

Washington Journal of Law, Technology & Arts

University of Washington School of Law

VOL. 6

WINTER 2011

NO. 3

2010-2011 EDITORIAL BOARD

*Associate Editor-in-Chief
Operations*
JAMES A. JONES II

Editor-in-Chief
GARETH S. LACY

*Associate Editor-in-Chief
Production*
CONNOR J. MORAN

Managing Operations Editor
AMBER L. LEADERS

Managing Submissions Editor
SUSUK LIM

Managing Articles Editor
KENDRA ROSENBERG

Faculty Advisors
ANITA RAMASASTRY
JANE WINN

Articles Editors
JEFF DOTY
HOMER YANG-HSIEN HSU
JAMES PROCTOR
CAITLIN STEIGER

Blog Editor
HOMER YANG-HSIEN HSU

Web Design
KATHY KEITHLY

EDITORIAL STAFF

MALLORY ALLEN
LINDSEY DAVIS
HEATHER L. GRIFFITH

ALICIA HOFFER
PARKER A. HOWELL
JEFF PATTERSON
LUKE M. RONA

JULIE R. SEVERSON
DUNCAN STARK
AURORA J. WILSON

EXTERNAL BOARD

NICHOLAS W. ALLARD
SCOTT L. DAVID
BRIAN W. ESLER
JONATHAN FRANKLIN
PARAG GHEEWALA
ERIC GOLDMAN

HENRY L. JUDY
ANDREW KONSTANTARAS
LIAM LAVERY
CECILY D. MAK
WILLIAM KENNETH MCGRAW

HEATHER J. MEEKER
JOHN P. MORGAN
JOHN D. MULLER
VINCENT I. POLLEY
WENDY SELTZER
ELAINE D. ZIFF

THE “THREE STRIKES” POLICY IN KOREAN COPYRIGHT
ACT 2009: SAFE OR OUT?

Sun-Young Moon & Daeup Kim *

© Sun-Young Moon & Daeup Kim

CITE AS: 6 WASH. J.L. TECH. & ARTS 171 (2011)
<https://digital.lib.washington.edu/dspace-law/handle/1773.1/559>

ABSTRACT

Korea has grown to be one of the Internet powers in a short period. Because of insufficient copyright protection, Korea recently revised the Korean Copyright Act to reinforce protection of copyright and promote sound distribution of copyrighted works. The new law allows the Minister of Culture, Sports and Tourism to issue orders and the Korea Copyright Commission to issue recommendations. Orders and recommendations are distinguished by the subject of the issuance and the legal force. Orders and recommendations enable online service providers to delete or stop transmission of illegal reproductions, give warning notices to infringers, or suspend the account of repetitive infringers. The “three strikes” policy is controversial and has raised several constitutional concerns. First, the suspension of the repeat infringer’s account may be an unconstitutional violation of the infringer’s freedom of speech. Second, an executive agency’s decision to issue a correction order could be an unconstitutional violation of the separation of powers. The final concern is that the policy violates the principles of due process. This Article examines the “three strikes” policy, the constitutional concerns regarding the policy, and possible policy revisions for more effective copyright protection.

* Sun-Young Moon is a Professor of Law at Sookmyung Women’s University in Seoul, Korea. Daeup Kim is an LL.M. Candidate at Sungkyun Kwan University in Seoul, Korea. This research was supported by the Sookmyung Women’s University Research Grants 2010.

TABLE OF CONTENTS

Introduction.....	172
I. Major Revisions of Korean Copyright Act to Prevent Illegal Online Reproduction	174
A. Order to Delete and Stop Transmission of the Pirated Material and Warning Notice	175
B. Account Suspension Order	175
C. Online Bulletin Board Service Suspension Order	176
D. Correction Recommendations For Transmitters of Pirated Material	177
II. Controversy Over the Constitutionality of the “Three Strikes” Policy	178
A. Freedom of Speech	179
B. Separation of Powers Between Branches of Government	180
C. The Principle of Due Process.....	180
III. Suggestions for the Application of the “Three Strikes” Policy	181
Conclusion	182

INTRODUCTION

Since the advent of the Internet, modern society has drastically changed from print-based to digitally powered. Just as the printing press revolutionized its era, the Internet has exponentially become the most interactive, yet inexpensive, communication medium in history. On one hand, it is undeniable that the Internet has enlarged the extent of freedom of speech with unprecedented characteristics of interaction, diversity, and openness. On the other hand, the Internet facilitated the distribution of unauthorized copyright reproduction. Such copyright infringements have become easier and more frequent, further worsening the self-inflicting and self-perpetuating damages from such violations.

Korea is now one of the Internet powerhouses with a high rate of Internet utilization. 77.2 percent of the Korean population over age

three currently use the Internet as of 2009.¹ Illegal reproduction and transmission of copyrighted works have become serious problems in Korea with the rise of new digital technologies such as peer-to-peer ("P2P") and Web-disc services. For prompt and efficient prevention of unlawful online reproductions and transmissions, revision of the Korean Copyright Act was inevitable. The revised bill allows the Minister of Culture, Sports and Tourism ("MCST") to issue correction orders to online service providers ("OSPs").² The law enables (1) deletion of illegal reproduction; (2) discontinuance of transmission; (3) warning notices to infringers; (4) suspension of an infringer's account; (5) suspension of an online bulletin board; and (6) granting of correction recommendation powers to the Korea Copyright Commission ("KCC") for OSP self-regulation.

Among the policies mentioned above, suspensions of accounts and online bulletin boards are carried out only if copyright infringements continue after three warnings of such violations. As the name accordingly implies, a so-called "three strikes" policy is carried out before any suspensions are enforced. Countries such as France, Taiwan, and New Zealand have also adopted "three strikes" policies, although the details of each policy may vary. Regardless of such adoptions, Korea's policy remains controversial. For example, critics note that the policy is biased towards protecting copyrights while violating users' fundamental right to freedom of speech.³

The validity and constitutionality of the policy are also controversial in Korea. This Article will provide an overview of the "three strikes" policy that was adopted to reinforce protection of copyright and to promote sound distribution of copyrighted works.

¹ Korea Internet & Security Agency, *Korea Internet White Paper*, KOREA COMMC'NS COMM'N 349 (2010), available at <http://isis.kisa.or.kr/eng/ebook/ebook.html>.

² Jeojakkwonbeop [Korean Copyright Act], Act No. 9785, July 31, 2009, art. 133-2 (S. Kor.), available at http://www.wipo.int/wipolex/en/text.jsp?file_id=190144.

³ See Kim Tong-hyung, *New Copyrights Law Alerts Bloggers*, KOREA TIMES, July 26, 2009, http://www.koreatimes.co.kr/www/news/tech/2009/07/129_49084.html; Kim Tong-hyung, *Upload A Song, Lose Your Internet Connection; New Copyright Law Causes Uproar Among Bloggers, Internet Companies*, KOREA TIMES, April 5, 2009, http://www.koreatimes.co.kr/www/news/tech/2009/04/133_42594.html.

Furthermore, this Article will explore the significance of the policy within the Korean Copyright Act and several arising issues, including constitutionality.

I. MAJOR REVISIONS OF KOREAN COPYRIGHT ACT TO PREVENT ILLEGAL ONLINE REPRODUCTION

The main point of the new Korean Copyright Act is to synthesize and integrate the Computer Protection Act within the Korean Copyright Act, and to introduce correction orders and recommendations on online illegal reproductions. The Korean Copyright Act has been revised several times, keeping pace with global standards.⁴ The revision in 1995 was essential for Korea to prepare for the World Trade Organization and the Bern convention and to protect copyright according to international standards.

The World Intellectual Property Organization (WIPO) Copyright Treaty (WCT)⁵ and WIPO Performances and Phonograms Treaty (WPPT)⁶ were established in 1996 to reinforce copyright infringement protection in response to the rising influence of digital distribution and the Internet. These treaties led to Japan's revision of

⁴ Korea invented the world's first bronze-type printing technology in 1235. Because the government controlled printing, copyright as a private right was not established until 1908 when the Japanese copyright act was adopted. The first Korean Copyright Act was passed in 1957, and there have been seventeen revisions so far. The first revision, in 1986, was designed to meet global standards, as Korea joined the Universal Copyright Convention, by extending copyright protection up to fifty years after death and modifying copyright protection of foreigners. In 1994, changes in domestic and international conditions due to Korea-U.S. intellectual property negotiations and the Uruguay round negotiations resulted in the sixth revision protecting databases as compilation works and extending neighboring copyright protection to 50 years. The eighth revision in 1995 met global standards by reflecting WTO trade-related aspects of intellectual property rights ("WTO TRIPS") and retroactively protecting foreigner's copyright. The latest revision in 2009 provides for the "three strikes" policy.

⁵ WIPO Copyright Treaty, Dec. 20, 1996, S. Treaty Doc. No. 105-17 (1997); 36 I.L.M. 65 (1997), http://www.wipo.int/export/sites/www/treaties/en/ip/wct/pdf/trtdocs_wo033.pdf.

⁶ WIPO Performances and Phonograms Treaty, Dec. 20, 1996, S. Treaty Doc. No. 105-17 (1997); 36 I.L.M. 76 (1997), http://www.wipo.int/export/sites/www/treaties/en/ip/wppt/pdf/trtdocs_wo034.pdf.

its copyright statutes in 1997 and 1999 and passage of the Digital Millennium Copyright Act (DMCA) in the United States in 1998.

Korea revised its copyright act in 2000 to comply with this trend, granting a right of transmission to copyright owners and excluding reproduction by public copy machines from immunity for private use reproduction. In preparation for joining the WCT and WPPT, a broad revision in 2006 imposed technical protection obligations for special OSPs (i.e., P2P service providers) and reinforced protection of neighboring rights. The most recent revision in 2009 provides power to delete illegal reproductions, give warning to the infringer, and suspend the infringer’s account and bulletin board to the MCST.

A. Order to Delete and Stop Transmission of the Pirated Material and Warning Notice

When the circulation of an illegal reproduction or data-protection-destroying program, or Internet protocol address of an infringer, is detected online, the MCST may take one of three actions: order the OSP to delete the illegal works, stop the transmission, or give a warning notice to the infringer by virtue of its own authority or by report of a relevant claimant.⁷

Prior to issuing such orders, preconsultation with the KCC is required. The purpose of these preconsultations is to prevent the potential for abusive orders and to ensure an order’s legitimacy and adequacy. Moreover, the OSP, as the recipient of such orders, may submit a statement regarding the order. Within five days after receipt of an MCST order, the OSP must report the result of action taken to the MCST. If the OSP does not execute the order, a fine up to ten million won (approximately \$9,000 USD) will be imposed.

B. Account Suspension Order

If an infringer receives three warning notices, the MCST may issue an order to suspend the infringer’s account for up to six months.⁸ Unlike the “three strikes” policy in France and Britain, the

⁷ Jeojakkwonbeop [Korean Copyright Act], Act No. 9785, July 31, 2009, art. 133-2(1) (S. Kor.).

⁸ Jeojakkwonbeop [Korean Copyright Act], Act No. 9785, July 31, 2009, art.

account suspension order in the new Korean Copyright Act does not terminate Internet access itself; instead, it suspends only the violator's account with the OSP. As such, a violator can technically bypass such suspension by creating other OSP accounts. It is important to note that e-mail service of the suspended account is excluded from the target of the order.

Preconsultation with the KCC is also required to issue the order, and the MCST must provide the OSP and the user an opportunity to submit a statement. The OSP must take action within ten days from receipt and also report the result to the MCST. When an account is suspended, the OSP is required to notify the infringer of the account suspension seven days before execution, providing time to secure materials pertaining to the illegal reproduction or transmission. When the OSP does not execute the order or notify the infringer of the account suspension, a fine up to ten million won will be imposed.

C. Online Bulletin Board Service Suspension Order

Various types of online bulletin boards exist within Web ports and Web-disc services (e.g., forums, blogs, and databases). If an entire OSP were shut down because of a copyright infringement on only one bulletin board, this would be over-regulation. Therefore, a balancing test must be conducted to suspend bulletin board services. On the other hand, it is nearly impossible to police every bulletin board to search out and delete every illegal reproduction posted online. Because of these competing concerns, the revised Korean Copyright Act calls for a temporary suspension of the bulletin board up to six months when there is clear intent to distribute illegal reproductions.⁹

Bulletin board service suspension orders are issued only for bulletin boards with commercial interests or distributions. General bulletin boards, such as those for an association or community, are excluded from the order's scope. If the intent of the posting is to distribute an illegal reproduction, the MCST may order suspension after consultation with KCC. Just as with an account suspension

133-2(2) (S. Kor.).

⁹ Jeojakkwonbeop [Korean Copyright Act], Act No. 9785, July 31, 2009, art. 133-2(4) (S. Kor.).

order, the OSP and the bulletin board operator have an opportunity to submit a statement. The OSP receiving a bulletin board suspension order must notify the OSP and the relevant bulletin board ten days before suspension to provide time for non-infringing users to secure relevant materials. If the OSP does not execute the bulletin board suspension order or notify the infringer of the suspension, a fine of up to ten million won will be imposed.

D. Correction Recommendations For Transmitters of Pirated Material

The most desirable way of reducing illegal online reproductions is for all OSPs and users to respect copyright and utilize copyrighted works in a legal and self-regulating manner. As correction orders impose compulsory obligations and remedies in case of breach, it is impossible to establish copyright orders in a voluntary and productive manner. The revised act provides "correction recommendations" power to the KCC and the OSP to take self-regulating measures before the administration issues a coercive correction order.¹⁰

When the KCC detects any distribution of illegal reproduction while monitoring an OSP's digital network, the KCC may recommend the OSP to (1) give a warning notice to the infringer, (2) delete or stop transmission of illegal reproduction, or (3) suspend the account of a repetitive infringer. To issue the KCC's correction recommendation, preconsultation with a subcommittee is required. An OSP that received a correction recommendation must report the result of execution to the KCC within five days from the reception in cases (1) and (2), above, and within ten days in case (3).

Because the correction recommendation is literally a recommendation, there is no direct sanction if the OSP fails to take action pursuant to the recommendation. The KCC may ask the MCST to issue a correction order, which does not require KCC preconsultation.

¹⁰ Jeojakkwonbeop [Korean Copyright Act], Act No. 9785, July 31, 2009, art. 133-3 (S. Kor.).

II. CONTROVERSY OVER THE CONSTITUTIONALITY OF THE “THREE STRIKES” POLICY

While Korea grew to become one of the Internet powers, copyright infringement became worse due to illegal online reproduction. P2P services, including Soribada¹¹ (similar to Napster¹² and Grokster¹³ in the United States), and other Web-disc services enabled music, television dramas, and movies to be broadly distributed. Such distributions spoiled cultural enterprises and dampened copyright owners’ appetite for creativity. In response, civil and criminal penalties have been imposed in Korea for distribution of illegal reproductions and Web site operators.¹⁴

Government and Internet enterprises are striving to protect copyright in Korea to foster a fair Internet environment and to create a sound Internet space where rights and responsibilities are balanced. Adoption of the “three strikes” policy in the revised Korean Copyright Act is also an expression of Korea’s strong will and determination to eradicate illegal reproductions. However, the constitutionality of suspension orders for accounts and bulletin boards, based on the “three strikes” policy, has been controversial. Therefore, an examination of whether the “three strikes” policy is constitutional in Korea is useful when considering the adequacy and operational direction of the policy and deciding the aim of copyright protection.

¹¹ Soribada, which is referred to as the Korean version of Napster, is a free MP3 sharing P2P program and the name of a free MP3 sharing website. Copyright owners sued Soribada for infringement of copyright because Soribada enabled users to illegally download MP3 files for free. The Korean Supreme Court recognized Soribada’s civil and criminal liability. *See* Supreme Court [S. Ct.], 2005Da11626, Jan. 25, 2007 (S. Kor.); Supreme Court [S. Ct.], 2005Do872, Dec. 14, 2007 (S. Kor.)

¹² *See* A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004 (9th Cir. 2001).

¹³ *See* MGM Studios, Inc. v. Grokster Ltd., 545 U.S. 913 (2005).

¹⁴ Cases that found P2Ps and Web-disc service providers civilly and criminally liable include: Supreme Court [S. Ct.], 2005Da11626, Jan. 25, 2007 (S. Kor.); Supreme Court [S. Ct.], 2005Do872, Dec. 14, 2007 (S. Kor.); Seoul High Court [Seoul High Ct.], 2006La1245, Oct. 10, 2007 (S. Kor.); Seoul Central District Court [Dist. Ct.], 2008Kahap968, Aug. 5, 2008 (S. Kor.); Seoul Central District Ct. [Dist. Ct.], 2008Godan3683, Feb. 12, 2009 (S. Kor.).

A. Freedom of Speech

The key issue of the constitutionality of the “three strikes” policy is whether the suspension of an Internet account or bulletin board service causes excessive infringement on freedom of speech.¹⁵ Since Internet access in a digital society is within the area of freedom of speech, is it then reasonable to restrict Internet access to protect copyright owners?

The revised Korean Copyright Act is the mediated result between competing forces of free speech and copyright protection. The main purpose of the correction order under the Korean Copyright Act is to discontinue infringement by heavy uploaders; it does not target casual infringers. Regulating account and bulletin board suspensions objectively within the maximum time frame precludes potential abuses. An account suspension order can be imposed for up to six months after three warnings or receipt of a discontinuance order. A maximum suspension of one month occurs for a first offense, up to three months for a second offense, and from three to six months for a third offense.¹⁶ Thus, given the current number of deletion or suspension orders issued, there should be at least three times the number of warnings.

The goal of account suspension under the revised Korean Copyright Act is not to stop Internet usage, but to regulate a particular OSP’s account (excluding e-mail service) and conduct targeted enforcement. An infringer can still create new accounts on the same or other OSPs and may still conduct Internet searches and receive and send e-mails, as long as a user login is not necessary.¹⁷

¹⁵ 1987 DAEHANMINKUK HUNBEOB [HUNBEOB] [CONSTITUTION] art. 21 (S. Kor.) (stating that “[a]ll citizens shall enjoy freedom of speech and the press, and freedom of assembly and association.”); 1987 DAEHANMINKUK HUNBEOB [HUNBEOB] [CONSTITUTION] art. 21 (S. Kor.) (providing that “[I]ncensing or censorship of speech and the press, and licensing of assembly and association shall not be recognized.”).

¹⁶ Jeojakkwonbeop Sihaengnyeong [Copyright Act Enforcement Decree], Presidential Decree No. 22003, Jan. 27, 2010, art. 72-3 to -4 (S. Kor.).

