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INTELLECTUAL PROPERTY LITIGATION

Expert Analysis

Copyright Statute Preempts Misappropriation Claims

By **Lewis R. Clayton**

Each year, major financial firms spend hundreds of millions of dollars producing research reports on publicly traded companies. Those reports—which often include specific purchase or sale recommendations—are provided to limited numbers of customers, whom the firms solicit for trades before the reports become public knowledge. Trading commissions earned by the firms in turn fund the research. Reports from respected analysts can move the market, and regulators and federal courts have often noted the crucial role analysts play in policing securities markets.

Invoking the unfair competition doctrine of "hot news" misappropriation, a group of large financial firms obtained a district court injunction last year against Theflyonthewall.com ("Fly"), a website that featured unauthorized announcements of the firms' nonpublic trading recommendations. Last month, in *Barclay's Capital Inc. v. Theflyonthewall.com Inc.*, 2011 WL 2437554 (2d Cir. June 20, 2011), the U.S. Court of Appeals for the Second Circuit reversed, finding the firms' claims preempted under the Copyright Act.

Origins and Evolution

"Hot news" misappropriation is often traced to a dispute that arose during World War I, when the Allies cut off cable access for the International News Service (INS) operated by the Hearst newspapers, reportedly because the British were displeased by Hearst's war reporting. The INS responded by paraphrasing war stories reported by its rival the Associated Press and distributing that news to papers across the country. In the still-controversial case of *International News Service v. Associated Press*, 248 U.S. 215 (1918), over dissents from both Justices Oliver Wendell Holmes and Louis D. Brandeis, the U.S. Supreme Court found that INS's conduct amounted to common-law misappropriation—in the famous phrase, INS was "endeavoring to reap where it had not sown."

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The misappropriation tort was transformed with enactment of the Copyright Act of 1976, which preempts all state law claims that are "equivalent to" any of the exclusive rights granted to copyright holders. Therefore, a misappropriation claim founded only on the reproduction of the type of material protected by copyright cannot be maintained. In *National Basketball Ass'n v. Motorola Inc.*, 105 F.3d 841 (2d Cir. 1997), the Second Circuit found that a misappropriation claim brought by the NBA against the operator of a paging service that provided real-time basketball scores was preempted. The *Motorola* court announced that a hot news claim can survive preemption when: "(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."

Applying that test, the Southern District of New York enjoined Fly from publishing trading recommendations of the firms for limited periods during the trading day. Reversing in an erudite opinion by Circuit Judge Robert D. Sack, a majority of the Second Circuit panel found that Fly was not "free riding" as required to avoid preemption. The panel majority found that, rather than free-riding as *Motorola* used the term, Fly "is collecting, collating and disseminating factual information—the *facts* that Firms and others in the securities business have made recommendations" about the value of particular securities. (Emphasis in original.) "The Firms are making the news; Fly, despite the Firms' understandable desire to protect their business model, is breaking it." In the majority's view, Fly's activities are not meaningfully different from traditional media reports on winners of the Tony Awards.

One can argue, however, that the plaintiffs' involvement in "making the news" strengthens, rather than weakens, their misappropriation claim. Indeed, the concurrence in *Barclay's*, written by Judge Reena Raggi, would not foreclose

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a misappropriation claim "by a party who disseminates news it happens to create." Judge Raggi was persuaded that Fly was free-riding, but found that the firms could not satisfy a different element of the *Motorola* framework, because Fly was not in "direct competition" with the firms.

While each firm disseminates only its own recommendations, the concurrence characterized Fly as an aggregator, reporting the views of many financial firms and attributing each recommendation to its source. Proponents of the tort claim would argue that, by charging its subscribers a fee for access to non-public trading recommendations, Fly was in direct competition with the firms, who use the same recommendations to persuade clients to trade and thereby generate commissions.

Unless modified en banc or in the Supreme Court, *Barclay's* will be an impediment to efforts to protect time-sensitive research and recommendations. Misappropriation claims may survive under *Barclay's*, however, where a stronger showing of competition can be made. And, as the *Barclay's* court acknowledged, firms that disseminate research and recommendations pursuant to agreements forbidding recipients from making the materials public are likely to have claims against media outlets and websites like Fly for tortious interference with contract.

