. Id.
180. See supra Section II.A.
181. FTC, BAPs, supra note 12, at 33.
“Why did I get this ad?” near an advertisement. The linked question would bring the user to the pertinent section of a privacy policy explaining how and why data would be collected.182

By having multiple short disclosures that link to relevant sections of a comprehensive privacy policy, companies can avoid some of the concerns raised by public commentators in response to the proposed BAPs, which included confusing consumers who have come to rely on a single privacy policy.183 Multiple pre-policy disclosures need not, however, replace a comprehensive privacy policy. Rather, they can work alongside the longer policy by offering consumers multiple entry points into the policy; at the same time, multiple short disclosures offer the most material information in digestible formats.

Given the limited space available for short disclosures, commentators also expressed concern over which types of information would be important enough to warrant pre-privacy policy disclosure.184 In Sears, the FTC indicated that information warranting pre-privacy policy disclosure included what types of data the application would track, how the tracked data would be used, and whether the data would be used by a third-party. Given that the FTC has not provided an exhaustive list of information warranting pre-privacy policy disclosure, companies seeking to comply with FTC disclosure standards should test proposed disclosures to see which types of additional information help to inform consumers effectively. The BAPs, for example, encourage companies to undertake “empirical research to explore the effects of possible disclosures on consumer understanding.”185 A company that undertakes such research and applies what it learns might not only avoid liability but also enrich the Commission’s understanding of effective privacy disclosures.

C. Disclosure in Initial Communications

In addition to multiple pre-privacy policy disclosures, a company should make sure that its initial contacts with consumers do not create misleading impressions about the company’s tracking practices. The Sears matter shows that a misleading initial impression is not always reparable by a later complete

182. Id. at 35–36.
183. Id. at 33.
184. See Gindin, supra note 9, at 20 (noting that not all disclosures can be presented first and asking how a company should decide which disclosures to provide and in which order); Gleason, supra note 150 (observing that “prioritization and separation of consumer disclosures would force companies to decide without additional guidance what type of disclosure should be presented to a consumer first, and what should follow”).
185. FTC, BAPs, supra note 12, at 37.
Disclosure. As such, companies should describe the full scope of tracking in their first relevant communications with consumers. In Sears, for example, the first pop-up box inviting consumers to join the My SHC Community could have disclosed the scope of tracking. Alternatively, Sears could have summarized details about the tracking in the initial email and then linked to the complete PSULA. This way, the privacy policy would be comprehensive and centrally located; at the same time, short initial disclosures would highlight material information about tracking up front.

D. Disclosure of the Most Extensive Tracking

In their pre-privacy policy disclosures, companies should specify their most extensive form of tracking rather than use general terms that could span the continuum of tracking invasiveness. Sears’s initial email was problematic because it used the term “online browsing” to describe tracking, and that phrase could signify either minimal or extensive tracking. Had Sears initially disclosed that it would track information submitted by consumers in secure sessions, consumers would have known more clearly that Sears’s tracking was extensive. Accordingly, the Sears order requires pre-privacy policy disclosures related to the tracking of consumers’ (1) interactions with a specific set of websites or broader Internet interactions; (2) transactions or information exchanged with third parties in secure sessions; (3) interactions with shopping baskets, application forms, or online accounts; and (4) personal financial or health information.

E. Disclosure in the System Tray

The Sears complaint also suggests that a company should design a tracking application so that it displays an icon in a computer’s system tray area when the tracking program is running. The complaint notes that although Sears’s tracking software ran at all times on consumers’ computers, the application did not indicate its presence on the desktop or the system tray icon area. Thus, though the application’s executable file name would be listed as a running process in any task manager program that provided information about the processes and programs running on a computer, Sears’s failure to indicate visibly the ongoing running of the application heightened the inadequacy of the company’s disclosures.