¹⁷ Jeojakkwonbeop [Korean Copyright Act], Act No. 9785, July 31, 2009, art. 133-2(4) (S. Kor.); MINISTRY OF CULTURE, SPORTS AND TOURISM, COMMENTARY ON NEW COPYRIGHT ACT 75 (2009), <http://www.mcst.go.kr/web/notifyCourt/notice/mctNoticeView.jsp?pCurrentPage=1&pSeq=4834> (then follow “copyright.

Bulletin suspension orders are not targeted at general bulletin boards; instead, they are focused on bulletin boards with commercial interests and those that promote illegal infringement, such as Web sites promoting illegal downloads and P2P service. General Internet portal sites such as forums, blogs, and personal homepages are not affected by an order. This limitation on targets is also a measure to balance copyright and freedom of speech.¹⁸

In sum, correction orders based on the “three strikes” policy properly balance the copyright act and freedom of speech, thereby hindering an unconstitutional finding. The new law is essentially constitutional despite some opposition.

B. Separation of Powers Between Branches of Government

A second issue regarding the constitutionality of the “three strikes” policy is whether giving power to an executive agency, instead of to the judiciary, to determine the presence of copyright infringement and issue corrective orders violates the separation of powers between the two branches.

Issuing judgment and relief from illegality are roles of the judiciary, but in Korea the MCST and KCC decide whether particular conduct violates copyright and whether to issue correction orders or recommendations.¹⁹ To preserve the separation of powers, the new law imposes an administrative fine rather than a retributive sanction. This avoids over-extending the power of the executive and, therefore, preserves the constitutionality of the “three strikes” policy.

C. The Principle of Due Process

Before issuing account and bulletin board suspension orders, the revised law provides procedural protections to safeguard the consti-

pdf” hyperlink).

¹⁸ Dae-Hee Lee, *Copyright Protection and Promotion of Fair Use Under the Amended Copyright Act*, 23 COPYRIGHT Q. 45, 50 (2009) (on file with author and Dae-Hee Lee, Korea University College of Law, it-law@korea.ac.kr).

¹⁹ Copyrights are enforced by a judicial copyright police force established on September 14, 2008.

tionally guaranteed principle of due process.²⁰ In particular, the new law imposes notice and hearing requirements to protect procedural due process.

First, the revised law provides the KCC with a consultation phase and gives each substantial party an opportunity to submit a response and documentation before issuance of any order. In addition, when issuing a correction order, the enforcement agency must consider recidivism of the infringer’s identity, amount of reproduction, type of illegally reproduced work, and availability of substitutions.²¹

When issuing a bulletin suspension order, the KCC must also consider: the purpose of the bulletin (i.e., whether it is profit-making), the function and utilization of the bulletin, the number of bulletin board users, and the component ratio of illegal reproduction.²² The OSP and bulletin board operator must have an opportunity to submit a statement. And the OSP receiving a bulletin board suspension order must notify the OSP and the relevant bulletin board ten days before suspension to provide time for non-infringing users to secure relevant documentation and respond.

These multiple phases—notice, consideration of factors, and opportunities to respond—indicate that the revised law complies with the principle of due process.

III. SUGGESTIONS FOR THE APPLICATION OF THE “THREE STRIKES” POLICY

Even though the “three strikes” policy may be considered constitutional, some reforms are suggested for making copyright

²⁰ 1987 DAEHANMINKUK HUNBEOB [HUNBEOB] [CONSTITUTION] art. 12 (S. Kor.) (“All citizens shall enjoy personal liberty. No person shall be arrested, detained, searched, seized, or interrogated except as provided by Act. No person shall be punished, placed, under preventive restrictions or subject to involuntary labor except as provided by Act and through lawful procedure.”); 1987 DAEHANMINKUK HUNBEOB [HUNBEOB] [CONSTITUTION] art 12 (S. Kor.) (“Warrants issued by a judge through due procedures upon the request of a prosecutor shall be presented in case of arrest, detention, seizure or search.”).

²¹ Jeojakkwonbeop Sihaengnyeong [Copyright Act Enforcement Decree], Presidential Decree No. 22003, Jan. 27, 2010, art. 72-3 (S. Kor.).

²² Jeojakkwonbeop Sihaengnyeong [Copyright Act Enforcement Decree], Presidential Decree No. 22003, Jan. 27, 2010, art. 72-4 (S. Kor.).

protection more effective. These reforms are an effort to intervene early with known infringers, rather than wait for the “third strike,” before taking action.

First, preventive education about the cost of copyright infringement and the lawful alternatives to infringement could be provided rather than correction orders for those who have received warnings. The goal would be to intervene early to prevent future repetitive infringement. It is still always an option to issue a correction order if an infringer continues to commit violations in the face of these preventative measures. But with the pressure of past warnings and the threat of future retribution, coerced education and training could expose bad actors to lawful alternatives to infringement.

Furthermore, it is recommended that the prosecution in-service considers dismissal of accusations against minor first offenders and stays of prosecution of infringers who complete copyright education and training. Such training and education opportunities are currently available for minor copyright infringers who are not involved in commercial activity. Such programs have been developed in Korea in response to concerns about indiscreet enforcement. For example, reckless accusations of infringement have been attributed to several suicides amongst Korean youth. In this context, preventive education and training and measured enforcement copyright laws are necessary for a rational and effective “three strikes” policy.

In sum, the government’s enforcement activities should focus on those repetitive and habitual cases that have the greatest negative effect on copyright rights. The participation of a judicial official should be considered during the judgment process. The threat of future sanctions can be leveraged to prod repeat infringers into a preventative education and training program designed to strike at the underlying reasons such infringers violate Korean law.

CONCLUSION

To date, no correction orders have been issued under Korea’s new “Three Strikes” policy. Instead, KCC has issued correction recommendations to P2P and Web-disc service providers. Those providers have accepted the KCC’s recommendations and have voluntarily deleted illegal copyrighted materials to avoid the issuance of correction orders. In the case of Internet portal companies, only

one Internet forum received a correction recommendation. In accordance with the policy considerations underlying the executive enforcement decrees, correction orders have not been recklessly issued despite initial concerns about constitutional violations. Nevertheless, there continues to be controversy regarding the constitutionality of correction orders. Left-leaning civil organizations have publicly expressed an interest in filing a constitutional complaint when a relevant case arises. Therefore, only the constitutional court may decide whether the "three strikes" policy is ultimately constitutional or not.

Meanwhile, copyright law remains a basic fence of protection for creators and an engine for freedom of speech. The new Korean Copyright Act is the result of the effort to balance these rights and freedoms. While this act has been effective, there is room for improvement. For example, administrative bodies must not issue reckless correction orders for the sake of convenience or efficiency. Instead, such orders should be used to prod infringers to take corrective action before multiple cases of infringement occur. To do otherwise risks suppressing Korea's inalienable right to freedom of speech. The "three strikes" policy on repetitive copyright infringement should therefore be enforced carefully and thoughtfully, and should be supplemented with user training and education, technical protection, and control of infringed materials.

STANDARDIZING WARHOL: ANTITRUST LIABILITY FOR
DENYING THE AUTHENTICITY OF ARTWORK

*Gareth S. Lacy**

© Gareth S. Lacy

CITE AS: 6 WASH. J.L. TECH. & ARTS 185 (2011)
<https://digital.lib.washington.edu/dspace-law/handle/1773.1/560>

ABSTRACT

*Art authentication boards are powerful; their determinations of authenticity can render artwork worthless or add millions of dollars to market value. In the past, boards that denied authenticity of artwork typically risked tort liability for disparagement, defamation, or fraud. In *Simon-Whelan v. Andy Warhol Foundation for the Visual Arts, Inc.*, however, an art collector alleged monopolization and market restraint after an authentication board denied the authenticity of his Andy Warhol painting by stamping “DENIED” on the back of it. The case is the first antitrust lawsuit against an authentication board to survive the defendant’s motion to dismiss. The decision therefore suggests potential liability exposure under the Sherman Antitrust Act for art professionals who render opinions on the authenticity of artwork. This Article discusses how *Simon-Whelan* provides a framework for pleading antitrust claims against authentication boards and considers what standard could be appropriate for analyzing similar claims at trial. This Article also describes how antitrust law governing standards setting and product certification outside the art world could apply to art authentication and organizations setting authenticity standards.*

* Gareth S. Lacy, University of Washington School of Law, Class of 2011. Thank you Professor Anita Ramasastry, University of Washington School of Law, and student editor Kendra Rosenberg for creative input and valuable feedback. Thank you Professor Dwight Drake for sharing your expertise in the area of antitrust law and Leonard DuBoff for your insider’s perspective on art law.

TABLE OF CONTENTS

Introduction.....	186
I. Art Market and Authentication Principles.....	189
II. How Simon-Whelan’s Lawsuit Survived the Board’s Motion to Dismiss.....	191
A. Plausibility	192
B. Relevant Market.....	194
C. Antitrust Injury.....	196
III. Two Litigation Paths: Per Se Illegal or Rule of Reason Analysis.....	197
A. Categorizing Market Restraints	197
B. Per Se Antitrust Violations	200
C. Rule of Reason Analysis	201
IV. Future Frameworks: Applying Antitrust Aspects of Certification and Standards Setting to Art Authentication ...	205
A. Does Per Se or Rule of Reason Apply to Standards Setting and Authentication?	207
B. Status of the Essential Facilities Doctrine.....	209
C. Liability Theories Challenging the Substantive Standard Itself.....	210
D. Liability Based on Procedural Defects in the Authentication Process	211
Conclusion	214
Practice Pointers.....	215

INTRODUCTION

In 1962, Andy Warhol began mass-producing silkscreened prints of Coke bottles, soup cans, and movie stars.¹ Warhol produced this art in his studio, known as The Factory, in much the same way corporations mass-produced consumer goods.² The line between business and art soon blurred for Warhol: “Business art is the step

¹ Robert Hughes, *The Rise of Andy Warhol*, N.Y. REV. BOOKS, Feb. 18, 1982 at 6.

² *The Factory*, WIKIPEDIA (Jan. 22, 2011, 1:48 PM), http://en.wikipedia.org/w/index.php?title=The_Factory&oldid=409360588.

that comes after Art. I started as a commercial artist, and I want to finish as a business artist.”³ Warhol reached his goal: In 2007, the art collection of the Andy Warhol Foundation for the Visual Arts, Inc. approached \$500 million.⁴ But with business-style success came business-style litigation.

In 2007, art collector Joe Simon-Whelan filed the first antitrust lawsuit against the Andy Warhol Art Authentication Board, Inc. (“Board”), a non-profit organization that renders opinions about whether Warhol paintings are authentic or not.⁵ Simon-Whelan had submitted his \$195,000 painting for authentication, but the Board stamped “DENIED” on the back of the painting, rendering the work of art worthless.⁶ Simon-Whelan documented the painting’s provenance and resubmitted it for authentication, but the Board again stamped “DENIED” on his painting.

In response, Simon-Whelan sued the Board and the Andy Warhol Foundation for the Visual Arts, Inc. (“Foundation”) in the United States District Court for the Southern District of New York.⁷ He

³ ANDY WARHOL, *THE PHILOSOPHY OF ANDY WARHOL (FROM A TO B AND BACK AGAIN)* 92 (Harcourt Brace Jovanovich, 1st ed. 1975).

⁴ Richard Dorment, *What is an Andy Warhol?*, N.Y. REV. BOOKS, Oct. 22, 2009, at 17, available at <http://www.nybooks.com/articles/archives/2009/oct/22/what-is-an-andy-warhol/>. The Foundation was formed in 1987 shortly after Warhol’s death, pursuant to his will, and received hundreds of millions of dollars of Warhol’s artwork from his estate in 1991.

⁵ Amended Class Action Complaint at 4-13, *Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc.*, No. 07 Civ. 6423(LTS), 2009 WL 1457177 (S.D.N.Y. May 26, 2009), 2007 WL 4825571; Defendants’ Memorandum of Law in Support of Motion to Dismiss Amended Complaint at 14, *Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc.*, No. 07 Civ. 6423(LTS), 2009 WL 1457177 (S.D.N.Y. May 26, 2009), 2008 WL 877019.

⁶ *Id.* Simon-Whelan’s Web site contains a detailed chronology of these events. Joe Simon-Whelan, *My Story*, MY ANDY WARHOL, http://www.myandywarhol.eu/my/my_story.asp (last updated Feb. 25, 2010). In 2006, the BBC also produced an interesting documentary about the events leading up to the litigation. *Imagine . . . Andy Warhol: Denied* (BBC television broadcast Jan. 24, 2006), available at Andy Warhol Art Authentication, YOUTUBE (July 7, 2007), <http://www.youtube.com/watch?v=mA1NBGtIIHE>.

⁷ *Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc.*, No. 07 Civ. 6423(LTS), 2009 WL 1457177, 2009 U.S. Dist. LEXIS 44242 (S.D.N.Y. May 26, 2009), available at http://scholar.google.com/scholar_case?case=4678372690327755692&hl=en&as_sdt=2&as_vis=1&oi=scholar.

claimed the Foundation and the Board violated section 1 of the Sherman Antitrust Act (“Sherman Act”),⁸ which prohibits conspiracies in restraint of trade; and section 2, prohibiting monopolization.⁹ In particular, he alleged the Board restricted the market for authentic Warhols to drive up the value of the Foundation’s own art collection.¹⁰ Defendants moved to dismiss the complaint for failure to state a claim pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure.¹¹ But the court denied this motion and allowed plaintiff’s monopolization and market restraint claims to proceed based on the Board’s rejection of the painting as an authentic Warhol.¹² Although the lawsuit was eventually dismissed with prejudice,¹³ the court’s decision provides useful analysis of what elements need to be alleged under the pleading standard articulated by the United States Supreme Court in *Bell Atlantic Corp. v. Twombly*¹⁴ to survive a motion to dismiss and proceed to discovery.

This Article will explain how Simon-Whelan alleged sufficient facts to survive the Board’s motion to dismiss, will describe the analysis courts use to evaluate antitrust allegations, and will discuss how antitrust cases involving certification and standards setting outside the art world could contribute to an emerging antitrust theory

⁸ Sherman Antitrust Act § 1, 15 U.S.C. § 1 (2006).

⁹ Sherman Antitrust Act § 2, 15 U.S.C. § 2 (2006).

¹⁰ Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc., No. 07 Civ. 6423(LTS), 2009 WL 1457177, at *1, 2009 U.S. Dist. LEXIS 44242 (S.D.N.Y. May 26, 2009), *available at* http://scholar.google.com/scholar_case?case=4678372690327755692&hl=en&as_sdt=2&as_vis=1&oi=scholar.

¹¹ FED. R. CIV. P. 12(b)(6); *see also* Defendants’ Memorandum of Law in Support of Motion to Dismiss Amended Complaint at 14, Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc., No. 07 Civ. 6423(LTS), 2009 WL 1457177 (S.D.N.Y. May 26, 2009), 2008 WL 877019.

¹² Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc., No. 07 Civ. 6423(LTS), 2009 WL 1457177, at *8, 2009 U.S. Dist. LEXIS 44242 (S.D.N.Y. May 26, 2009).

¹³ Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc., No. 07 Civ. 6423(LTS), 2009 WL 1457177 (S.D.N.Y. May 26, 2009), *complaint dismissed per stipulation*, No. 07 Civ. 6423(LTS)(AJP) (Nov. 30, 2010); Press Release, The Andy Warhol Foundation for the Visual Arts, Warhol Foundation Case Dismissed By U.S. Court (Nov. 15, 2010), http://www.warholfoundation.org/foundation/32_detail.html?page=1.

¹⁴ 550 U.S. 544, 570 (2007).

and also suggest best practices to reduce exposure to liability.

I. ART MARKET AND AUTHENTICATION PRINCIPLES

Contemporary art is bought and sold on two basic markets: the primary market for newly-created work of living artists; and the secondary market for work that has already been sold on the primary market.¹⁵ Secondary art market sales generally occur through auctions and private-dealer sales where prices are often much higher than in primary markets.¹⁶ The primary market involves curated gallery exhibitions of work obtained directly from artists' studios. The supply side of both markets includes individual collectors, private owners, museums, foundations, and dealers holding inventories, while the demand side includes collectors, museums, and dealers seeking inventory. Intermediary dealers, galleries, and auction houses bring these buyers and sellers together on the primary and secondary art markets.

Authentication supports the secondary art market by stamping out forgery and misrepresentation and providing a measure of certainty in the secondary market.¹⁷ “[Stylistic] authentication is the process by which art experts—academic or independent art historians, museum or collection curators, art dealers, auction house experts—attribute a work of visual art . . . to a particular artist.”¹⁸ Opinions about authenticity can change and various experts may have competing views on the authenticity of a particular work of art.

Stylistic authentication methods vary, but often include: connoisseurship, in which the expert expresses observations in words;

¹⁵ *New or Secondhand: The Ins and Outs of Primary and Secondary Markets*, ECONOMIST (Nov. 6, 2009), <http://www.economist.com/node/14941173>.

¹⁶ Auction prices of art sold on the secondary market can be tracked through various online services. *E.g.*, *Most Frequently Asked Questions About the Fine Art and Design Price Database*, ARTNET, http://www.artnet.com/products/pdb_faq.asp?H=1 (last visited Jan. 18, 2011).

¹⁷ Sam Sachs II, *Introduction: Right or Wrong, Real or Fake: Who Cares?*, 8 IFARJ. 6 (2006), http://www.ifar.org/publication_detail.php?docid=1210707503.

¹⁸ *Thome v. Alexander & Louisa Calder Found.*, 890 N.Y.S.2d 16, 23 (N.Y. App. Div. Dec. 1, 2009) (citing Ronald D. Spencer, *Introduction to THE EXPERT VERSUS THE OBJECT: JUDGING FAKES AND FALSE ATTRIBUTIONS IN THE VISUAL ARTS* xi (Ronald D. Spencer ed., 2004)), *appeal denied*, 15 N.Y.3d 703 (2010).

reviewing the *catalogue raisonné*, an annotated book of the artist's works; documenting provenance; and gathering eyewitness testimony.¹⁹ Authentication based solely on stylistic inquiry is inherently subjective and therefore exposes the expert to potential liability.²⁰ Another approach is scientific authentication in which the expert conducts objective investigation based on tests including radiocarbon dating, chemical analysis, or x-ray diffraction.²¹

Authentication of certain artwork, such as Warhol or Rembrandt, can be particularly challenging when the artist was prolific and employed assistants. Auction houses face considerable liability regarding the authenticity of artwork sold on secondary markets and will often refuse to sell work excluded from an artist's *catalogue raisonné*. In other words, authentication is as much a product of market consensus as expert or scholarly inquiry.