Trademark

In *Eva's Bridal Ltd. v. Halanick Enterprises Inc.*, 639 F.3d 788 (7th Cir. 2011), the U.S. Court of Appeals for the Seventh Circuit reminded trademark owners of their obligation to police a licensee's use of their marks, holding that the trademark owner had abandoned its mark by failing to exercise "reasonable control over the nature and quality" of the licensed business—a practice called "naked licensing." Plaintiff trademark owner had licensed the Eva's Bridal mark to family members who operated a bridal shop, but failed to retain or exercise any right to supervise operation of the store.

When the relatives stopped paying license fees, plaintiff sued for trademark infringement. Affirming dismissal of the claim, the Seventh Circuit rejected plaintiff's argument that supervision was unnecessary where the trademark owner was satisfied that the store sold only high-quality merchandise. The requirement that licensors exercise control over use of the mark, the court wrote, is not meant to ensure "high quality" but rather "consistent quality," "ensuring a repeatable experience."

The Seventh Circuit declined to decide how much control would be sufficient "to insure that the licensee's goods or services would meet the expectations created by the presence of the trademark," noting that this question depends on "the nature of the business, and customers' expectations." Because plaintiff exercised "no authority over the appearance and operations of defendants' business, or even over what inventory to carry or avoid," the case was "the paradigm of a naked license."

Considering as a matter of first impression what it called a "case of joint endeavors," the U.S. Court of Appeals for the Eleventh Circuit resolved a dispute about ownership of the common law trademark in the name of the "American girl band" Exposé. *Crystal Entertainment & Filmworks Inc. v. Jurado*, 2011 WL 2449016 (11th Cir. June 21, 2011). Plaintiff Crystal formed Exposé in 1984, but the band was a commercial flop. In 1986, the original performers were replaced by defendants, the current band members, who produced best-selling albums in the 1980s.

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Defendants used the Exposé name under a series of license agreements with Crystal. Complaining that Crystal had failed to promote the band, defendants stopped paying license fees in 2007 and Crystal sued for infringement. Affirming dismissal of Crystal's claim, the Eleventh Circuit found that defendants, not Crystal, owned the Exposé mark. Although a "corporate entity" may own rights in the name of a musical group "and the public need not associate the mark with the name of the corporate entity," Crystal failed to establish that, before defendants joined the band, it had appropriated the mark "in a way sufficiently public to identify and distinguish the marked goods in an appropriate segment of the public mind." Therefore, Crystal could not establish prior use as against defendants.

Trademark rights, the court found, should be awarded to "the claimant who controls the nature and quality of the services performed under the mark." While defendants had acknowledged in license agreements that Crystal owned the mark, Crystal had done little other than collect royalties. It was defendants who had, through their commercial success, developed the mark and exercised the requisite control over the nature and quality of the group, entitling them to the goodwill in the mark.

Voice of the Arab World Inc. v. MDTV Medical News Now Inc., 2011 WL 2090132 (1st Cir. May 27, 2011), illustrates the requirement that a trademark owner seeking a preliminary injunction must act with dispatch. MNN, a medical news organization, produces a television series titled "MDTV Medical News Now." VOAW used the MDTV mark in connection with health care periodicals and educational services aimed at Arab and Muslim countries. The parties disputed when VOAW began using the mark and whether VOAW had the right to use the mark without a limiting reference to "Muslim and Arab World." MNN began threatening legal action in 2000, and the parties attempted several times, without success, to resolve their disputes. No legal action was commenced until VOAW filed for declaratory judgment in 2009 and MNN counterclaimed for trademark infringement.

The district court granted an injunction relying on a presumption of irreparable injury arising from a showing of likelihood of success. The U.S. Court of Appeals for the First Circuit held that the presumption was unavailable because of MNN's "leisurely pace and lack of urgency" in seeking an injunction. Plaintiff's business dealings with the defendant and 10-year delay in seeking injunctive relief indicated acquiescence with defendant's use of the mark. While VOAW had recently revised its website, MNN failed to show that those revisions created a qualitatively new harm that would have excused the delay.

The First Circuit noted, but did not decide, a significant issue—the continued validity of the presumption of irreparable harm in trademark cases in light of *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006), which held that injunctions in patent cases must be governed by the traditional four-part test for injunctive relief, without the application of special presumptions of irreparable injury. District courts are split on the application of *eBay* in trademark cases and the Fifth and Eleventh circuits have flagged the question without deciding it. Hinting that a presumption might not be appropriate, the appeals court wrote that, like the Patent Act at issue in *eBay*, "nothing in the Lanham Act indicates that Congress intended to depart from traditional equitable principles." The question was moot because, regardless of how *eBay* applied, plaintiff's delay foreclosed application of any presumption.