186. See supra III.A–B.
187. Order, supra note 100, § I.A.
188. Complaint, supra note 2.
189. Id.
F. EXPRESS CONSENT MAY NOT BE ENOUGH

Lastly, the Commission’s order requires that Sears obtain express consent from consumers regarding the download and installation of any tracking applications.\(^{190}\) The BAPs similarly recommend that companies should only collect sensitive data after obtaining affirmative, express consent from the consumer targeted to receive the behavioral advertising.\(^{191}\) The *Sears* case shows that even obtaining express consent is not always enough to ensure that a practice is not deceptive. Although the consumers in *Sears* were required to click that they “ha[d] read, agree[d] to, and ha[d] obtained the agreement of all computer users to the terms and conditions of the [PSULA],”\(^{192}\) the FTC still found Sears’s practice to be deceptive because the full scope of tracking was not disclosed until approximately the 75th line of the scroll box PSULA.\(^ {193}\) Thus, even if companies obtain consumers’ express consent, they should consider the measures recommended in Sections IV.A–E so that they disclose adequately the scope of their tracking.

V. CONCLUSION

Although privacy lawyers were surprised by the FTC’s complaint and Sears’s settlement, this Note has argued that the Commission properly analyzed Sears’s conduct as a deceptive practice under Section 5 of the FTCA. Sears failed to disclose the scope of personal information that the My SHC Community tracking application would monitor, and this failure was a material omission likely to create a misleading impression in reasonable consumers. Although Sears did ultimately describe the scope of its tracking in the PSULA, that disclosure was inadequate, particularly given Sears’s emphasis on user choice and control in its initial contacts with consumers. To comply with the disclosure standards identified in *Sears* and the FTC’s principles for behavioral advertising, companies should adopt privacy disclosure practices that include multiple pre-privacy policy disclosures linked to corresponding sections of a comprehensive privacy policy, disclosure of the most extensive form of tracking in initial communications with consumers, and system tray icons that indicate when an application is running.

Although this Note has focused on the implications of *In re Sears* for behavioral advertising, the disclosure standards set forth in the case will likely

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\(^{190}\) Order, *supra* note 100, § I.B.

\(^{191}\) FTC, BAPs, *supra* note 12, at 42.

\(^{192}\) Exhibit D, *supra* note 119.

\(^{193}\) See Complaint, *supra* note 2.
apply beyond that context. In December 2009, the FTC held the first of three public roundtables focused on privacy challenges created by technology and business practices that collect and use consumer data, such as social networking, cloud computing, and mobile marketing. At the opening of the first roundtable, FTC Chairman Jon Leibowitz described *Sears* as an example of how companies are grappling with protecting privacy while collecting and using consumer data:

> [W]hile the extent of tracking was described in [Sears’s PSULA], that disclosure wasn’t sufficiently clear or prominent given the extent of the information tracked, which included online bank statements, drug prescription records, video rental records, library borrowing histories, and the sender, recipient, subject, and size for web-based e-mails.

> So consumers didn’t consent with an adequate understanding of the deal they were making. 194

As the collection and use of consumer data develops across a variety of contexts, the privacy disclosure requirements outlined in *Sears* provide a useful starting point for companies seeking to comply with FTC standards. Yet because the technologies, business practices, and consumer expectations in each context inevitably differ, *Sears’s* privacy disclosure requirements should be applied with nuance and reconsidered as needed.

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ADDITIONAL DEVELOPMENTS—PRIVACY LAW

AMERICAN BANKERS ASSOCIATION v. BROWN
541 F.3d 1214 (9th Cir. 2008), cert. denied, 129 S.Ct. 2893 (2009)

After nearly six years of federal preemption challenges, the State of California won its right to prohibit financial institutions that do business with California residents from sharing nonpublic consumer financial information with affiliates. In American Bankers Association v. Brown, the Ninth Circuit held that federal law did not preempt SB 1, the affiliate-sharing provisions of the California Financial Information Privacy Act. The court did restrict, however, the scope of the provisions to exclude the regulation of “consumer report information,” as defined by the federal Fair Credit Reporting Act (FCRA).