If a work of art is not listed in a *catalogue raisonné*, secondary market actors may, however, turn to authentication boards.²² Authentication boards are often created by artists' foundations and comprised of individuals who have scholarly interest in an artist's work or first-hand experience working with the artist. Unlike a *catalogue raisonné*, an authentication board only reviews artwork as it is submitted by owners. In addition, the *catalogue raisonné* is often attributed to a single author, while an authentication board is a committee.

Some authentication boards have been short-lived, which can make secondary market actors cautious about their opinions. For

¹⁹ Steven M. Levy, *Authentication and Appraisal of Artwork*, in ART LAW HANDBOOK 829 (Roy S. Kaufman ed., 2000); Samuel Butt, *Authenticity Disputes in the Art World: Why Courts Should Plead Incompetence*, 28 COLUM. J.L. & ARTS 71, 73-74 (2004).

²⁰ Steven M. Levy, *Liability of the Art Expert for Professional Malpractice*, 1991 WIS. L. REV. 595, 596 (1991).

²¹ LEONARD D. DUBOFF, ET AL., THE DESKBOOK OF ART LAW 22-41 (2d ed. 1993). Scientific and stylistic authentication methods are not mutually exclusive, but rather can be used together to make even more reliable determinations.

²² Examples of authentication boards include: Roy Lichtenstein Authentication Committee, Calder Foundation, The Moholy-Nagy Foundation, The Keith Haring Foundation, and The Pollack-Krasner Authentication Board (disbanded). Jack Cowart, *A Listing of Some Deceased Visual Artists' Foundations Filing 990 PFS* (Jan. 19, 2008) (on file with author), http://sharpeartfdn.qwestoffice.net/supplement/D-3_A-Listing-of-Some-Deceased-Visual-Artists.pdf.

example, the *Comite Picasso*, a group of experts and members of Pablo Picasso's family, formed to make definitive assessments of Picasso artwork, but broke up after Picasso's daughter refused to participate. The Andy Warhol Art Authentication Board, Inc. was formed in 1995.²³

II. HOW SIMON-WHELAN'S LAWSUIT SURVIVED THE BOARD'S MOTION TO DISMISS

Before *Simon-Whelan*, plaintiffs typically alleged tort theories such as defamation, disparagement, or fraud against those who denied the authenticity of submitted artwork.²⁴ Only one of the six major art-law treatises even mentions an antitrust cause of action.²⁵ Until *Simon-Whelan*, no plaintiff who had attempted an antitrust claim against an authentication board had ever survived the defendant's motion to dismiss.²⁶

Although the Federal Rules of Civil Procedure only require that a complaint contain "a short and plain statement of the claim showing that the pleader is entitled to relief,"²⁷ the plaintiff in *Simon-Whelan* had additional hurdles at the pleading stage under *Bell Atlantic Corp. v. Twombly*:

²³ Key members of the Board have included: Gary Garrels, Judith Goldman, Christoph Heinrich, Jed Johnson, Sally King-Nero, Neil Printz, Robert Rosenblum, and David Whitney.

²⁴ See, e.g., *McNally v. Yarnall*, 764 F. Supp. 838, 840 (S.D.N.Y. 1991) (defamation); *Hahn v. Duveen*, 234 N.Y.S. 185, 187 (Sup. Ct. 1929) (disparagement); *Goldman v. Barnett*, 793 F. Supp. 28 (D. Mass 1992) (fraud). See generally Ronald D. Spencer, *The Risk of Legal Liability for Attributions of Visual Art*, in *THE EXPERT VERSUS THE OBJECT: JUDGING FAKES AND FALSE ATTRIBUTIONS IN THE VISUAL ARTS* 144 (Ronald D. Spencer, ed., 2004).

²⁵ RALPH E. LERNER, ET AL., *ART LAW: THE GUIDE FOR COLLECTORS, INVESTORS, DEALERS, AND ARTISTS* 624 (3d ed. 2005). At press time, art-law expert Leonard D. DuBoff has said future editions of *LEONARD D. DUBOFF, ET AL., THE DESKBOOK OF ART LAW* (2d. ed. 1993) and *LEONARD D. DUBOFF & CHRISTY O. KING, ART LAW IN A NUTSHELL* (4th ed. 2004) will contain discussions of the issues raised in this Article.

²⁶ See, e.g., *Vitale v. Marlborough Gallery*, No. 93 Civ. (PKL) 6276, 1994 WL 654494 (S.D.N.Y. July 5, 1994); *Kramer v. Pollock-Krasner Found.*, 850 F. Supp. 250 (S.D.N.Y. 1995).

²⁷ FED. R. CIV. P. 8(a)(2).

[S]tating such a claim requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made. Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement.”²⁸

Antitrust litigation is tremendously complex and therefore factual allegations in the complaint must be pled with sufficient specificity to justify dragging the defendant through discovery.²⁹ The Board moved to dismiss plaintiff’s complaint on grounds it did not meet *Twombly*’s pleading requirements. But *Simon-Whelan* found the complaint did meet *Twombly*’s requirements by alleging (A) “sufficient factual matter, accepted as true, to ‘state a claim to relief that is plausible on its face[]’” which (B) occurred within a “relevant market” and (C) caused antitrust injury.³⁰ As a result, discovery was allowed to proceed. The litigation ultimately cost defendants nearly \$7 million in legal fees before the case was dismissed with prejudice.³¹

A. *Plausibility*

Plaintiff alleged Sherman Act section 1 (“Section 1”) violations involving collusion between the Foundation that sold Warhol artwork and the Board that authenticated Warhol artwork. Plaintiff also

²⁸ Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 556 (2007).

²⁹ *Id.* at 558 (“a district court must retain the power to insist upon some specificity in pleading before allowing a potentially massive factual controversy to proceed. . . . [T]he costs of modern federal antitrust litigation and the increasing caseload of the federal courts counsel against sending the parties into discovery when there is no reasonable likelihood that the plaintiffs can construct a claim from the events related in the complaint.”)

³⁰ *Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc.*, No. 07 Civ. 6423(LTS), 2009 WL 1457177, at *4, 2009 U.S. Dist. LEXIS 44242 (S.D.N.Y. May 26, 2009) (quoting *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007))).

³¹ Linda Sandler, *Warhol Foundation's \$7 Million Defense Beats Collector's 'Fakes' Lawsuit*, BLOOMBERG, Nov. 16, 2010, available at <http://www.bloomberg.com/news/2010-11-16/warhol-foundation-for-the-visual-arts-wins-lawsuit-with-7-million-defense.html>.

alleged Sherman Act section 2 (“Section 2”) violations including claims that the Foundation used the Board to remove competing Warhol artwork from the market to drive up the value of the Foundation’s art collection. The court found such allegations satisfied *Twombly* because they “raise[d] a right to relief above the speculative level.”³²

The court concluded Simon-Whelan’s Section 1 claim met the “plausibility” standard by alleging the Board (1) made unsolicited suggestions that Warhol owners submit their work for authentication, (2) reversed prior authentication determinations, (3) refused to authenticate works the Foundation had attempted to purchase, and (4) and was not independent of the Foundation.³³ A recent decision from the New York Supreme Court, Appellate Division, *Thome v. Alexander & Louisa Calder Foundation*, has discussed how these allegations are now a possible framework for pleading antitrust complaints against parties who deny authenticity.³⁴

Simon-Whelan also found sufficient allegations of a Section 2 violation.³⁵ Section 2 complaints must allege facts “indicative of anticompetitive conduct with a specific intent to monopolize and a dangerous probability of achieving monopoly power . . .”³⁶ It is notable that the court did not analyze the “specific intent to monopolize” element. A Section 2 complaint should allege monopoly power resulted from *willful acquisition*, not just accident or business acumen.³⁷ It is possible this element was adequately met by pleading facts establishing plausibility, such as the Board’s alleged refusal to authenticate works after attempting to purchase them. Nevertheless, future authentication committee defendants should consider raising the issue of specific intent to weaken complaints after *Simon-*

³² *Id.* at 555.

³³ *Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc.*, No. 07 Civ. 6423(LTS), 2009 WL 1457177, at *5, 2009 U.S. Dist. LEXIS 44242 (S.D.N.Y. May 26, 2009).

³⁴ 890 N.Y.S.2d 16, 32 (N.Y. App. Div. 2009), *appeal denied*, 15 N.Y.3d 703 (2010).

³⁵ Sherman Antitrust Act § 2, 15 U.S.C. § 2 (2006).

³⁶ *Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc.*, No. 07 Civ. 6423(LTS), 2009 WL 1457177, at *5, 2009 U.S. Dist. LEXIS 44242 (S.D.N.Y. May 26, 2009).

³⁷ *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

Whelan.³⁸ Moreover, given how much this case ultimately cost defendants, courts in the future may be more vigilant about scrutinizing complaints before so readily allowing discovery to proceed.³⁹

B. Relevant Market

After meeting *Twombly*'s plausibility standard, Simon-Whelan also alleged the anticompetitive effects occurred within a "relevant market."⁴⁰ Section 1 and 2 claims both require plaintiffs to define this relevant market.⁴¹ The relevant market includes both a "geographic market," where the defendant competes, and a "product market" with which the defendant's product competes.⁴² (Both elements should be established.)⁴³ Antitrust plaintiffs argue the relevant market is narrow, while defendants will downplay their market share by arguing their products fit within a broader market.⁴⁴ Although products like artwork exist within a broad market, distinct submarkets can also constitute distinct products.⁴⁵

Two key decisions discussed in *Simon-Whelan* helped establish there is a relevant submarket for Warhol artwork within the market for modern and contemporary art. First, *Simon-Whelan* relied on

³⁸ See *infra* text accompanying notes 95-97.

³⁹ Cf. *Tamayo v. Blagojevich*, 526 F.3d 1074, 1083 (7th Cir. 2008) (citations omitted) ("For complaints involving complex litigation—for example, antitrust or RICO claims—a fuller set of factual allegations may be necessary to show that relief is plausible."); *Kirihara v. Bendix Corp.*, 306 F.Supp. 72, 76 (1969) ("This court believes that in potentially complex cases, particularly in cases involving violations of the antitrust laws, the plaintiff should go beyond the 'short' requirements of Rule 8 if necessary to present a 'plain', i.e., understandable and factual statement of the alleged antitrust violations.")

⁴⁰ See, e.g., *Grinnell*, 384 U.S. at 570-72; *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 380 (1956).

⁴¹ Adam J. Biegel, et al., *Private Enforcement of the Antitrust Laws*, in ANTITRUST ADVISER § 10.23, at 10-71 (Irving Scher ed., 4th ed. 2009).

⁴² 1 Irving Scher, *Horizontal Restraints and Monopolization*, in ANTITRUST ADVISER § 1.22, at 1-63 (Irving Scher ed., 4th ed. 2009).

⁴³ See *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 459 (1993).

⁴⁴ Compare *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 481-82 (1992) (finding a relevant market for a single brand of replacement parts) with *Elliot v. United Ctr.*, 126 F.3d 1003, 1005 (7th Cir. 1997) (rejecting allegation of a relevant market for food sales within a single sports arena).

⁴⁵ *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962).

dictum in *Vitale v. Marlborough Gallery* to find a relevant market for famous works within the modern and contemporary art market.⁴⁶ In *Vitale*, the court had noted that “paintings by Jackson Pollock may constitute a submarket, the monopolization of which may be unlawful . . .” under the Sherman Act because such paintings lacked a practical substitute.⁴⁷ Second, the court relied on *Kramer v. Pollock-Krasner Foundation* to find a narrowly defined submarket for famous artwork can be a relevant market sufficient to state a claim.⁴⁸

Although the court correctly stated “relevant market” contains two elements—product market and geographic market—it may have conflated the analysis. In particular, *Simon-Whelan* found the “distinct submarket . . . of Andy Warhol works within the modern and contemporary art market” was a sufficient “*relevant geographic product market*.”⁴⁹ Again, product market concerns whether defendant’s product can be substituted,⁵⁰ while geographic market concerns the region of “effective competition.”⁵¹ While future antitrust plaintiffs can safely assert the existence of a “relevant submarket” for famous paintings, they should still carefully evaluate both elements of the relevant market. Indeed much of the contemporary art market is concentrated in New York City, but it is also an international market. A clearly defined relevant market helps courts identify the area of economic activity and whether defendant has exercised sufficient market power in that relevant market to constitute a violation.

Another problem with the court’s definition of the relevant

⁴⁶ *Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc.*, No. 07 Civ. 6423(LTS), 2009 WL 1457177, at *6, 2009 U.S. Dist. LEXIS 44242 (S.D.N.Y. May 26, 2009) (citing *Vitale v. Marlborough Gallery*, 1994 WL 654494, at *4 (S.D.N.Y. July 5, 1994)).

⁴⁷ *Vitale v. Marlborough Gallery*, No. 93 Civ. (PKL) 6276, 1994 WL 654494, at *4 (S.D.N.Y. July 5, 1994).

⁴⁸ *Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc.*, No. 07 Civ. 6423(LTS), 2009 WL 1457177, at *6, 2009 U.S. Dist. LEXIS 44242 (S.D.N.Y. May 26, 2009) (citing *Kramer v. Pollock-Krasner Found.*, 890 F. Supp. 250, 254 (S.D.N.Y. 1995)).

⁴⁹ *Id.* (emphasis added).

⁵⁰ *See, e.g., Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 481-482 (1992).

⁵¹ *United States v. Grinnell Corp.*, 384 U.S. 563, 575-76 (1966).

market is that it seems to overlook the possibility that other contemporary artwork could substitute for Warhol work in the secondary market. While some collectors might prefer Warhol, this does not necessarily create a submarket for Warhol artwork. By analogy, consumers might prefer particular automobile manufacturers, but this does not necessarily create separate relevant markets for Hondas and Toyotas. In sum, the court's finding—that there is a relevant submarket for Warhol work—seems to exclude artwork from other contemporary artists that are potential economic substitutes for Warhol artwork.

C. Antitrust Injury

After establishing plausibility and relevant market, Simon-Whelan alleged an “antitrust injury.”⁵² He argued the Board action caused an injury that “reflect[s] the anticompetitive effect either of the violation or of anticompetitive acts made possible by the violation.”⁵³ Simon-Whelan alleged the Board's practice of stamping “DENIED” on his artwork prevented him from participating as a seller in the market for authentic Warhol art.⁵⁴ The court affirmed the Board's practice of stamping “DENIED” on artwork, deeming it “not authentic,” was a sufficient antitrust injury: “the double-stamping of ‘Denied’ on his artwork in furtherance of the alleged antitrust conspiracy has prevented him from competing as a seller in the lucrative market for authentic Warhols . . .”⁵⁵

One unresolved issue is what type of market restraint occurs when an art authentication committee prevents a seller from marketing his or her own artwork. The first possibility is that such practices are nonprice vertical restraints in which the committee is analogous to a

⁵² Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc., No. 07 Civ. 6423(LTS), 2009 WL 1457177, at *6, 2009 U.S. Dist. LEXIS 44242 (S.D.N.Y. May 26, 2009).

⁵³ Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977).

⁵⁴ Amended Class Action Complaint at 4-13, Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc., No. 07 Civ. 6423(LTS), 2009 WL 1457177 (S.D.N.Y. May 26, 2009), 2007 WL 4825571

⁵⁵ Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc., No. 07 Civ. 6423(LTS), 2009 WL 1457177, at *6, 2009 U.S. Dist. LEXIS 44242 (S.D.N.Y. May 26, 2009)

producer dictating terms of sale to dealers.⁵⁶ A second possibility is that authentication is a nonprice horizontal restraint in which various dealers conspire to shut out a particular dealer—a practice that would be per se illegal.⁵⁷ A plaintiff’s ability to uncover unlawful horizontal market restraints often requires discovery, which is why surviving a motion to dismiss was significant in *Simon-Whelan*.⁵⁸

III. TWO LITIGATION PATHS: PER SE ILLEGAL OR RULE OF REASON ANALYSIS

Surviving a motion to dismiss is just the beginning. Next, a successful antitrust plaintiff must either prove defendant’s actions were so blatantly anticompetitive as to be “per se illegal” or the negative anticompetitive effects of such actions outweighed any pro-competitive market effect. Whether a practice is per se illegal or analyzed under the more flexible—and defendant-friendly—“rule of reason” is a matter of law.⁵⁹ This section describes how courts might determine whether the per se or rule of reason analysis applies to an art authentication activity.

A. *Categorizing Market Restraints*

Some business practices are considered unreasonable by their very nature and therefore per se unlawful under the Sherman Act. Unlawful Section 1 activities include agreements to fix prices, boycott competitors, or limit production and control markets. To determine whether a practice is per se illegal, courts will: (1) distinguish between vertical and horizontal market restraints, (2) consider the effect on both interbrand and intrabrand competition, and (3) may analyze price and nonprice restraints differently. Antitrust cases often

⁵⁶ See *Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 57-59 (1977); see *infra* notes 62-66 and accompanying text.

⁵⁷ *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U.S. 656 (1961).

⁵⁸ All discovery is stayed pending resolution of a motion to dismiss an antitrust cause of action. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 558 (2007).

⁵⁹ *Craftsmen Limousine, Inc. v. Ford Motor Co.*, 363 F.3d 761, 772 (8th Cir. 2004).

turn on how courts categorize a particular business practice.⁶⁰

First, courts determine whether a business practice is a vertical or horizontal market restraint.⁶¹ A vertical restraint occurs when businesses at different levels of competition collude in the same market, while a horizontal restraint is an agreement between businesses at the same level of competition. For example, an agreement between a producer and dealer not to supply to other dealers could be a vertical restraint.⁶² Collusion between dealers to fix prices would be a horizontal restraint. Vertical restraints are often subject to rule of reason analysis; horizontal restraints are more likely to be per se illegal.⁶³

The distinction between vertical and horizontal restraints blurs in a “dual distribution” system in which a producer also competes with dealers that sell the producer’s products.⁶⁴ For example, an artist or an art collector might sell paintings directly to the public and also through particular private dealers. In most cases, the rule of reason applies to such dual distribution systems.⁶⁵ But if there is evidence of a horizontal conspiracy to limit sales to particular dealers—even if a dealer arranged the conspiracy—that would be per se illegal.⁶⁶ Dual distribution could involve a vertical group boycott (per se illegal) or a

⁶⁰ Mark A. Lemley & Christopher R. Leslie, *Categorical Analysis in Antitrust Jurisprudence*, 93 IOWA L. REV. 1207, 1210 (2008).