Copyright

California courts have long protected writers who submit ideas to producers on the understanding that the writer will be paid if the idea is used, holding that the writer has an implied contract claim if the project goes forward. As ideas cannot be copyrighted, detractors have argued that such claims are preempted by federal copyright law. In *Montz v. Pilgrim Films & Television Inc.*, 2011 WL 1663119 (9th Cir. May 4, 2011), a split en banc U.S. Court of Appeals for the Ninth Circuit rejected preemption, finding that certain implied contract claims do not assert rights equivalent to those protected by copyright.

The court held that the "bilateral understanding of payment constitutes an additional element that transforms a claim from one asserting a right exclusively protected by federal copyright law, to a contractual claim that is not preempted." Four dissenting judges would have found preemption, because the plaintiff claimed an agreement not to use his ideas without authorization—an exclusive right protected by copyright—rather than alleging an implied contract to pay for use of the ideas. The majority, however, found "no meaningful difference between the conditioning of use on payment…and conditioning use in this case on the granting of a partnership interest in the proceeds of the production." For similar reasons, plaintiff's claim of "breach of confidence" survived a preemption analysis.

Penguin Group (USA) Inc. v. American Buddha, 640 F.3d 497 (2d Cir. 2011), will make it easier for New York copyright holders to establish jurisdiction over alleged infringers in New York courts. Penguin alleged that Buddha infringed its copyrights by posting four Penguin books on the Internet. The district court dismissed for lack of personal jurisdiction, holding that the injury occurred in Oregon or Arizona, where the books were uploaded to the internet.

The Second Circuit certified to the New York Court of Appeals the question whether, under New York's long-arm statute, the situs of the injury was the location of the infringing action or instead the residence of the copyright holder. The Court of Appeals found that "'a New York copyright owner alleging infringement sustains an in-state injury pursuant to CPLR 302(a)(3)(ii) when its printed literary work is uploaded without permission onto the Internet for public access.'"

The Court of Appeals held that it was "'illogical'" to equate injury with the place where business is lost in online infringement cases "'where the place of uploading is inconsequential and it is difficult, if not impossible, to correlate lost sales to a particular geographic area.'" Plaintiffs must still satisfy the remaining four jurisdictional prerequisites in the long-arm statute, as well as the requirements of the Due Process clause. Relying on the Court of Appeals' holding, the Second Circuit vacated and remanded to the district court.

Patents

Two Supreme Court decisions issued in May and June considered important procedural issues under the Patent Act. *Global-Tech Appliances Inc. v. SEB S.A.*, 131 S.Ct. 2060 (2011), heightened the U.S. Court of Appeals for the Federal Circuit's standard for proving that a defendant induced infringement of a patent. The Supreme Court held that a claim of induced infringement under 35 U.S.C. §271(b) requires a showing that the defendant had "knowledge that the induced acts constitute patent infringement." The Federal Circuit had found that proof that a defendant had "disregarded a known risk" of infringement was sufficient to show actual knowledge.

The Supreme Court disagreed, holding that a "deliberate indifference" standard is too lenient because it allows for liability without a showing of "active efforts by an inducer to avoid knowing" about the infringing activities. The Court also held, however, that the actual knowledge requirement could be satisfied by showing "willful blindness." A "willfully blind defendant," the Court found, "is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actually known the critical facts."

In *Microsoft Corp. v. i4i Ltd. P'ship*, 2011 WL 2224428 (U.S. June 9, 2011), the Court reaffirmed longstanding precedent, holding that a claim of patent invalidity must be established by clear and convincing evidence. The Court found that the clear and convincing standard had been well-established when the Patent Act was enacted in 1952, and it rejected Microsoft's argument that a lower standard should apply when an invalidity challenge is based on evidence that had never been considered by the Patent and Trademark Office.

On the other hand, the Court noted that evidence not considered by the PTO may "carry more weight" in proving invalidity. The Court observed that "a jury instruction on the effect of new evidence can, and when requested, most often should be given. When warranted, the jury may be instructed to consider that it has heard evidence that the PTO had no opportunity to evaluate before granting the patent."