SB 1, which was enacted in 2003 and took effect in July 2004, restricted the ability of financial institutions to share consumer information with affiliates. The Act required that institutions provide annual written notices informing consumers that their non-public personal information may be shared and that they have the opportunity to “opt-out” of having such information disclosed. Shortly after the enactment, the financial services industry challenged the state’s authority to regulate affiliate sharing practices, claiming that FCRA preempted California law.

In July of 2005, the Ninth Circuit held that FCRA preempted SB 1, but limited the preemption to the FCRA’s coverage of consumer report information. The court distinguished between FCRA’s restrictions, which cover only consumer report information, and SB 1’s affiliate sharing provisions, which apply broadly to nonpublic personal information. The Ninth Circuit found that FCRA’s preemption clause prevents states from regulating the sharing of consumer report information among affiliates. The case was remanded to resolve the question of whether any portion of SB 1 survived preemption if the court’s restricted meaning of “information” was applied, and if so, whether the surviving portion can be severed from the preempted portion. On remand, the district court enjoined the enforcement of all the affiliate sharing provisions of SB 1 by holding that all the provisions were preempted and that the preempted portions could not be severed. The Ninth Circuit reversed the district court on appeal, holding that California’s affiliate sharing statute can be severed to exclude the regulation of consumer report information preempted by federal law. As a result, SB 1’s affiliate-sharing rules cover information that falls outside the definition of “consumer report” information under the FCRA.
The Ninth Circuit based its decision on California laws that allow a court to alter a statute if it concludes that revising, rather than invalidating, the statute would further the Legislature’s intent in passing SB 1. After considering the statute’s severability clause, legislative findings, as well as declarations of intent, the court found that the Legislature enacted SB 1 in order to give consumers notice of, and control over, the disclosure of their private personal information. Limiting the statute’s reach to exclude consumer report information would still advance the Legislature’s goals, even if the scope was not as broad as the Legislature originally intended.

**IRS SEeks US Taxpayer Information From UBS**

On August 19, 2009, the United States government and the Swiss Confederation entered into an agreement outlining the process by which the Swiss government would turn over to the IRS information about Americans with UBS accounts located in Switzerland. The process agreed to by both parties would comply with the U.S. tax goals as well as Swiss’ privacy standards.

This new agreement allowed the U.S. Internal Revenue Service (IRS) to audit Americans with UBS accounts in Switzerland who were also suspected of offshore tax evasion. It came about as a result of a John Doe Summons filed against UBS in June 2008 asking for the account information of a “John Doe” class of as many as 52,000 U.S. taxpayers with undeclared accounts at the bank in Switzerland.

The agreement allowed for a two-part resolution. First, the U.S. is to drop its enforcement of the John Doe Summons against UBS by filing a Stipulation of Dismissal in return for access to the information. However, the U.S. remains free to enforce the summons if it found the information provided by the Swiss government to be inadequate. Second, the IRS is to submit a treaty request to the Swiss government; once the request is received, the Swiss government would direct UBS to notify account holders that their information had been included in an IRS request. UBS would then produce account information on a rolling basis to the Swiss Federal Tax Administration (SFTA), which would review the information and decide what it would pass onto the U.S. government.

It is estimated that it could take up to a year for SFTA to decide what information to give to the United States. Furthermore, UBS would inform customers that they had the right to appeal to the Swiss Federal Administrative Court to keep their accounts secret. UBS also informed account holders that under the Voluntary Disclosure Program, account holders can submit a waiver to the UBS or the SFTA in return for the possibility of reduced penalties.
One consequence of this agreement is the creation of a new office to monitor the “global high wealth industry”; this office would handle incoming accounts as well as violations of tax treaties. A more significant consequence is the undetermined impact this agreement will have on offshore accounts and the level of privacy Americans with such accounts will be able to expect from foreign banks in the future. This agreement may heighten the duties of overseas financial institutions to detect and report tax evasion.

**TOFFOLONI v. LFP PUBLISHING GROUP, LLC**

572 F.3d 1201 (11th Cir. 2009)

The United States Court of Appeals for the Eleventh Circuit considered whether nude photographs not central to a corresponding news article qualified for the newsworthiness exception to the right of publicity. Overturning the lower court’s decision, it held that a brief biographical piece accompanying nude, personal photographs did not exempt a defendant from violating a plaintiff’s right of publicity.