⁶¹ See *A-Abart Elec. Supply, Inc. v. Emerson Elec. Co.*, 956 F.2d 1399, 1402-03 (7th Cir. 1992) (vertical restraints are analyzed under rule of reason unless they involve price fixing).

⁶² See *Yeager’s Fuel, Inc. v. Pa. Power & Light Co.*, 953 F. Supp. 617, 654 (E.D. Pa. 1997) (forcing contractors to install only electric heating was a vertical restraint because the power company and developers were at different distribution levels).

⁶³ See *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 135-36 (1998) (antitrust law does not apply per se rule to vertical boycotts unless there is also horizontal agreement or price fixing); *Crane & Shovel Sales Corp. v. Bucyrus-Erie Co.*, 854 F.2d 802, 805 (6th Cir. 1988).

⁶⁴ Lemley, *supra* note 60, at 1235-41.

⁶⁵ See *AT&T Corp. v. JMC Telecom, LLC*, 470 F.3d 525, 531 (3d Cir. 2006) (although vertical relationship had horizontal elements, per se analysis was inappropriate for dual distributorship arrangements).

⁶⁶ *E.g.*, *Toys “R” Us, Inc. v. FTC*, 221 F.3d 928, 934-36 (7th Cir. 2000) (finding evidence that dominant toy dealer coordinated a horizontal conspiracy among manufacturers to limit their sales to certain dealers); *accord NYNEX Corp.*, 525 U.S. at 133-37 (single dealer’s decision to buy from one producer was a vertical agreement not subject to per se rule against horizontal group boycotts).

unilateral refusal to deal (likely to be lawful under rule of reason analysis).

Second, courts always consider the effects of a business practice on both interbrand and intrabrand competition. Interbrand competition means competition between businesses with developed brands or labels; intrabrand competition, in contrast, means horizontal competition between distributors of the same product.⁶⁷ Some art authentication services arguably reduce interbrand competition by suppressing the market for products deemed “not authentic.” Another possibility is that art dealers reduce interbrand competition between various authentication services by refusing to acknowledge the opinions of certain types of authentication experts. Antitrust law is mostly concerned with protecting interbrand competition; practices that restrain interbrand competition are more likely per se unlawful.⁶⁸

Courts have upheld exclusive dealership plans when such decisions had only slight effects on intrabrand competition and a high level of interbrand competition already existed.⁶⁹ This suggests that if a producer took action to shut down all sales of artwork outside authorized channels that could arguably be an unlawful restriction on intrabrand competition of certain distribution channels.⁷⁰

Third, courts sometimes distinguish between price restraints and nonprice restraints such as prohibiting sales outside designated geographic areas or limiting sales to particular classes of customers.⁷¹

⁶⁷ Competition between Coca-Cola and Pepsi is an example of interbrand competition. Competition between department stores and discount outlets selling the same products is an example of intrabrand competition.

⁶⁸ *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 51-52 n. 19 (1977) describes this principle: “[W]hen interbrand competition exists, as it does among television manufacturers, it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product.”

⁶⁹ *E.g.*, *Elecs. Commc’ns. Corp. v. Toshiba Am. Consumer Prods., Inc.*, 129 F.3d 240, 244-45 (2d Cir. 1997).

⁷⁰ *Cf. Eiberger v. Sony Corp. of Am.*, 622 F.2d 1068, 1075-76 (2d Cir. 1980) (territorial restrictions imposed by producer upon distributors were unreasonable when restrictions eliminated intrabrand competition within each distributor’s territory); *Graphic Prods. Dist., Inc. v. Itek Corp.*, 717 F.2d 1560, 1577-78 (11th Cir. 1983) (benefits to interbrand competition did not outweigh the significant burden on intrabrand competition).

⁷¹ *E.g.*, *Beach v. Viking Sewing Mach. Co.*, 784 F.2d 746, 750-51 (6th Cir.

After *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, the rule of reason applies to both price and nonprice vertical restraints.⁷² Nevertheless, courts might still view price restraints with more caution and scrutinize vertical price restraints for related unlawful horizontal price restraints.

B. *Per Se Antitrust Violations*

Standards setting and certification activities outside the art world are usually subject to the defendant-friendly rule of reason analysis.⁷³ Nevertheless, it is important to consider the potential for a per se violation because the consequence can be disastrous for an antitrust defendant: If plaintiff establishes a per se violation, defendant will be barred from attempting to offer procompetitive justifications for why the restraint was reasonable.⁷⁴ The penalty for an antitrust violation is treble damages and the cost of suit, including attorney's fees.⁷⁵

A per se Section 1 Sherman Act violation requires plaintiff to prove: two or more entities engaged in a conspiracy, combination, or contract;⁷⁶ to effect a market restraint prohibited per se;⁷⁷ that proximately caused of the plaintiff's antitrust injury.⁷⁸ In general, the per se rule applies to boycotts and price fixing, but not to unilateral decisions to only buy goods from one producer.⁷⁹ For example, *Fashion Originators' Guild of America, Inc. v. Federal Trade Commission* held it was per se illegal for competing clothing designers and dealers to agree not to deal with stores that sold copied styles.⁸⁰ If

1986) (prohibitions requiring dealers to provide after-sale services were non-price restraints evaluated under rule of reason).

⁷² 551 U.S. 877, 881 (2007).

⁷³ *Cf.* 15 USC § 4302 (2006) ("a standards development organization while engaged in a standards development activity, shall not be deemed illegal per se; such conduct shall be judged on the basis of its reasonableness").

⁷⁴ *See, e.g.,* *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940).

⁷⁵ Clayton Antitrust Act, 15 U.S.C. § 15 (2006).

⁷⁶ *E.g.,* *Guzowski v. Hartman*, 969 F.2d 211, 214 (6th Cir. 1992).

⁷⁷ *Dunn & Mavis, Inc. v. Nu-Car Driveaway, Inc.*, 691 F.2d 241, 245 (6th Cir. 1982).

⁷⁸ *Hodges v. WSM, Inc.*, 26 F.3d 36, 38 (6th Cir. 1994).

⁷⁹ *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 135 (1998).

⁸⁰ 312 U.S. 457, 465 (1941).

competing art dealers banded together to shut out disfavored dealers, this could also be an unlawful horizontal restraint.

In addition, an art producer's actions could be unlawful if other dealers were involved in setting market restrictions, rather than just merely acceding to them.⁸¹ It could even be per se unlawful for distributors to lobby a producer to impose price restraints.⁸² On the other hand, the plaintiff would have to show other dealers were actively setting the market restraints in concert with the producer—if dealers merely go along with a producer's restrictions, that would not be enough.⁸³

In summary, the following practices are likely per se illegal: a vertical agreement between a producer and a dealer to fix prices; horizontal agreements between dealers or producers to fix prices; and practices that eliminate all interbrand competition for production or sale of particular works of art. In contrast, a nonprice vertical restraint—such as refusal to sell artwork from producers who have not obtained authentication—is likely subject to a rule of reason analysis.

C. Rule of Reason Analysis

If a court does not find a per se antitrust violation, it will conduct a rule of reason analysis of the alleged market restraint.⁸⁴ *The Chicago Board of Trade Case* gave the analysis its classic formulation: “whether the restraint imposed is such as merely regulates and

⁸¹ See, e.g., *Toscano v. Prof'l Golfers' Ass'n*, 258 F.3d 978, 984 (9th Cir. 2001) (rejecting claim of conspiracy, when local golf tournament sponsors did not participate in negotiating terms of restraints).

⁸² See *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 734-36 (1988) (agreement between a manufacturer and a distributor to terminate a competing price-cutting distributor could be a per se violation if the parties actually agree on the price to be charged).

⁸³ *Morrison v. Murray Biscuit Co.*, 617 F. Supp. 800, 808-09 (N.D. Ind. 1985), *aff'd*, 797 F.2d 1430, 1439 (7th Cir. 1986).

⁸⁴ *FTC v. Indep. Fed. of Dentists*, 476 U.S. 447, 458-59 (1986); See generally, M. Howard Morse, *Standard Setting and Antitrust: The Intersection Between IP Rights and the Antitrust Laws*, IP LITIGATOR, May-June 2003, at 17, available at <http://www.drinkerbiddle.com/publications/> (select articles from 2003; then scroll to June 1, 2003).

perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition.”⁸⁵ Today, the basic rule of reason test is whether “anticompetitive effects outweigh . . . pro-competitive effects.”⁸⁶ This ad hoc balancing approach generally requires the plaintiff to prove an agreement to restrain trade exists⁸⁷ and the agreement was anticompetitive.⁸⁸

While courts differ on how to conduct the ad hoc rule of reason analysis, all courts focus on some of the following factors: (1) the severity of the restraint; (2) defendant’s market power; and (3) defendant’s intent.⁸⁹

First, courts weigh the severity of the market restraint. Restraints with “pernicious effects” will be held unlawful.⁹⁰ For example, restraints involving price restrictions will likely be unlawful.⁹¹ Second, courts examine whether the defendant has significant market power.⁹² Market power means dominant market share in a well-defined product and geographic market.⁹³ A standard measure of

⁸⁵ The Chicago Board of Trade Case, 246 U.S. 231, 244 (1918).

⁸⁶ *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 342 (1988). In particular, a prima facie case requires proving: (1) the defendant contracted, combined, or conspired; (2) the combination or conspiracy produced adverse anticompetitive effects; (3) within relevant product and geographical markets; and (4) plaintiff was injured as a proximate result. *Int’l Logistics Grp., Ltd. v. Chrysler Corp.*, 884 F.2d 904, 907 (6th Cir. 1989).

⁸⁷ *E.g.*, *St. Martin v. KFC Corp.*, 935 F. Supp. 898, 905-06 (W.D. Ky. 1996).

⁸⁸ *E.g.*, *Tunis Bros. Co. v. Ford Motor Co.*, 952 F.2d 715, 722 (3d Cir. 1991).

⁸⁹ *E.g.*, *Coffey v. Healthtrust, Inc.*, 955 F.2d 1388, 1393 (10th Cir. 1992) (analyzing vertical relationship under rule of reason); *Ball Mem’l Hosp., Inc. v. Mutual Hosp. Ins., Inc.*, 784 F.2d 1325, 1334 (7th Cir. 1986) (affirming that establishing market power is a necessary element of every rule of reason case); *United States v. United States Gypsum Co.*, 438 U.S. 422, 436, n.13 (1978) (noting “the general rule [is] that a civil violation can be established by proof of either an unlawful purpose or an anticompetitive effect.”).

⁹⁰ *E.g.*, *Schaeffer v. Am. Honda Motor Co.*, 976 F. Supp. 736, 740-41 (W.D. Tenn. 1997).

⁹¹ *See Clairol, Inc. v. Bos. Disc. Ctr. of Berkeley, Inc.*, 608 F.2d 1114, 1124 (6th Cir. 1979) (upholding vertical customer restraints when seller did not impose any restrictions on resale prices).

⁹² *E.g.*, *Winter Hill Frozen Foods & Servs., Inc. v. Haagen-Dazs Co.*, 691 F. Supp. 539, 546-48 (D. Mass. 1988).

⁹³ *E.g.*, *James M. King & Ass’n, Inc. v. G.D. Van Wagenen Co.*, 717 F. Supp. 667, 675 (D. Minn. 1989).

market power would be sales within the relevant market divided by total sales.⁹⁴ Nevertheless, the art market's relatively inelastic nature and barriers to entry may allow dealers with smaller market share to dominate—consumers will not necessarily turn to substitutes if prices increase. Third, courts frequently indicate that unlawful intent does not violate the rule of reason in the absence of anticompetitive effects.⁹⁵ Intent may, however, be relevant in determining whether the effect of a restraint is unreasonable.⁹⁶ Even a denial of authentication that rendered art unmarketable would not violate antitrust law unless there is some anticompetitive rationale, such as evidence that the committee who made the decision also sells artwork in the same relevant market.⁹⁷

Regardless of which factors a court considers, the key inquiry is the reasonableness of the challenged standard or certification.⁹⁸ “Reasonableness” in this context generally refers to the effect of the standard on competition, not to substantive reasonableness of the standard itself.⁹⁹

Once plaintiff shows anticompetitive effects of a market restraint, the burden shifts to the defendant to offer a procompetitive justification.¹⁰⁰ Courts have accepted procompetitive justifications such as

⁹⁴ There is no magic number, but courts have rejected challenges to geographic restraints when producers only command 10% of the relevant market. *E.g.*, *Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1231-34 (8th Cir. 1987).

⁹⁵ *E.g.*, *Ideal Dairy Farms, Inc. v. Farmland Dairy Farms, Inc.*, 282 N.J. Super. 140, 186 (N.J. Super. Ct. App. Div. 1995).

⁹⁶ *Am. Soc’y of Mech. Eng’rs, Inc. v. Hydrolevel Corp.*, 456 U.S. 556 (1982) (association liable for restraint of trade by misinterpreting an standard for association’s own purposes).

⁹⁷ *Cf. DM Research, Inc. v. Coll. of Am. Pathologists*, 170 F.3d 53, 57-58 (1st Cir. 1999) (defendant not liable for denying certification of laboratory-grade water because defendant represented laboratories, rather than competing producers).

⁹⁸ *See e.g.*, *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492 (1988); *U.S. Trotting Ass’n. v. Chi. Downs Ass’n.*, 665 F.2d 781, 787 (7th Cir. 1981); *see generally*, ABA ANTITRUST SECTION, MONOGRAPH NO. 23, THE RULE OF REASON 6-7 (1999).

⁹⁹ 13 HERBERT HOVENKAMP, ANTITRUST LAW, ¶¶ 2232a, 2232b, at 414 (2d ed. 2005).

¹⁰⁰ *E.g.*, *Expert Masonry, Inc. v. Boone County*, 440 F.3d 336, 343 (6th Cir. 2006).

increased information for consumers,¹⁰¹ uniformity across geographic regions,¹⁰² and improved product quality.¹⁰³ Art authentication has the important procompetitive effect of suppressing forgeries and helping consumers select genuine artwork. The defendant must show this procompetitive effect cannot be achieved in a substantially less restrictive manner.¹⁰⁴

Courts will investigate proffered justifications to determine whether they are genuine. Sometimes courts determine a purported procompetitive justification is just a sham to cover for an underlying anticompetitive practice. For example, courts found a warranty regulation system was a façade for an anticompetitive vertical market allocation.¹⁰⁵ Courts have examined press releases and meeting minutes for evidence of ulterior motives in imposing a geographic restraint.¹⁰⁶ If dealers were refusing to sell artwork in an effort to drive up the value of their holdings—rather than to exclude forgeries—this would weigh against the dealers in an antitrust analysis. Practices could also be unlawful if solely motivated by price considerations, rather than assisting customers or increasing market efficiencies.¹⁰⁷

In summary, vertical nonprice restraints are likely to be upheld as reasonable under the “rule of reason” if the restraint promotes interbrand competition without overly restricting intrabrand competition.¹⁰⁸ But vertical restraints may be struck down if they have a pernicious effect on interbrand competition, which will more likely

¹⁰¹ *E.g.*, *Consol. Metal Prods., Inc. v. Am. Petroleum Inst.*, 846 F.2d 284, 296 (5th Cir. 1988).

¹⁰² *E.g.*, *Eliason Corp. v. Nat’l Sanitation Found.*, 614 F.2d 126, 129-30 (6th Cir. 1980) (the standard “helps promote nationwide competition and enables manufacturers . . . to be reasonably sure they will not have to modify their product . . .”).

¹⁰³ *E.g.*, *Mendelovitz v. Adolph Coors Co.*, 693 F.2d 570, 575 (5th Cir. 1982) (manufacturer has legitimate interest in taste and quality of its product).

¹⁰⁴ *Wilk v. Am. Med. Assn.*, 719 F.2d 207, 227 (7th Cir. 1983); *Kreuzer v. Am. Academy of Periodontology*, 735 F.2d 1479 (D.C. Cir. 1984).

¹⁰⁵ *Eiberger v. Sony Corp. of Am.*, 622 F.2d 1068, 1076-81 (2d Cir. 1980).

¹⁰⁶ *Alvord-Polk, Inc. v. F. Schumacher & Co.*, 37 F.3d 996, 1012-13 (3d Cir. 1994).

¹⁰⁷ *See Beach v. Viking Sewing Mach. Co.*, 784 F.2d 746, 751 (6th Cir. 1986).

¹⁰⁸ *See, e.g., Three Movies of Tarzana v. Pac. Theatres, Inc.*, 828 F.2d 1395, 1399 (9th Cir. 1987).

occur when there is a latent horizontal component to the restraint.¹⁰⁹ Courts have also struck down vertical nonprice restrictions under the rule of reason when a producer was not acting independent from distributors in imposing a market restraint.¹¹⁰ Again, this might occur when the restriction on a producer is imposed at the behest of another dealer.¹¹¹

IV. FUTURE FRAMEWORKS: APPLYING ANTITRUST ASPECTS OF CERTIFICATION AND STANDARDS SETTING TO ART AUTHENTICATION

Allegations of antitrust violations may be on the rise within the art world so it is useful for authentication boards to consider the application of antitrust law as it applies to certification and standards-setting organizations.¹¹² This section will explain how certification and standards setting can raise antitrust liability and will describe how best practices adopted by certification and standards-setting bodies could apply to art authentication boards.

An industry standard is “a document established by consensus and approved by a recognized body that provides for common and

¹⁰⁹ *E.g.*, *Carlson Mach. Tools, Inc. v. Am. Tool, Inc.*, 678 F.2d 1253, 1261-62 (5th Cir. 1982) (rejecting distributor’s assertion that territorial restraints curbed intrabrand competition without allegations of harm to interbrand competition).

¹¹⁰ *See Graphic Prods. Distribs., Inc. v. ITEK Corp.*, 717 F.2d 1560, 1569-70 (11th Cir. 1983) (violation found under rule of reason when dual distributor-supplier with 70% market share terminated a distributor for not complying with market restrictions).

¹¹¹ *See, e.g.*, *Toys “R” Us, Inc. v. FTC*, 221 F.3d 928, 934-36 (7th Cir. 2000).

¹¹² In January 2010 art collector Susan Shaer also sued the Andy Warhol Art Authentication Board for denying the authenticity of Warhol artwork. *Shaer v. Andy Warhol Foundation For The Visual Arts, Inc.*, No. 2010 Civ. 00373 (S.D.N.Y. filed Jan. 15, 2010), *available at* http://dockets.justia.com/docket/court-nysdce/case_no-1:2010cv00373/case_id-357265/; *see generally* Eileen Kinsella, *Warhol Board Faces New Lawsuit*, ZIMBIO.COM (Jan. 26, 2010), <http://www.zimbio.com/Andy+Warhol+Art+Authentication+Board/articles/8wlvvExOKA/Warhol+Art+Authentication+Board+Faces+New>. *But see*, *Andy Warhol’s Red Self-Portrait: An Exchange*, ARTNET, (Nov. 17, 2010), <http://www.artnet.com/magazine/us/news/artnetnews/joe-simon-andy-warhol11-17-10.asp>. (describing how the lawsuit was abandoned in November 2010).

repeated use, rules, guidelines or characteristics for activities . . .”¹¹³ Examples include standards for wall sockets, organic produce, and cellular phone frequencies. Some standards are government mandated, while others result from voluntary self-regulation.¹¹⁴ Groups such as the American National Standards Institute (ANSI) have promulgated thousands of industry standards to promote safety or quality.¹¹⁵ Standards are also important for facilitating commerce and providing valuable information to consumers.

Once an industry standard is set, third-party certification bodies often assess whether products conform to the standard.¹¹⁶ For example, the Good Housekeeping “Seal of Approval” certifies that a product underwent testing to meet a quality standard.¹¹⁷ When an art authentication board authenticates a painting, it is, for all purposes, certifying that the artwork met an authenticity standard.

Standards and certification activities by their nature restrain trade because they divert business from one competitor to another.¹¹⁸

¹¹³ *What are standards?*, EUR. TELECOMMS. STANDARDS INST., <http://www.etsi.org/WebSite/Standards/WhatIsAStandard.aspx> (last visited Jan. 19, 2011); Maureen A. Breitenber, *The ABC's of Standards-Related Activities in the United States* (Nat'l Inst. of Standards & Tech., Paper No. NISTIR 7614, Aug. 2009), available at http://gsi.nist.gov/global/docs/pubs/NISTIR_7614.pdf. See also Herbert Hovenkamp, *Standards Ownership and Competition Policy*, 48 B.C. L. REV. 87 (2007), <http://lawdigitalcommons.bc.edu/bclr/vol48/iss1/4/>;

¹¹⁴ NAT'L RESEARCH COUNCIL, STANDARDS, CONFORMITY ASSESSMENT AND TRADE INTO THE 21ST CENTURY 11 (1995), available at http://www.nap.edu/openbook.php?record_id=4921&page=R1.

¹¹⁵ AM. NAT. STANDARDS. INST., *About ANSI Overview*, http://www.ansi.org/about_ansi/overview/overview.aspx?menuid=1 (last visited January 19, 2011).

¹¹⁶ Jonathan T. Howe, Leland J. Badger, *The Antitrust Challenge to Non-Profit Certification Organizations: Conflicts of Interest and a Practical Rule of Reason Approach to Certification Programs as Industry-Wide Builders of Competition and Efficiency*, 60 WASH. U. L.Q. 357 (1982-1983).

¹¹⁷ *The History of the Good Housekeeping Seal*, GOOD HOUSEKEEPING, <http://www.goodhousekeeping.com/product-testing/history/good-housekeeping-seal-history> (last visited Jan. 18, 2011).

¹¹⁸ FTC, Bureau of Consumer Protection, STANDARDS AND CERTIFICATION (FINAL STAFF REPORT) at 275-76 (1983); Harry S. Gerla, *Federal Antitrust Law and Trade and Professional Associations Standards and Certification*, 19 DAYTON L. REV. 471 (1994). For an excellent overview see Andrew Updegrove, *Laws, Cases and Regulations*, CONSORTIUMINFO.ORG (2007), <http://www.consortiuminfo.org/laws/>.

Antitrust violations occur when standards are promulgated in an effort to exclude competitors from the market.¹¹⁹ Standards setting and certification practices are generally subject to the same antitrust analysis as any other business practice. Nonprofit entities are also subject to antitrust liability just like for-profit businesses.¹²⁰

Drawing on these principles, an art authentication board should ensure its authentication service benefits the market: “The paramount antitrust challenge for nonprofit product certification products is to demonstrate aggressively that such programs strengthen the competitive market system on an industry-wide basis.”¹²¹

A. Does Per Se or Rule of Reason Apply to Standards Setting and Authentication?

In general, the rule of reason analysis applies to standards setting: such activities will be upheld as long as the standard is reasonably necessary to achieve a procompetitive benefit.¹²² For example, a court refused to apply the per se rule to the American Kennel Club’s establishment of mandatory dog “breed” standards because uniformity was necessary for competition among owners and breeders.¹²³

Although rule of reason generally applies, some practices—such as group boycotts—would be blatantly anticompetitive and always per se antitrust violations.¹²⁴ If a group of art dealers or auction houses coordinated to exclude a particular authentication service from the market for authentication services, this could arguably constitute a

¹¹⁹ 13 HOVENKAMP, *supra* note 99, ¶ 2231a, at 409.

¹²⁰ *See, e.g.*, Cal. Dental Ass’n. v. FTC, 526 US 756, 768-69 (1999).

¹²¹ Howe, *supra* note 116, at 357.

¹²² *See, e.g.*, Cont’l Airline, Inc. v United Airlines, Inc., 277 F.3d 499 (4th Cir. 2002) (per se rule inapplicable to a standard imposed by trade association to limit the size of carry-on baggage). *But see* United States v. Nat’l Ass’n. of Broadcasters, 536 F. Supp. 149, 160-62 (D.D.C. 1982) (television broadcasters trade association standard prohibiting the advertisement of more than one product in a commercial lasting less than 60 seconds held per se illegal).

¹²³ Jessup v. Am. Kennel Club, Inc., 61 F. Supp. 2d 5 (S.D.N.Y. 1999), *aff’d per curiam*, 210 F.3d 111 (2d Cir. 2000).

¹²⁴ FTC v. Super. Ct. Trial Lawyers Ass’n, 493 U.S. 411 (1990) (competitively motivated horizontal group boycotts). A group boycott, also known as a refusal to deal, means “withholding or enlisting others to withhold patronage or services from the target.” St. Paul Fire & Marine Ins. Co. v. Barry, 438 U.S. 531, 541-43 (1978).

per se violation. A per se violation could also occur if an authentication committee forced others to follow its recommendations.¹²⁵

In *Radiant Burners, Inc. v. Peoples Gas, Light & Coke Co.*, the Supreme Court found a per se illegal boycott when a powerful group of producers manipulated an industry standard to arbitrarily deny certification to a competitor's product.¹²⁶ This suggests an authentication practice could also be per se illegal if the standard constituted a horizontal agreement among competitors not to deal with a particular dealer.¹²⁷

It is worth noting, however, that courts sometimes refuse to apply the per se rule in cases involving unique markets on the ground that courts lack experience to condemn certain practices on their face.¹²⁸ For example, *Vogel v. American Society of Appraisers* refused to apply the per se rule to the practice of barring member appraisers from charging fixed appraisal fees.¹²⁹ Commentators have similarly argued the art market is sufficiently complex such that courts should not decide issues of authenticity on a per se basis.¹³⁰

In summary, standards setting will generally be subject to rule of reason analysis unless the standard is a mere sham to facilitate exclusion. Moreover courts generally apply rule of reason analysis to certification decisions about particular products.¹³¹ In part, this is

¹²⁵ See *Consol. Metal Prods., Inc. v. Am. Petroleum Inst.*, 846 F.2d 284, 292 (5th Cir. 1998); *Int'l Healthcare Mgmt. v. Haw. Coal. For Health*, 332 F.3d 600, 606 (9th Cir. 2003) (no antitrust violation when professional association did not force anyone to follow its advice).

¹²⁶ *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U.S. 656 (1961). Although *Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co.* has since held that boycotts should be analyzed under the rule of reason, a restraint can be per se unlawful if plaintiff "present[s] a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects." 472 U.S. 284, 298 (1985).

¹²⁷ See e.g., *Pretz v. Holstein Friesian Ass'n.*, 698 F. Supp. 1531, 1539 (D. Kan. 1988); *Consol. Metal Prods., Inc. v. Am. Petroleum Inst.*, 846 F.2d 284, 292 (5th Cir. 1988).

¹²⁸ See, e.g., *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 24 (1979) (refusing to apply the per se rule to issuances of blanket licensing to music).

¹²⁹ 744 F.2d 598, 603-04 (7th Cir. 1984).

¹³⁰ See e.g., Samuel Butt, *Authenticity Disputes in the Art World: Why Courts Should Plead Incompetence*, 28 COLUM. J.L. & ARTS 71, 85 (2004).

¹³¹ E.g., *Eliason Corp. v. Nat'l Sanitation Found.*, 614 F.2d 126, 129-30 (6th

because courts do not want to condemn practices with which they lack sufficient expertise.¹³²

B. Status of the Essential Facilities Doctrine

When product certification is necessary for a business to compete in a given market, denial of certification could be a per se violation.¹³³ This “essential facilities” doctrine is not really an independent basis for antitrust liability, but rather a type of monopolization claim.¹³⁴ The Supreme Court has not directly supported a cause of action for denial of essential facilities.¹³⁵ Nevertheless, the concept still has applicability to standards and certification and lower courts continue to speak in terms of “essential facilities.”¹³⁶

Radiant Burners found a producer of gas burners properly alleged an antitrust claim against an industry association who refused to certify the company’s gas burners as safe, thereby making them impossible to sell.¹³⁷ Denial of the association’s “seal of approval” raised antitrust concerns because the seal had such prestige in the industry that it had become mandatory in some local codes. An art authentication board’s opinion could raise similar issues if a work of

Cir. 1980); *Moore v. Boating Indus. Ass’ns*, 819 F.2d 693 (7th Cir. 1987); *Hatley v. Am. Quarter Horse Ass’n*, 552 F.2d 646 (5th Cir. 1977); *Jessup v. Am. Kennel Club, Inc.*, 61 F. Supp. 2d 5 (S.D.N.Y. 1999).

¹³² *E.g.*, *Vogel v. American Society of Appraisers*, 744 F.2d 598, 603 (7th Cir. 1984) (noting, “the novelty of the challenged practice (novel to the courts, that is) is a reason against per se classification.”).

¹³³ Brett M. Frischmann & Spencer Weber Waller, *Revitalizing Essential Facilities*, 75 ANTITRUST L.J. 1 (2008).

¹³⁴ *Kramer v. Pollock-Krasner Found.*, 890 F. Supp. 250, 257 (S.D.N.Y. 1995).

¹³⁵ *Verizon Commc’ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

¹³⁶ *Gregory v. Fort Bridger Rendezvous Ass’n*, 448 F.3d 1195, 1204 (10th Cir. 2006); *Daisy Mountain Fire Dist. v. Microsoft Corp.*, 547 F. Supp. 2d 475, 490 (D. Md. 2008). *Sanjuan v. Am. Bd. of Psychiatry & Neurology*, 40 F.3d 247 (7th Cir.) (1994) (holding American Board of Psychiatry and Neurology did not improperly refuse certification that was unnecessary for medical practice and did not inhibit competition), *cert. denied*, 516 U.S. 1159 (1996); *accord* *George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc.*, 508 F.2d 547, 558 (1st Cir. 1974) (standards setting did not restrain trade when few architects followed the standard).

¹³⁷ *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U.S. 656 (1961).

art becomes unsalable without an authentication opinion.¹³⁸

Given the factual similarities between “seals of approval” and opinions about authenticity, plaintiffs like Simon-Whelan might consider the reasoning from *Radiant Burners* when challenging authentication decisions. This issue could also perhaps arise if auction houses and dealers refused to sell paintings without authentication from a particular board.

C. Liability Theories Challenging the Substantive Standard Itself

In *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, the Supreme Court held that standards setting must be substantively and procedurally fair.¹³⁹ Courts rarely analyze the substantive “reasonableness” of the standard itself on grounds they lack expertise to analyze the technical details. That said, if there is evidence that the standard is patently arbitrary, a court might reject the substantive standard itself as unreasonable.

According to an FTC advisory opinion, standards should be kept current with new research and authentication based on rigid “pass/fail” processes should be avoided.¹⁴⁰ In cases challenging a substantive standard, the burden of proof with respect to reasonableness lies on those who develop and enforce the standards.¹⁴¹ This suggests there is a significant liability exposure for authentication boards employing secretive methods or methods based on subjective knowledge rather than a consistent industry standard. *Radiant Burners*, for example, struck down a certification test for lack of “objective standards” because the standards had a potential to be arbitrary and capricious.¹⁴²

¹³⁸ See *Brookins v. Int’l Motor Contest Ass’n.*, 219 F.3d 849, 853-54 (8th Cir. 2000); *Kramer*, 890 F. Supp. at 256.

¹³⁹ *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 509 (1988) (holding legality of standards-setting conduct under antitrust law “depends upon the existence of safeguards sufficient to prevent the standard-setting process from being biased by members with economic interests in restraining competition.”).

¹⁴⁰ FTC Advisory Opinion No. 457, 78 F.T.C. 1628, 1971 WL 128741 (Mar. 8, 1971).

¹⁴¹ *Id.*

¹⁴² *Radiant Burners*, 364 U.S. at 658.

There must be a basis for determining whether a product complies with the standard. A standards setting organization might even be forced to alter its standard if there is no reasonable justification for excluding new products from the standard.¹⁴³ For example, *Wilk v. American Medical Association* struck down American Medical Association standards denying chiropractors access to health facilities because plaintiffs provided detailed information about the medical benefits of chiropractic treatments.¹⁴⁴ Those seeking authentication should also marshal all relevant extrinsic evidence showing their artwork is authentic.

D. Liability Based on Procedural Defects in the Authentication Process

As collectors, boards, and courts grapple with antitrust litigation over art authenticity, laws governing certification and standards setting could provide guidance for evaluating the procedural aspects of art authentication practices.¹⁴⁵ If there is evidence that standard setting or authentication was improperly manipulated to gain a competitive advantage, this could raise antitrust concerns.¹⁴⁶

Radiant Burners held standards and certification should be evaluated by looking at the intent of those setting them and whether the defendants have anticompetitive incentives.¹⁴⁷ Evidence that authentication practices were applied arbitrarily in the past would also help the plaintiff.¹⁴⁸ Courts might examine the composition of a

¹⁴³ *Am. Soc’y of Sanitary Eng’g*, 106 F.T.C. 324, 329 (1985), 1985 WL 668922.

¹⁴⁴ 719 F.2d 207, 213-217 (7th Cir. 1983).

¹⁴⁵ There is precedent for examining certification, standards setting, and authentication under the same lens. For example, the Indian Arts and Crafts Board within the U.S. Department of the Interior assists with registering certification marks to ensure Native American art is genuine. 25 U.S.C. § 305a (2006).

¹⁴⁶ *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492 (1988); *Radiant Burners, Inc. v. Peoples Gas Light & Coke Co.*, 364 U.S. 656 (1961); *Hydrolevel Corp. v. Am. Soc’y of Mech. Eng’rs, Inc.* 635 F.2d 118 (2d Cir. 1980), *aff’d* 456 U.S. 556 (1982); *Jessup v. Am. Kennel Club*, 61 F. Supp. 2d 5 (S.D.N.Y. 1999); *Carleton v. Vermont Dairy Herd Improvement Ass’n.*, 782 F. Supp. 926, 934 (D. Vt. 1991).

¹⁴⁷ *Radiant Burners*, 364 U.S. 656.

¹⁴⁸ *See Hatley v. Am. Quarter Horse Ass’n*, 552 F.2d 646, 653-54 (5th Cir.

Board to identify procedural irregularities or possible conflicts of interest.¹⁴⁹

In response to an FTC advisory opinion regarding antitrust liability for certification, ANSI promulgated due process guidelines to ensure decisions are based on objective judgments rather than economic self-interest.¹⁵⁰ These guidelines are consistent with emerging practices in the art world. For example, College Art Association authentication guidelines prohibit certifying bodies from offering self-interested opinions.¹⁵¹

The U.S. Department of Justice has also affirmed that certification bodies should award seals of approval on non-discriminatory bases.¹⁵² In short, numerous standards and certification guidelines make clear there is a duty to administer authentication fairly and without hindering competition:

[T]he objective character of a seal, and a reputation for reliability, give rise to an obligation to administer the seal with the utmost fairness and to make it available to everyone who can meet the tests. This follows from the fact that *when a seal has such prestige it can mean the difference between success and failure to a*

1977) (rejecting a challenge to a decision not to register a horse as a quarter horse because the standards “were not applied in a discriminatory, arbitrary, or capricious fashion”).

¹⁴⁹ Cf. *Pretz v. Holstein Friesian Ass’n*, 698 F. Supp. 1531, 1539 (D. Kan. 1988) (holding cattle-breeding association liable for denying certification of plaintiff’s cattle for failing milk content test because cattle became worthless without certification).

¹⁵⁰ See, e.g., *ANSI Essential Requirements: Due process requirements for American National Standards*, AM. NAT. STANDARDS INST. (Jan. 5, 2010, 8:10 AM), <http://publicaa.ansi.org/sites/apdl/default.aspx> (follow “American National Standards” hyperlink; then follow “Procedures, Guides, and Forms” hyperlink; then follow “2010 ANSI Essential Requirements” hyperlink; then follow “2010 ANSI Essential Requirements” hyperlink).

¹⁵¹ Compare FTC Advisory Opinion No. 457, 78 F.T.C. 1628, ¶ 16, 1971 WL 128741 (1971) *with Standards and Guidelines: Authentications and Attributions*, COLLEGE ART ASS’N (Oct. 25, 2009), <http://www.collegeart.org/guidelines/authentications>.

¹⁵² Joel E. Hoffman, *Industry-Wide Codes, Advertising, Seals of Approval and Standards: As Participated in by the Trade Association*, 13 ANTITRUST BULL. 595 (1968).

*business.*¹⁵³

Authentication committees should therefore consider less restrictive alternatives to stamping “DENIED” on rejected artwork.¹⁵⁴ Alternatives could include refusing to provide a letter of authentication or publishing a denial decision in the artist’s *catalogue raisonné*.

In the 1970s, the International Foundation for Art Research (IFAR) was formed as an independent art accreditation service after New York Attorney General Louis J. Lefkowitz raised concerns about the growing risk of forgeries flooding the art market.¹⁵⁵ Although organizations like IFAR had fewer conflicts of interest, there were still concerns about transparency because “[authentication committees] possess[] the aura of impartiality and scholarship . . . [but their] internal procedures are secret . . .”¹⁵⁶ Some art professionals responded to these concerns by adopting codes of ethics or best practices guidelines.