The plaintiff, Maureen Toffoloni, was the mother and representative of the estate of her deceased daughter Nancy Benoit. In June of 2007, Nancy and her son were killed by Nancy’s husband, Chris Benoit, in a murder-suicide. Both Chris and Nancy had been professional wrestlers, and their deaths gained national media attention.

In February of 2008, Toooloni brought suit against LFP Publishing, seeking an injunction against the publication of the photos as well damages for violation of her daughter’s right to publicity. Toffoloni alleged that her daughter had asked photographer Mark Samansky to destroy the nude photos and video after a shoot and that Nancy believed that Samansky had done so. Instead, Samansky kept the video and extracted nude photos from the stills that he passed on to *Hustler* magazine, which is published by LFP Publishing. *Hustler* had run the photos in their March 2008 issue along with a short article about Nancy.

The state of Georgia, which had been Nancy’s residence at the time of the murder, recognizes a right of publicity. The courts had also adopted a “newsworthiness” exception to the right of publicity in order to balance rights of privacy and publicity with the rights of freedom of speech and of the press.

In *Toffoloni*, the court held that the nude photos were not central to the murder of Nancy Benoit and therefore, were not newsworthy. The court noted that the heart of the article was the publication of the nude photos and not the corresponding biography. Furthermore, the court observed that there are “timeliness or relatedness boundaries” that circumscribe the depth of an
incident of public interest. Here, the published photos were in no way related to the “incident public concern” or “drama” of Benoit’s death.

**Verizon California, Inc. v. Federal Communications Commission**

555 F.3d 270 (D.C. Cir. 2009)

The District of Columbia Court of Appeals declined to review the Federal Communications Commission’s (FCC) ruling that Section 222(b) of the Telecommunications Act, which mandates that a telecommunications carrier that receives information from another carrier in order to provide a telecommunications service, may only use that information for that purpose, applied to a carrier receiving such information but not itself providing the telecommunications service.

When a telephone user seeks to terminate her old provider and “port” her existing phone number to a new provider, the new service transmits a Local Service Request (LSR) to the old provider in order for the new one to perform the necessary technical action. Verizon California, Inc. (Verizon) received LSRs from other voice service providers. Yet before the number port could be completed, Verizon would use the LSR information to contact its defecting customers and offer them incentives not to join the new provider.

In 2008, the FCC determined that Verizon violated Section 222(b) of the Telecommunications Act by using LSRs from other carriers to market to its departing customers and ordered Verizon to cease and desist. Verizon petitioned the D.C. Circuit to grant review of the FCC’s order, arguing that Section 222(b) applied only to carriers that themselves provided the requested telecommunications service. Verizon asserted that it was exempt from Section 222(b)’s restrictions, since it merely received the LSR information from the other provider but did not itself perform the requested number port.

The D.C. Circuit denied the petition to review, finding that the FCC’s interpretation did not unambiguously contradict the statutory language. First, the panel addressed an FCC precedent stating that Section 222(b) applied to a carrier receiving information even though the service in question was provided solely by the carrier submitting the information. Verizon argued that the precedent was inapplicable because in that ruling, the FCC justified its interpretation of the statute as promoting carrier competition, whereas in the Verizon order the FCC sought to use the interpretation to restrain competition (between carriers submitting LSRs and Verizon receiving them).
Though the court expressed some misgivings about the “oddities” of the FCC’s reliance on the precedent, it nevertheless concluded that the “Commission’s concern is really to assure the losing carrier’s neutral role in the execution process (here, execution of porting).” Moreover, the FCC’s record showed that Verizon’s use of the LSR information was in fact interfering with other providers’ number porting. Accordingly, the panel deferred to the FCC’s administrative order applying Section 222(b) to Verizon as a carrier receiving information from another carrier but not itself performing a requested service.
ADDITIONAL DEVELOPMENTS—
ANTITRUST LAW

GOOGLE AND ANTITRUST

Google Inc. (Google) has faced several antitrust examinations within the past several years. As a result, the company has begun a public relations offensive. Within the past several years, antitrust examinations have placed Google Inc. within a public relations effort to convince the public that it is not a monopoly.