Most museums, for example, prohibit curators from consulting on third-party works.¹⁵⁷ The Art Dealers Association of America also adopted an ethical code.¹⁵⁸ The College Art Association of America issued authentication guidelines that require “[a]rt-historical documentation, stylistic connoisseurship, and technical or scientific

¹⁵³ Robert B. Hummel, *Antitrust Problems of Industry Codes of Advertising, Standardization, and Seals of Approval*, 13 ANTITRUST BULL. 607 (1968) (emphasis added).

¹⁵⁴ See *supra* note 104. On the other hand, such practices would likely be upheld under a rule of reason analysis if there were a rational basis for taking those steps. Given that Warhol art is, quite literally, a product of mass reproduction through near-identical series, there is a potentially high risk of Warhol forgeries entering the market. Nevertheless, connoisseurship or scientific authentication could provide less restrictive alternatives of weeding out fakes.

¹⁵⁵ Leonard D. DuBoff, *Controlling the Artful Con: Authentication and Regulation*, 27 HASTINGS L.J. 973, 1020 (1976) (citing Arnason, *Introducing the International Foundation for Art Research*, MUSEUM NEWS, Apr. 1972, at 28). See generally, INT’L FOUND. FOR ART RESEARCH, <http://www.ifar.org/authentication.php> (last visited Apr. 4, 2010).

¹⁵⁶ DuBoff, *supra* note 155, at 1019-20.

¹⁵⁷ ELAINE A. KING & GAIL LEVIN, *ETHICS AND THE VISUAL ARTS* 257 (2006).

¹⁵⁸ See generally, *Professional Guidelines*, INT’L FOUND. FOR ART RESEARCH, http://www.ifar.org/professional_guidelines.php (last visited Jan. 18, 2011); LEONARD D. DUBOFF & CHRISTY O. KING, *ART LAW IN A NUTSHELL* 85 (3d ed. 2000).

analysis . . .”¹⁵⁹ Despite such efforts, many authentication boards continue to conduct their work in secret.¹⁶⁰ This strategy could be harmful in defending against antitrust lawsuits because clear procedural safeguards in the standards development and authentication process can tip the rule of reason analysis in the defendant’s favor.¹⁶¹

In summary, antitrust issues arising from non-art certification and standards setting could offer additional legal theories for litigants challenging art authentication decisions by suggesting procedural protections the authentication boards should provide. At the same time, adopting formal procedures for authentication shields authentication boards that consistently follow the procedures. Committees should not attempt to enforce their standards by punishing market actors that deviate.¹⁶² Instead, the authentication process should include clear criteria, appeal processes, and a mechanism for amending existing standards.

CONCLUSION

Simon-Whelan potentially increases the liability of art professionals who pass judgment on the authenticity of artwork.¹⁶³ Tort litigation has already shuttered many authentication bodies in the past.¹⁶⁴ After *Simon-Whelan*, antitrust liability has the potential to

¹⁵⁹ *Standards and Guidelines: Authentications and Attributions*, COLLEGE ART ASS’N (Oct. 25, 2009), <http://www.collegeart.org/guidelines/authentications>.

¹⁶⁰ Kai B. Singer, ‘Sotheby’s Sold Me a Fake!’—*Holding Auction Houses Accountable for Authenticating and Attributing Works of Fine Art*, 23 COLUM. J.L. & ARTS 439, 449 (1999-2000); See Steven M. Levy, *Liability of the Art Expert for Professional Malpractice*, 1991 WIS. L. REV. 595, 596 (1991)

¹⁶¹ Committees that insist on secret authentication practices should consider carrying an Errors and Omissions insurance policy. *CRSA Guidelines for Issuing Scholarly Opinions about Authenticity*, CATALOGUE RAISONNÉ SCHOLARS ASS’N (Apr. 2010), <http://www.catalogueraisonne.org/CRSAGuidelines.pdf>.

¹⁶² See, e.g., *Santana Prods., Inc. v. Bobrick Washroom Equip., Inc.*, 401 F.3d 123, 132-33 (3d Cir. 2005) (no antitrust violation when trade association criticized plaintiff’s products, but did not coerce market actors).

¹⁶³ Sharon Flescher & Mary Morabito Rosewater, *Dispute Against the Warhol Authentication Board Allowed to Proceed*, 11 IFAR J. 36 (2009), http://www.ifar.org/publication_detail.php?docid=1251923912.

¹⁶⁴ The Pollock-Krasner Authentication Board, for example, shut down after fighting numerous legal battles with disappointed collectors. *McCloud v. Lawrence*

make this line of work even more risky. As this new legal theory emerges, the law of antitrust governing certification and standards setting could both strengthen causes of action against art authentication bodies and suggest best practices to reduce liability. Authentication bodies should therefore respond by carefully evaluating the current practices and protections offered by certification and standards setting outside the art world.

PRACTICE POINTERS

- A denial of authenticity that prohibits a collector from selling his or her painting can constitute a sufficient antitrust injury under the Sherman Antitrust Act, but factual allegations in a complaint must be sufficiently specific to justify dragging a defendant through discovery. Plaintiffs should review the factors outlined in *Simon-Whelan* and *Thome* to ensure pleadings contain a plausible claim for antitrust relief under *Twombly*.
- Famous paintings, such as works by Jackson Pollock or Andy Warhol, might constitute a relevant submarket for purposes of antitrust pleading. But the exact contours of a submarket for Warhol artwork remains unclear and may overlook the possibility that other contemporary artwork could be economic substitutes for Warhols.
- Antitrust law has a rich body of precedent dealing with standards setting and certification that could also apply to art authentication. Those laws suggest there is a duty to administer authentication fairly and without hindering competition.
- Art authentication is likely subject to “rule of reason” antitrust analysis and therefore lawful unless the anticompetitive effects of the authentication process outweigh the procompetitive benefits. While courts usually will not analyze the substantive reasonableness of a standard itself, a court might reject a substantive standard if there is evidence it is patently arbitrary.

Gallery, Ltd., No. 90 Civ. 30(KMW), 1991 WL 136027 (S.D.N.Y. July 12, 1991); *Kramer v. Pollock-Krasner Found.*, 890 F. Supp. 250 (S.D.N.Y. 1995); *Lariviere v. Thaw*, 2000 NY Slip Op. 50000(U), 2000 WL 33965732 (N.Y. Sup. Ct. June 26, 2000).

- Organizations authenticating artwork should avoid conflicts of interest—or perceived conflicts of interest—by ensuring no one involved in authentication sells potentially competing artwork. Procedural due process protections should be transparent and organizations should conduct periodic reviews to ensure internal compliance.

“CAPITAL” PUNISHMENT: EVALUATING AN INVESTOR’S
SECONDARY COPYRIGHT INFRINGEMENT LIABILITY AFTER
VEOH

*James L. Proctor, Jr.**
© James L. Proctor, Jr.

CITE AS: 6 WASH. J.L. TECH. & ARTS 217 (2011)
<https://digital.lib.washington.edu/dspace-law/handle/1773.1/561>

ABSTRACT

In UMG Recordings, Inc. v. Veoh Networks, Inc., the U.S. District Court for the Central District of California considered claims that investors in a privately-held corporation were secondarily liable for copyright infringement. The Veoh court findings, which set out current secondary copyright infringement law, provide guidance for investors by clarifying their potential liability for copyright infringement committed by the company in which they invested. However, because the decision was fact-specific, this guidance is incomplete. For example, the court found that the investor neither controlled the infringing activities nor reaped direct financial benefit from them. This leaves open for further decisions the situation in which only one factor is present. In addition, Veoh bases secondary liability on such subjective concepts as “control,” “supervision,” “ability to supervise,” “reason to know,” “material assistance,” “encouragement to infringe,” and “direct financial interest.” Therefore, future cases involving similar facts are susceptible to contrary

* James L. Proctor, Jr., University of Washington School of Law, Class of 2011; Oregon State University, M.B.A., 1987; Supply Corps Officer, United States Navy, 1987-2008. Many thanks to Professor Jane Winn of the University of Washington School of Law and Jennifer Heidt White, student editor, for their superb feedback and invaluable guidance. Thank you also to Elaine D. Ziff, Counsel, of Skadden, Arps, Slate, Meagher & Flom, LLP, for her thorough and very helpful review of this Article.

results based on the court’s interpretation of these concepts. This Article examines the standards established and the cases distinguished by the Veoh court to determine conditions under which an investor may be held liable for the copyright infringement of the investment target and proposes practical steps to minimize liability exposure.

TABLE OF CONTENTS

Introduction.....218
 I. Contributory and Vicarious Copyright Infringement under *Veoh*.....220
 II. Contributory Liability Requires Action to Effect Infringement221
 III. Vicarious Liability Requires Direct Financial Interest and Operational Control223
 IV. Infringement Liability Requires Inducement via Product Distribution.....227
 V. Impact of *Veoh*: Investors Not Per Se Liable, but Due Diligence Still Essential229
 Conclusion231
 Practice Pointers.....231

INTRODUCTION

With the rapid emergence of Internet-based technologies, investors increasingly seek guidance regarding potential secondary liability for copyright infringement. Penalties for secondary infringement can be high, ranging from an injunction against the infringing conduct to an award of damages. Attorney’s fees are routinely awarded to successful plaintiffs. Moreover, with respect to start-up companies, investors may have deeper pockets that claimants can pursue for recovery.

Statutory coverage related to the rights of copyright holders is limited to protection against direct infringement.¹ However, this lack of statutory coverage does not preclude the imposition of secondary

¹ 17 U.S.C. § 501(a) (2006).

liability.² To account for parties who indirectly benefit from copyright infringement, courts have developed concepts of secondary liability.³ Nevertheless, they have provided this guidance piecemeal, reflecting the challenge of maintaining the correct balance between copyright holders' rights and the encouragement of commerce. As the Supreme Court noted in *MGM v. Grokster*, "the more artistic protection is favored, the more technological innovation may be discouraged; the administration of copyright law is an exercise in managing the tradeoff."⁴

In February 2009, the United States District Court for the Central District of California provided some direction for investors in *UMG Recordings, Inc. v. Veoh Networks, Inc.*⁵ The federal district court considered claims of contributory, vicarious, and inducement liability against investors in an Internet company providing services used to infringe copyrights.⁶ The court, in dismissing the case, found, under the facts as pled, that the investor defendants did not exercise sufficient control over the infringing activity to be held liable for contributory infringement⁷ and lacked a sufficient financial interest tied to the infringement to be held liable for vicarious infringement.⁸

² 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 12.04 (2010) (quoting *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 435 (1984) ("The absence of such express language in the copyright statute does not preclude the imposition of liability for copyright infringement on certain parties who have not themselves engaged in the infringing activity.")).

³ *See, e.g.*, *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913 (2005) (secondary liability found for inducement, encouragement and profiting from direct infringement while declining to exercise a right to stop or limit it); *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 435 (1984) (Active steps taken to encourage direct patent or copyright infringement incurs secondary liability); *Perfect 10, Inc. v. Visa Int'l Service Ass'n*, 494 F.3d 788 (9th Cir. 2007) (copyright infringement exists when one has knowledge of another's infringement and either materially contributes to or induces the infringement). *But see, e.g.*, *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 442 (1984) (no secondary liability for copyright infringement when the product provided is widely used for legitimate, unobjectionable purposes).

⁴ *Grokster*, 545 U.S. at 928.

⁵ *UMG Recordings, Inc. v. Veoh Networks Inc.*, No. CV 07-5744 AHM, 2009 WL 334022, at *6 (C.D. Cal. Feb. 2, 2009).

⁶ *Id.* at *1.

⁷ *Id.* at *3.

⁸ *Id.* at *6.

The court also found that the defendants did not encourage the direct infringement in a manner to be held liable for inducement to infringe.⁹

This Article examines *Veoh's* analysis of investor liability in light of the then-existing state of secondary copyright infringement law, and provides practical suggestions for potential investors in companies providing products or services that customers could use to infringe copyrights.

I. CONTRIBUTORY AND VICARIOUS COPYRIGHT INFRINGEMENT UNDER *VEOH*

In September 2007, Universal Music Group, Inc. (“UMG”), a major record company, filed suit in federal court against Veoh Networks, Inc. (“Veoh”). In its initial complaint, UMG claimed that Veoh was liable for direct, contributory and vicarious copyright infringement, and for inducement of copyright infringement. The ground for this claim was that Veoh allowed customers to upload copyright-protected video files via its Internet-based video network.¹⁰ UMG later made secondary liability claims against Veoh’s investors, who were also shareholders and collectively controlled a majority of Veoh’s board seats, for facilitating this infringing technology by providing financial and management support.¹¹

The court granted the investor defendants’ motion to dismiss the case.¹² In doing so, the court held that, based on the facts pled by plaintiff, the investors did not provide sufficient material assistance to support a claim of contributory copyright infringement.¹³ The court also found that the investors lacked sufficient financial interest in the infringing activities to support a claim of vicarious copyright infringement.¹⁴ The district court distinguished several cases that previously set the boundaries of secondary copyright infringement

⁹ *Id.*

¹⁰ *UMG Recordings, Inc. v. Veoh Networks Inc.*, 665 F.Supp.2d 1099, 1100 (C.D. Cal. Sep. 11, 2009).

¹¹ *Id.* at *6.

¹² *Id.* at *6.

¹³ *Id.* at *3.

¹⁴ *Id.* at *5.

liability. The court provided UMG an opportunity to amend its complaint, although it discouraged it from doing so, in part, because the claims could raise "vexing issues of corporate governance."¹⁵ UMG amended the complaint, but the district court dismissed it with prejudice.¹⁶ The district court's dismissal of the claims in *Veoh* is on appeal to the Ninth Circuit and a decision is expected within the year.¹⁷

The liability boundaries for investors in companies found to have infringed copyrights will almost certainly continue to develop. However, at least for the time being, the *Veoh* analysis may be instructive for those seeking to predict future developments in secondary copyright infringement liability.

II. CONTRIBUTORY LIABILITY REQUIRES ACTION TO EFFECT INFRINGEMENT

In *Veoh*, the subscribers allegedly committed direct copyright infringement by uploading copyrighted television shows onto the *Veoh* network. *Veoh* itself was sued for contributory infringement but successfully asserted that it was protected by section 512(c) of the Digital Millennium Copyright Act.¹⁸

"The theory of contributory liability generally permits direct action against those who aid and abet the offender in his infringing activities."¹⁹ These principals need not necessarily exercise dominion over the primary tortfeasor or criminal. However, generally, they

¹⁵ *Id.* at *6.

¹⁶ *UMG Recordings, Inc. v. Veoh Networks Inc.*, No. CV 07-5744 AHM, 2009 U.S. Dist. LEXIS 70553 (C.D. Cal. May 5, 2009), *appeal docketed*, No. 09-56777 (9th Cir. Nov. 4, 2009).

¹⁷ *Id.*; Brief of Appellants, *UMG Recordings, Inc., v. Shelter Capital Partners, LLC*, No. 09-55092, 2010 WL 3708623 (9th Cir. Apr. 20, 2010); Consolidated Answering Brief of Defendants-Appellees, *UMG v. Shelter Capital Partners*, No. 09-55092, 2010 WL 3708628 (9th Cir. Jun 3, 2010); Reply Brief of Appellants, *UMG v. Shelter Capital Partners*, No. 09-55092, 2010 WL 3708631 (9th Cir. Jul 15, 2010).

¹⁸ *UMG Recordings, Inc. v. Veoh Networks Inc.*, 665 F.Supp.2d 1099 (C.D. Cal. Sep 11, 2009). This decision of the District Court is on appeal as well, and has been consolidated with the appeal, see *supra* note 16, against the investors.

¹⁹ David R. Plane, *Going After the Middleman: Landlord Liability in the Battle Against Counterfeits*, 99 TRADEMARK REP. 810, 817 (2009).

must know (or, as the court in *Veoh* framed it, have “reason to know”) about the infringing activity and must provide material assistance to the infringer.²⁰ Courts finding sufficient knowledge and contribution can find the principal jointly and severally liable with the primary tortfeasor.²¹

The *Veoh* court found that, although UMG sufficiently claimed that the investor defendants *knew* of *Veoh*’s infringement, it failed to state a claim that the investors provided material assistance to the primary infringers.²² A number of findings supported this holding, the most important being that the *Veoh* investors merely exercised “plain vanilla” control characteristic of board members rather than actual control over the infringing activity. Indeed, some examples of control pled by plaintiff were fairly generic (e.g., the hiring of employees and determining what content should be carried on the *Veoh* network).²³ However, other examples of control related more closely to the infringing conduct (e.g., approving the launch of software that facilitated uploading and deciding not to employ filters to identify copyrighted content).²⁴ The court rejected UMG’s claim that holding board meetings at an investor-stockholder’s office constituted control on the ground that such action, in itself, was normal director behavior.²⁵ There was also no claim that the board appointees were merely puppets of the investors.²⁶

Prior to *Veoh*, the leading case on investor liability for copyright infringement was *UMG Recordings, Inc. v. Bertelsmann AG*.²⁷ The *Bertelsmann* case involved a lawsuit for copyright infringement

²⁰ See *UMG Recordings, Inc. v. Veoh Networks Inc.*, No. CV 07-5744 AHM, 2009 WL 334022, at *3 (C.D. Cal. Feb. 2, 2009) (quoting *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004, 1019-22 (9th Cir. 2001)); *Perfect 10*, 494 F.3d at 795; 6 WILLIAM F. PATRY, PATRY ON COPYRIGHT § 21:41 (“[T]he essence of contributory infringement is knowledge of the infringing conduct and facilitating the means by which the direct infringement is accomplished.”).

²¹ See, e.g., *Screen Gems-Columbia Music, Inc. v. Mark-Fi Records, Inc.*, 256 F.Supp. 399, 404-405 (S.D.N.Y. 1966).

²² *Veoh*, 2009 WL 334022, at *3

²³ *Id.* at *1.

²⁴ *Id.* at *2.

²⁵ *Id.* at *4.

²⁶ *Id.*

²⁷ *UMG Recording, Inc. v. Bertelsmann AG*, 222 F.R.D. 408, 412-413 (N.D. Cal. 2004).

damages against an investor in Napster, an online music file-sharing service. The direct infringement was committed by the company, which maintained a library of infringing music uploaded by users. *Bertelsmann* held that the investor-defendant (Bertelsmann AG) incurred contributory liability for Napster's copyright infringement.