In 2008, Yahoo! Inc. (Yahoo!) and Google abandoned their advertising agreement after the Department of Justice (DOJ) stated that it would file an antitrust lawsuit to block the implementation of the agreement. Under the agreement, Google would have placed sponsored search and contextual ads on Yahoo! search result pages and on the web pages of Yahoo! syndication partners in the United States and Canada. After an extensive investigation in which both companies cooperated, the DOJ concluded that Google and Yahoo! would have become collaborators rather than competitors for a significant portion of their search advertising businesses, materially reducing important competitive rivalry between the two companies.

Specifically, the DOJ’s investigation revealed that Internet search advertising and Internet search syndication are each relevant antitrust markets. It found Google to be the largest provider of such services, with shares of more than 70% in both markets, and Yahoo! to be Google’s most significant competitor. Because combined market shares would have amounted to 90% of the search advertising market and 95% of the search syndication market, the DOJ concluded that if implemented, the Google-Yahoo agreement would likely harm competition in both markets.

In addition, Google faces three other government investigations. In summer of 2009, the DOJ began to investigate whether some of the nation's largest technology companies including Google, Yahoo!, and Apple violated antitrust laws by agreeing not to hire away top talents. Specifically, the DOJ is looking into whether the companies’ hiring practices are costing computer engineers and other workers opportunities to change jobs for higher pay or better benefits. After more than a year of investigation, DOJ investigators concluded that the agreements do raise competitive concerns. The DOJ is continuing to meet with various companies and has not yet decided whether to challenge the practices.

In September of 2009, the DOJ filed a memorandum opposing Google’s October 2008 agreement between Google with the Authors Guild
(AG) and the Association of American Publishers (AAP). This settlement sought to end lawsuits brought by the AG and AAP in 2005, which challenged Google's unauthorized scanning of in-copyright books for its Google Book Search project. Under the 125 million dollar settlement, Google would have had the right to make available and to profit from digitalization of millions of books. The Justice Department argued, however, that the agreement raised significant issues regarding class-action, copyright, and antitrust. In particular, the DOJ argued that the agreement would give Google exclusive rights for the digital distribution of orphan works, which are books whose rights holders cannot be located through a reasonably diligent search.

On Nov. 13, 2009, Google and groups representing book publishers and authors filed a modified version of their books settlement with the federal district court, which provided for the appointment of an independent fiduciary for decisions regarding orphan work. The trustee, with congressional approval, could also grant licenses to other companies who wanted to sell these works. In a February 2010 filing with the court, however, the DOJ stated that changes in the revised settlement were not enough to placate its concerns that Google would gain a monopoly over millions of orphan works though the settlement.

Last year, the Federal Trade Commission (FTC) also undertook antitrust investigation into the ties between the boards of Apple and Google. Apple and Google shared two directors, Eric E. Schmidt, chief executive of Google, and Arthur Levinson, former chief executive of Genentech. Under the Clayton Antitrust Act, a person may not serve on the boards of two rival companies when that dual presence would reduce competition between the companies. In August of 2009, Eric E. Schmidt stepped down from the board of Apple. Following the resignation of Eric Schmidt, Arthur D. Levinson also stepped down from the board of Google. In a statement, FTC Chairman Jon Leibowitz commended the companies and Levinson “for their willingness to resolve [the FTC’s] concerns without the need for litigation.”

In March of 2010, venture capitalist John Doerr announced that he would step down from the board of Amazon.com. Although Doerr, Amazon, and Google did not comment on the matter, some have suggested that Doerr’s decision to step down was prompted by a Federal Trade Commission inquiry into ties between Amazon and Google, where Doerr is a director. It was not clear whether the Commission had begun a preliminary inquiry or a formal investigation or whether it was still merely looking into the matter.