The *Veoh* court made several distinctions with *Bertelsmann* in determining that UMG's contributory infringement claims were insufficiently pled. First, unlike *Veoh*, the *Bertelsmann* plaintiff complained that Napster's investor knew about the infringing activity before it invested in Napster.²⁸ In addition, one of the plaintiffs in *Bertelsmann* claimed that Bertelsmann's management, not just its board appointees, caused Napster to engage in infringement.²⁹ Also, the *Bertelsmann* plaintiff accused the defendants of specifically ordering "such activity [to] take place," rather than merely knowing of it, as was the case in *Veoh*.³⁰ Finally, Bertelsmann was Napster's only available source of funding, a fact not pled in *Veoh*. Thus, Bertelsmann was assumed to have the absolute power to stop Napster's infringement by withholding funds.³¹

Based on *Bertelsmann* and *Veoh*, actions an investor may undertake without incurring liability for contributory infringement include those categorized as routine day-to-day management of the investment target, provided that the investor does not direct the continuance of activities that are known to be infringing. However, to preclude secondary copyright infringement on any other theory, the investor must also be mindful of vicarious liability and inducement to infringe claims, as discussed below.

III. VICARIOUS LIABILITY REQUIRES DIRECT FINANCIAL INTEREST AND OPERATIONAL CONTROL

In general, under the principle of vicarious liability in tort, courts can hold an investor strictly liable to a third party for the acts of the

²⁸ *Veoh*, 2009 WL 334022, at *4.

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.* See also *UMG Recording, Inc. v. Bertelsmann AG*, 222 F.R.D. 408, 412-413 (N.D. Cal. 2004).

primary tortfeasor.³² Vicarious liability grew out of the agency doctrine of *respondeat superior*,³³ which holds a principal liable for its agent's wrongful acts committed within the scope of the agency.³⁴ In general, courts will hold an investor liable to a third party for the acts of the primary tortfeasor. Under the theory of vicarious liability, courts may find a person strictly liable for a second person's torts "simply because there is a relationship between the two people and the second person was acting within the scope of that relationship when he committed the tort."³⁵

Factors influencing a finding of liability for vicarious infringement of copyrights include the investor's right and ability to supervise the infringing activity and its direct financial interest in such activities.³⁶ Unlike contributory liability, the court need not find that the investor had knowledge of the specific infringement in order to establish vicarious liability.³⁷

The *Veoh* court determined that UMG failed to sufficiently state a claim of vicarious copyright infringement liability. It did not consider allegations regarding Veoh's investors' ability to supervise Veoh's infringing conduct because the investors had an insufficient direct financial interest in the infringement to be held vicariously liable. In particular, the plaintiff in *Veoh* did not claim investors received fees

³² Andrew J. Lee, *MGM Studios, Inc. v. Grokster, Ltd. & In Re Aimster Litigation: A Study of Secondary Copyright Liability in the Peer-To-Peer Context*, 20 BERKELEY TECH. L.J. 485, 487 (2005).

³³ *Id.*

³⁴ 3 NIMMER & NIMMER, *supra* note 2, at § 12.04.

³⁵ See Thomas B. Foley, *Show Me The Money!: Third-Party Copyright Infringement Liability Reaches Investors & Lenders*, 38 SW. U. L. REV. 89, 93 (2008).

³⁶ *E.g.*, Warner Bros., Inc. v. Lobster Pot Inc., 582 F.Supp. 478, 482 (N.D. Ohio 1984) (citing Famous Music Corp. v. Bay State Harness Horse Racing and Breeding Ass'n, Inc., 554 F.2d 1213, 1215 (1st Cir. 1977)). See also *Grokster*, 545 U.S. at 914; *Gershwin Pub. Corp. v. Columbia Artists Mgmt., Inc.*, 443 F.2d 1159, 1163 (2d Cir. 1971); *Shapiro, Bernstein & Company v. H.L. Green Company*, 316 F.2d 304, 307 (2d Cir. 1963); 6 PATRY, *supra* note 20, at § 21:41 ("The essence of vicarious liability is the right to control the infringing conduct and derivation of a financial benefit from that conduct.").

³⁷ *Gershwin Pub. Corp. v. Columbia Artists Mgmt., Inc.*, 443 F.2d at 1162 (one who promotes or induces the infringing acts of a performer need have no actual knowledge of copyright monopoly impairment in order to be held jointly and severally liable as a "vicarious"-infringer).

from customers or advertisers, or dividends or distributions from Veoh.³⁸ Instead, UMG alleged that infringement "attract[ed] users and advertising dollars to Veoh, and increase[d] the value of [the investors'] financial interests . . . [and] profit . . . through the sale of Veoh . . . [or] public offering."³⁹ The Court concluded that the investors' financial benefit was too far removed from the alleged infringement to be considered a "direct" financial interest.⁴⁰ Merely having an objective of increasing ownership value is neither sufficiently invidious nor of sufficiently "direct" benefit to make an investor secondarily liable for copyright infringement.⁴¹

The *Veoh* court distinguished three leading cases on vicarious infringement. *Fonovisa, Inc. v. Cherry Auctions, Inc.*⁴² and *A&M Records, Inc. v. Napster Inc.*,⁴³ where liability was found, and *Ellison v. Robertson*,⁴⁴ where it was not. As none of these cases involved investors in the classic sense, their holdings are only analogous.

In *Fonovisa*, the plaintiff sued a flea market operator for facilitating copyright infringement through "swap meet" style sales of musical recordings.⁴⁵ The Ninth Circuit reversed the district court's decision to dismiss the suit and held the complaint sufficiently alleged vicarious copyright infringement arising from the sale of pirated music by vendors. The defendant derived substantive benefit from vendor rental fees, customer admissions fees, and revenues from supporting services.⁴⁶ The court of appeals also found that the defendant financially benefitted from the infringement because the availability of pirated recordings "drew" customers, thereby increasing defendant's revenues.⁴⁷

In *Napster*, eighteen record companies sued to enjoin Napster

³⁸ UMG Recordings, Inc. v. Veoh Networks Inc., No. CV 07-5744 AHM, 2009 WL 334022, at *6 (C.D. Cal. Feb. 2, 2009).

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Fonovisa, Inc. v. Cherry Auction, Inc.*, 76 F.3d 259 (9th Cir. 1996).

⁴³ *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001).

⁴⁴ *Ellison v. Robertson*, 357 F.3d 1072 (9th Cir. 2004).

⁴⁵ *Fonovisa*, 76 F.3d at 261.

⁴⁶ *Id.* at 263.

⁴⁷ *Id.*

from offering its file-sharing technology to its subscribers.⁴⁸ The plaintiffs based their lawsuit on the ground that customers were using Napster's technology to commit copyright infringement.⁴⁹ The court granted a preliminary injunction until Napster took action to prevent future infringement.⁵⁰ The Ninth Circuit held Napster liable for vicarious copyright infringement, finding "ample evidence . . . that Napster's future revenue is directly dependent upon 'increases in userbase.' More users register with the Napster system as the 'quality and quantity of available music increases.'"⁵¹

Ellison involved an appeal of summary judgment dismissing a copyright infringement lawsuit filed by an author.⁵² The suit claimed that an individual, the alleged direct infringer, had posted a copy of the plaintiff's copyrighted works on a peer-to-peer file-sharing network.⁵³ The suit also alleged that the Internet service provider, America Online ("AOL"), was vicariously liable for copyright infringement due to the direct financial benefit it received because of the defendant's actions.⁵⁴ The Ninth Circuit upheld the dismissal of plaintiff Ellison's liability claim against AOL.⁵⁵ As to AOL, the court found no proof that it benefitted financially from attracting subscribers who infringed copyrights or failing to obstruct subscriber infringement.⁵⁶

The *Veoh* holding suggests that establishing investor liability for vicarious infringement requires more than merely proving an investment objective. Instead, plaintiffs need to demonstrate that the investors derived direct financial benefit from the infringement itself.

⁴⁸ *A&M Records, Inc. v. Napster, Inc.*, 114 F.Supp.2d 896, 900 (N.D. Cal. 2000).

⁴⁹ *Id.*

⁵⁰ *Id.* at 927.

⁵¹ *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004, 1023 (9th Cir. 2001) (citing *A&M Records, Inc. v. Napster, Inc.*, 114 F.Supp.2d 896, 902 (N.D. Cal. 2000) ("The existence of a large user base that increases daily and can be "monetized" makes Napster, Inc. a potentially attractive acquisition for larger, more established firms.")).

⁵² *Ellison v. Robertson*, 357 F.3d 1072, 1074 (9th Cir. 2004).

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.* at 1079.

⁵⁶ *Id.*

Veoh did not demonstrate the latter, as the "ability to supervise" prong of the vicarious liability test was not considered by the court because it found no direct financial benefit. Investors must also be vigilant to avoid the third type of secondary copyright infringement liability, namely, inducement of copyright infringement.

IV. INFRINGEMENT LIABILITY REQUIRES INDUCEMENT VIA PRODUCT DISTRIBUTION

Liability for inducement to infringe copyright requires distribution of a product "necessary for the infringement to occur."⁵⁷ As the *Veoh* court stated it, "Inducement to infringe copyright requires distribution of a device with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement."⁵⁸

Veoh did not analyze criteria for determining when investing in a company distributing a service, such as an Internet TV network, rather than a product, would result in secondary liability for infringement under an inducement theory. This was because *Veoh* found the allegations of the complaint insufficient to assert encouragement of infringement in connection with the distribution of such services. However, prior to financing file-transfer technology, investors should consider potential legal ramifications of distributing copyrighted material via these media as they have already been considered susceptible to inducement to infringe claims.⁵⁹

In *In re Aimster Copyright Litigation* ("Aimster"),⁶⁰ the Northern District of Illinois assumed that the provision of file-sharing software and a downloading service could form the basis of an inducement to infringement claim. Aimster was found liable for secondary copyright infringement.⁶¹ Specifically, by advertising that clicking on a "play"

⁵⁷ Foley, *supra* note 35, at 102 (quoting 2 PAUL GOLDSTEIN, GOLDSTEIN ON COPYRIGHT § 8:10 (3d ed. 2008)).

⁵⁸ UMG Recordings, Inc. v. Veoh Networks Inc., No. CV 07-5744 AHM, 2009 WL 334022, at *6 (C.D. Cal. Feb. 2, 2009).

⁵⁹ See *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 942 (2005); *In re Aimster Copyright Litigation*, 252 F. Supp. 2d 634, 653 (N.D. Ill. 2002).

⁶⁰ *In re Aimster Copyright Litigation*, 252 F. Supp. 2d 634 (N.D. Ill. 2002).

⁶¹ *Id.* at 652.

button would prompt the software to automatically create a connection between users' computers to facilitate finding, copying, and distributing copyrighted files, Aimster created a "road map" for its customers to commit copyright infringement.⁶² However, exceptions have been made for products widely used for legitimate, unobjectionable purposes, or capable of substantial non-infringing uses.⁶³ For example, although people can use a videocassette recorder to illegally copy and distribute a copyrighted movie, they are much more likely to use it to "time shift", that is, to record the movie for later personal viewing.⁶⁴ *Aimster* did not have substantial non-infringing uses and, in any event, the "substantial non-infringing use" defense was found inapplicable to services involving an ongoing relationship.⁶⁵

In its rather brief analysis of liability for inducement to infringe copyright, the *Veoh* Court cited the latest United States Supreme Court decision on inducement to infringe, *MGM Studios v. Grokster*.⁶⁶ In *Grokster*, artists, music publishers, and movie studios sued the distributors of peer-to-peer file sharing software for copyright infringement inducement.⁶⁷ The Supreme Court, in finding the defendant liable for inducement to infringe copyright, held that "one who distributes a device with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties."⁶⁸ The *Veoh* Court distinguished *Grokster* by finding that UMG did not claim the investors "encouraged" infringement through the mere distribution of *Veoh*'s video downloading service.⁶⁹

⁶² *Id.*

⁶³ *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 442 (1984).

⁶⁴ *Id.* at 443.

⁶⁵ *Aimster*, 252 F.Supp. 2d at 653.

⁶⁶ *UMG Recordings, Inc. v. Veoh Networks Inc.*, No. CV 07-5744 AHM, 2009 WL 334022, at *6 (C.D. Cal. Feb. 2, 2009).

⁶⁷ *Grokster*, 545 U.S. at 913.

⁶⁸ *Id.* at 936-37.

⁶⁹ *Veoh*, 2009 WL 334022, at *6.

V. IMPACT OF *VEOH*: INVESTORS NOT PER SE LIABLE, BUT DUE DILIGENCE STILL ESSENTIAL

The development of secondary copyright infringement law has historically favored the rights of copyright holders. Investors, therefore, face the risk of being held liable for the infringing activities of their target companies. This risk creates a potential chilling effect on capital investment.⁷⁰

Veoh provides some comfort to investors considering providing funds to high-technology companies. Nevertheless, issues related to secondary liability remain unresolved by *Veoh*. First, because the court found UMG's direct financial interest insufficient, it bypassed the "ability to supervise" prong of the vicarious liability test.⁷¹ In addition, the court's inducement to infringe analysis in *Veoh* was very cursory, making it of little use in refining the boundaries of this cause of action as applied to investors. As a general matter, the factors on which secondary liability rests involve subjective concepts such as "control," "supervision," "ability to supervise," "reason to know," "material assistance," "encouragement of infringement," and "direct financial interest," which seem bound to lead to contrary results on similar facts. All of this foreshadows additional showdowns between investors and copyright advocates looking to improve their respective rights.

Yet, even though *Veoh* does not resolve all issues of secondary liability, it still provides several important lessons for investors. Investors should carefully assess their potential exposure to liability for the infringing actions of their investment targets. Courts strive to support commerce and the arts by maintaining balance between investor and copyright holder rights when applying copyright law. Practitioners and investors, however, must understand that case law has historically favored the rights of copyright holders.

Prospective investors should obtain a "warranty of no knowledge"

⁷⁰ Foley, *supra* note 35 at 92. See also 6 PATRY, *supra* note 20, at § 21:48.50 (stating that holding investors liable for copyright infringement for merely providing financial assistance "gives a tool of evil to those who need no further such further tools in their unshakable thirst for crushing innovation, competition, and consumers.").

⁷¹ *Veoh*, 2009 WL 334022 at *5.

of copyright infringement from their targets in order to minimize exposure to secondary liability.⁷² This warranty should include a statement that the target has not received copyright infringement complaints, or, alternatively, full disclosure of all known infringements. In addition to providing comfort as to the facts, such a warranty may be useful to the investor in defending against a secondary infringement claim. Specifically, the absence of infringements mentioned in the warranty could be cited to defeat the knowledge prong of contributory infringement.

However, obtaining a “no knowledge” warranty does not relieve the investor of the need to thoroughly research the activities of investment targets.⁷³ As a practical matter, infringements could still exist without knowledge and be the source of vicarious liability, where knowledge is not an issue. More significantly, the entity making the representation may be poorly capitalized and unable to compensate the investor for the damages resulting from infringement claims.

The final lesson is that investors should remain vigilant to avoid any conduct on their part after investment that could be causally linked to copyright infringement. Examples of such actions include specifically ordering infringing activity to take place⁷⁴ or the failure of the investor to use its operational control (to the extent it has it) to order stoppage of copyright infringement once made aware of it.⁷⁵

In sum, *Veoh* and analogous cases expose the infringement liability risks of investing in firms providing high-technology services or products. The fact that the investors were found not liable in *Veoh* is encouraging to investors hoping to avoid secondary liability for making such investments. However, because of the prohibitive penalties for copyright infringement (not to mention the potential for loss of the investment if the infringing conduct is enjoined), the dearth of cases, and the lack of clear guidelines, caution is still

⁷² Foley, *supra* note 35 at 129.

⁷³ *Id.* (“Any such guarantee by the financing target should also be coupled with the financier’s own due diligence. Financiers rely on others’ due diligence at their own detriment.”).

⁷⁴ UMG Recording, Inc. v. Bertelsmann AG, 222 F.R.D. 408, 413 (N.D. Cal. 2004).

⁷⁵ A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1023 (9th Cir. 2001)

advisable. Investors should perform thorough due diligence before and after making a capital investment in high-technology companies. The practice pointers following this Article provide suggestions for legal practitioners advising investors looking to anticipate and limit their secondary liability.

CONCLUSION

The *Veoh* court has demonstrated that the standards for determining secondary copyright infringement liability are still far from settled. Investing in an infringing company and controlling its overall operations are not, in and of themselves, sufficient grounds for derivative liability. The absence of knowledge (or reason to know) of the infringing activity protects against liability for contributory infringement, but not vicarious infringement if there is a direct financial benefit derived from the infringement. To distill it down conceptually, the plaintiff must establish sufficient causation between the infringing activity and the investor’s financial benefit and operational control. In making such determinations, courts strive to balance investor and copyright holder rights.

PRACTICE POINTERS

- Perform due diligence to determine current and potential uses of the target company’s technology. This effort should include the compilation and review of documents held by the company providing permission to use copyrighted works of third parties. Where due diligence does not provide clear answers about infringement, consider the company’s potential value without the arguably infringing elements, should they be enjoined or discontinued, before making the investment.
- Negotiate for a warranty and representation from the investment target company that, to the target’s knowledge, no third party is using the target’s technology to infringe copyrights. In addition, the target should warrant and represent that it has not received complaints from copyright holders or, if the company has received complaints—or will receive such complaints in the future—it must disclose germane information to the investor by giving proper notice.

- Obtain indemnification from the target against all losses resulting from any third-party copyright infringement claims arising from use of the target's technology. Note, however, that indemnity is only as good as the capitalization of the entity providing it; if the indemnity would merely come out of one pocket and go into another—with respect to equity investors—then investigate whether insurance is an option.
- Be mindful that if the returns on the investment are paid directly out of revenues, and the revenues are heavily influenced by infringing activities, then the risk of liability for vicarious infringement appears somewhat greater than if the return on investment will come from the ultimate appreciation of the equity.

EXPORTABILITY'S EFFECT ON PROCESS PATENT
ENFORCEMENT: WHY § 271(F) EXPORT RESTRICTIONS DO
NOT APPLY TO INTANGIBLE PROCESS CLAIMS

Homer Yang-hsien Hsu^{*}

© Homer Yang-hsien Hsu

CITE AS: 6 WASH. J.L. TECH. & ARTS 233 (2011)
<https://digital.lib.washington.edu/dspace-law/handle/1773.1/562>

ABSTRACT

*Congress enacted 35 U.S.C. § 271(f) to broaden U.S. patent protection and prohibit shipping patented devices in smaller components for assembly overseas. Section 271(f) creates an infringement cause of action for sending components outside the United States for assembly. Whether § 271(f)—which clearly applies to physical things—also applies to process claims has been hotly debated. In *Cardiac Pacemakers, Inc. v. St. Jude Med Inc.*, the United States Court of Appeals for the Federal Circuit held that § 271(f) does not apply to process claims because a component of a process claim is an intangible step that cannot be physically supplied. This Article surveys the origins of 35 U.S.C. § 271(f), examines how courts applied the statute before *Cardiac Pacemakers*, analyzes the Federal Circuit's reasoning in *Cardiac Pacemakers*, and discusses implications for those with process claims. Although § 271(f) offers limited protection against acts giving rise to foreign commercial activity, *Cardiac Pacemakers* suggests patent attorneys should consider possible claims for tangible combinations elements occurring during performance of intangible processes.*

^{*} Homer Yang-hsien Hsu, University of Washington School of Law, Class of 2011. Many thanks to Professor Anita Ramasastry, University of Washington School of Law, and Timothy Siegel, a private-practice patent attorney in Bellevue, Washington, for all their valuable thoughts on this article.

TABLE OF CONTENTS

Introduction.....	234
I. Origin of the Export Restriction in 35 U.S.C. § 271(f)	236
II. Export Restriction Applies to Process Claims before <i>Cardiac Pacemakers</i>	238
III. The <i>Cardiac Pacemakers</i> Decision and Its Reasoning.....	239
IV. What Are the Components of a Process Claim?.....	241
V. A Pragmatic Interpretation: Cannot Be Supplied, Cannot Apply.....	242
VI. Presumption against Extraterritoriality and Other Possible Factors	243
VII. Implications of the <i>Cardiac Pacemakers</i> Decision	244
Conclusion	245
Practice Pointers.....	245

INTRODUCTION

Direct patent infringement occurs when the actions or products of an unlicensed party meet all the limitations of a patent claim, while inducement and contributory infringement occur when a party intentionally encourages or causes a third-party to infringe.¹ Inducement infringement occurs when a party intentionally encourages or otherwise causes a third party to infringe a patent.² Contributory infringement occurs when a party knowingly provides a material component within the United States that will be used in something covered by a patent.³

To provide stronger protection of products covered by U.S. patents, Congress enacted § 271(f) of the Patent Act, which expanded the definition of patent infringement to include exporting a substantial portion of the components of a patented invention “in

¹ Patent law regulates two types of infringement: direct infringement and indirect infringement. *See* 35 U.S.C. § 271(a) (2006). Indirect infringement includes contributory infringement, *See* 35 U.S.C. § 271(c), (f), (g). Indirect infringement also includes inducement infringement. 35 U.S.C. § 271(b).

² 35 U.S.C. § 271(b).

³ 35 U.S.C. § 271(c).

such manner as to actively induce the combination of such components outside of the United States in a manner that would infringe the patent . . .”⁴ The Act was clearly designed to prevent U.S. manufacturers from circumventing patent protections by shipping components out of the country for overseas assembly.

The statutory language does not, however, state whether § 271(f) also applies to intangible process claims. (A process claim, also known as a method patent, protects the series of steps taken to manufacture something.) Instead, the section applies to a “patented invention” and does not explicitly refer to more specific terms like “apparatus” or “process.”⁵ U.S. patent law does protect both apparatuses and processes; both could arguably be considered a “patented invention.”⁶ On the other hand, the statute refers to “components” and it has been asserted this signals the legislature’s intent to exclude intangible methods. Such statutory ambiguities have been a source of longstanding confusion.⁷

Cardiac Pacemakers, Inc. v. St. Jude Med Inc.,⁸ significantly changes the law because the United States Court of Appeals for the Federal Circuit (“Federal Circuit”) overruled its 2005 *Union Carbide Chemicals v. Shell Oil*⁹ decision and held that the export

⁴ 35 U.S.C. § 271(f) (“Whoever . . . supplies or causes to be supplied in or from the United States all or a substantial portion of the components of a patented invention, where such components are uncombined in whole or in part, in such manner as to actively induce the combination of such components outside of the United States in a manner that would infringe the patent if such combination occurred within the United States, shall be liable as an infringer . . .”).

⁵ Instead of using the specific terms like “apparatus claims” or “process claims,” 35 U.S.C. § 271(f) uses the term “a patented invention.”

⁶ 35 U.S.C. § 101 (2006) (“Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor . . .”).

⁷ See, e.g., Alejandro Valencia, *Inequitable Results in Transnational Patent Infringement Liability: Closing the Method Loophole*, 2008 BOS. COLL. INTELL. PROP. & TECH. F. 032501 (2008).

⁸ *Cardiac Pacemakers, Inc. v. St. Jude Med., Inc.*, 576 F.3d 1348 (Fed. Cir. 2009).

⁹ *Union Carbide Chemicals & Plastics Tech. Corp. v. Shell Oil Co.*, 425 F.3d 1366 (Fed. Cir. 2005).

restriction in § 271(f) does not apply to process claims.¹⁰ In reaching this decision, the Federal Circuit mainly relied on the United States Supreme Court's 2007 decision in *Microsoft Corp. v. AT&T Corp.* (“*AT&T SC*”).¹¹ *AT&T SC* narrowly interpreted the export regulation and held master disks were not a § 271(f) component when sent abroad to be copied and then installed to form a would-be infringing system.¹² The Court had based its decision on the extraterritorial theory:

Recognizing that § 271(f) is an exception to the general rule that our patent law does not apply extraterritorially, we resist giving the language in which Congress cast § 271(f) an expansive interpretation.¹³

This Article first discusses the origins of § 271(f) and how courts prior to *Cardiac Pacemakers* applied the statute. This Article further analyzes the *Cardiac Pacemakers* decision and the Federal Circuit's reasoning, and then discusses the possible implications of the *Cardiac Pacemakers* decision.

I. ORIGIN OF THE EXPORT RESTRICTION IN 35 U.S.C. § 271(F)

U.S. patent law protects both tangible apparatuses and intangible processes.¹⁴ A process claim is a patent claim whose subject matter is a process or a method.¹⁵ Patent applicants can seek process claim protection on any new method for achieving certain useful results or any new way of utilizing existing substances. The statutory language used in § 271(f) to protect “any component of a patented invention” does not clearly indicate whether this section applies to both apparatus and process claims.

¹⁰ *Id.*

¹¹ *Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437 (2007).

¹² *Id.* at 449 n. 9.

¹³ *Id.* at 442.

¹⁴ 35 U.S.C. § 101.

¹⁵ An example of a process claim would be a method for creating a bicycle break system comprising of: mounting two wheels on a framework of a bike; connecting the two wheels to a breaking device; and configuration of the breaking device according to a predetermined parameter.

An apparatus claim has tangible elements as its components, while a process claim has intangible steps as its components. This difference between apparatus and process claims may cause distinct results when courts interpret or apply patent law to adjudicate a patent infringement case.

Prior to the enactment of § 271(f), U.S. law already recognized causes of action for contributory patent infringement¹⁶ and inducement to infringe,¹⁷ both of which are restricted to supplying tangible apparatuses and intangible processes within the United States. Section 271(f) partially expands these provisions to prohibit supplying a patented invention's components to a foreign destination, in or from the United States.¹⁸ Section 271(f) was passed in response to a Supreme Court decision, *Deepsouth Packing Co. v. Laitram Corp.*,¹⁹ which held it was not infringement to assemble a product abroad even when the unassembled parts were intentionally shipped from the United States. In *Deepsouth Packing*, the accused infringer, who shipped unassembled parts of a patented shrimp-deveining machine abroad, was not liable for patent infringement because U.S. patent law could not regulate the infringing conduct abroad.²⁰ The Supreme Court indicated that the legislative branch should resolve the issue.²¹

In response to *Deepsouth*, Congress enacted § 271(f) to bar the exportation of components from the U.S. to overseas locations with the intent that they be assembled abroad.²² After the statute was enacted, several issues regarding interpretation have been raised. One issue is whether the scope of the "patented invention"

¹⁶ 35 U.S.C. § 271(c).

¹⁷ 35 U.S.C. § 271(b).

¹⁸ 35 U.S.C. § 271(f).

¹⁹ 406 U.S. 518 (1972).

²⁰ *Id.* at 527.

²¹ *Id.* at 532 (holding that absent a clear congressional indication of intent, courts had no warrant to stop the manufacture and sale of the parts of patented inventions for assembly and use abroad).

²² See e.g. S. Rep. No. 98-663, at 2 (1984) (Conf. Rep.) (describing § 271(f) as a response to the "*Deepsouth* decision which interpreted the patent law not to make it infringement where the final assembly and sale is abroad"); see also AT&T SC, 550 U.S., at 444, n. 3 (stating that § 271(f) was enacted by Congress focusing its attention on *Deepsouth*).

also includes intangible process claims or is merely limited to tangible apparatuses. Another issue is whether the components of intangible process claims can be “supplied” abroad.

II. EXPORT RESTRICTION APPLIES TO PROCESS CLAIMS BEFORE *CARDIAC PACEMAKERS*

In 2005, the Federal Circuit interpreted § 271(f) in three different decisions. First, in *Eolas Technologies Inc. v. Microsoft Corp.*,²³ the Federal Circuit held that Microsoft was liable under § 271(f) because the software code included on Microsoft’s master disks was a “component” of a patented invention under § 271(f).²⁴ Shortly thereafter, the Federal Circuit decided a similar issue in *AT&T FC*,²⁵ holding intangible software could be “supplied” under § 271(f) when a single copy was sent abroad with the intent that it be replicated.²⁶ Then, in *NTP, Inc. v. Research in Motion Ltd.*,²⁷ the Federal Circuit held that while it is difficult to conceive of how one might supply the steps of a patented process, the supply of BlackBerry devices to customers in the U. S. did not constitute the supply step required by § 271(f).²⁸

In 2006, the Federal Circuit explicitly held that § 271(f) applied to process claims in *Union Carbide Chemicals*.²⁹ The Federal Circuit distinguished *NTP* by noting that the catalyst at issue was directly supplied to foreign affiliates whereas the infringing device in *NTP* was sold domestically and then used in a foreign

²³ *Eolas Technologies, Inc. v. Microsoft Corp.*, 399 F.3d 1325 (Fed. Cir. 2005).

²⁴ *Id.* at 1339 (holding that the “computer readable code claimed in claim 6,” the product claim, was “apart or component of that invention”).

²⁵ *AT&T Corp. v. Microsoft Corp.*, 414 F.3d 1366 (Fed. Cir. 2005).

²⁶ *Id.* at 1370.

²⁷ *NTP, Inc. v. Research in Motion, Ltd.*, 418 F.3d 1282 (Fed. Cir. 2005).

²⁸ *Id.* at 1322.

²⁹ *Union Carbide Chemicals & Plastics Tech. Corp. v. Shell Oil Co.*, 425 F.3d 1366 (Fed. Cir. 2005) (holding § 271(f) applicable to the process claims when a catalyst that was necessary to perform a patented process for producing ethylene oxide was exported abroad because the court considered the catalyst to be a “component” under in § 271(f)).

country.³⁰ Thus, the Federal Circuit held that the exportation of catalysts may result in liability under § 271(f).³¹ It then held that § 271(f) makes no distinction between patentable process inventions and other forms of patentable inventions.³²

The Supreme Court's 2007 decision, *AT&T SC*, however caused dramatic changes in the Federal Circuit's point of view regarding whether § 271(f) applies to process claims.³³ *AT&T SC* sent a clear message that the territorial limits of patents should not be extended, and thus provided certain bases for *Cardiac Pacemakers* to overrule *Union Carbide Chemicals* and hold § 271(f) does not apply to devices supplied outside the U.S. that may be used to perform a patented process.³⁴

AT&T SC held that software uncoupled from a medium cannot be considered as a combinable component in § 271(f).³⁵ In other words, only a copy of Windows (the operating system)—not Windows in the abstract—could qualify as a “component” under § 271(f).³⁶ *AT&T SC* also held that no infringement occurs when a patented product is made and sold in another country and § 271(f) is only an exception.³⁷ Without a clear Congressional indication of intent, the courts had no authority to stop the manufacture and sale of the parts of patented inventions for assembly and use abroad.³⁸

III. THE *CARDIAC PACEMAKERS* DECISION AND ITS REASONING

In *Cardiac Pacemakers*, the Federal Circuit revisited the issue

³⁰ *Id.* at 1380 (reasoning that if the shipment of master disks by copies in *Eolas Technologies* could apply § 271(f), the chemical catalyst would apply more strongly because the catalyst was directly shipped).

³¹ *Id.* at 1380.

³² *Id.* at 1379.

³³ *Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437 (2007) (holding Microsoft did not supply combinable components of a patented invention when it shipped master disks abroad to be copied and therefore Microsoft was not liable for loading Windows software abroad that was copied from a master disk dispatched from the United States).

³⁴ *Id.* at 454-56.

³⁵ *Id.* at 450.

³⁶ *Id.* at 451-52.

³⁷ *Id.* at 441.

³⁸ *Deepsouth Packing Co. v. Laitram Corp.*, 406 U.S. 518 (U.S. 1972).

of whether § 271(f) should apply to process patents. The patent in dispute³⁹ covered a process whereby implantable cardioverter-defibrillators (“ICDs”) executed appropriate heart stimulation for an identified heart condition.⁴⁰ The Plaintiffs-Appellants owned various patents relating to cardiac defibrillators and had sued Defendants-Cross Appellants⁴¹ for patent infringement, alleging the ICDs sold by defendants infringed plaintiffs’ process claim.⁴²

The United States District Court for the Southern District of Indiana ruled § 271(f) was applicable to this case.⁴³ Relying on *Eolas Technologies*, the District Court held that every component of every form of invention deserves the protection of § 271(f). Namely, “components” and “patented inventions” under § 271(f) are not limited to physical machines.⁴⁴ But the Federal Circuit reversed the district court’s decision and held that practicing the process claim outside the United States did not infringe under § 271(f).⁴⁵

The *Cardiac Pacemakers* court acknowledged receiving a number of amicus curiae briefs on the scope of § 271(f) protection and expressly showed appreciation of these contributions in a

³⁹ U.S. Patent No. 4,407,288 (issued Oct. 4, 1983).

⁴⁰ *Cardiac Pacemakers, Inc. v. St. Jude Med., Inc.*, 576 F.3d 1348, 1352 (Fed. Cir. 2009).

⁴¹ Defendants-Cross Appellants in the *Cardiac Pacemakers* case include St. Jude Medical, Inc. and Pacemaker, Inc. (collectively referred “St. Jude entities”).

⁴² The Claim 4 of the ’288 patent, the only claim at issue on appeal, is dependent on Claim 1. Claim 1 states: “A method of heart stimulation using an implantable heart stimulator capable of detecting a plurality of arrhythmias and capable of being programmed to undergo a single or multi-mode operation to treat a detected arrhythmia, corresponding to said mode of operation the method comprising: (a) determining a heart condition of the heart from among a plurality of conditions of the heart; (b) selecting at least one mode of operation of the implantable heart stimulator which operation includes a unique sequence of events corresponding to said determined condition; (c) executing said at least one mode of operation of said implantable heart stimulator thereby to treat said determined heart condition.” Claim 4 states: “The method of claim 1, wherein said at least one mode of operation of said implantable heart stimulator includes cardioversion.”

⁴³ *Cardiac Pacemakers, Inc. v. St. Jude Med., Inc.*, 418 F. Supp. 2d 1021 (S.D. Ind. 2006).

⁴⁴ *Id.* at 1044.

⁴⁵ *Cardiac Pacemakers*, 576 F.3d at 1366.

footnote of the opinion.⁴⁶ This affirmed that supportive amicus briefs might also play an important role in determining outcomes of certain Federal Circuit cases. In particular, the Federal Circuit adopted the suggestions made by the Federal Circuit Bar Association and American Intellectual Property Law Association, in their amicus brief, that § 271(f) does not apply to process claims.⁴⁷

IV. WHAT ARE THE COMPONENTS OF A PROCESS CLAIM?

The first key issue decided by the Federal Circuit was whether the term “patented invention” in § 271(f) covers process claims. The Federal Circuit looked to the plain meaning of the statute, the legislative history,⁴⁸ and the context of the statute.⁴⁹

The Federal Circuit stated that the fundamental distinction between tangible *apparatus* claims and intangible *process* claims is critical to devising statute's meaning.⁵⁰ The Federal Circuit recognized that a component of an apparatus claim is a tangible part of the product, device, or apparatus, whereas a component of a process claim is an intangible step in that process.⁵¹

By comparing § 271(f) with § 271(c), the Federal Circuit further confirmed that components of a process are also steps of the process.⁵² Thus, a component of a process claim is an intangible step, but a component of an apparatus claim is a tangible element.

⁴⁶ *Id.* at 1359 n. 2 (stating that the court has received a number of briefs amicus curiae on the § 271(f) issue and is appreciative of these contributions).

⁴⁷ Brief for Federal Circuit Bar Ass'n and American Intellectual Prop. Law Ass'n as Amici Curiae Supporting Cross-Appellants, *Cardiac Pacemakers, Inc. v. St. Jude Med., Inc.*, 576 F.3d 1348 (2009) (Nos. 2007-1296, 2007-1347), 2009 WL 1208020.

⁴⁸ *Cardiac Pacemakers*, 576 F.3d at 1362.

⁴⁹ *Id.* at 1363 (Federal Circuit considered context and stated that it is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme).

⁵⁰ *Id.* at 1362.

⁵¹ *Id.* at 1362-63.

⁵² *Id.* at 1362-63.

V. A PRAGMATIC INTERPRETATION: CANNOT BE SUPPLIED, CANNOT APPLY

Cardiac Pacemakers overruled *Union Carbide Chemicals*⁵³ by holding that a component of process claims, namely a step in a process, cannot be supplied abroad under § 271(f). In *Union Carbide Chemicals*, relying on *Eolas Technologies*,⁵⁴ the Federal Circuit had ruled that § 271(f) makes no distinction between patentable process inventions and other forms of patentable subject matters.⁵⁵ *Cardiac Pacemakers*, however, observed that in the wake of *AT & T SC*,⁵⁶ § 271(f) requires components be supplied abroad for infringement to occur, and this “supplied” requirement eliminates process patents from § 271(f)’s reach.⁵⁷

Cardiac Pacemakers reasoned that the ordinary meaning of “supply” is to “provide that which is required,” or “to furnish with supplies, provisions, or equipment.”⁵⁸ Because this meaning implies the transfer of a tangible object, the Federal Circuit reasoned that supplying an intangible step is thus a physical impossibility.⁵⁹ The Federal Circuit cited its prior *NTP* case to support its position, stating that it is difficult to conceive how one might supply or cause to be supplied all or a substantial portion of the steps contemplated by § 271(f).⁶⁰

The Federal Circuit also found support for its decision in the legislative history. The Federal Circuit reasoned that because Congress enacted § 271(f) only to resolve the *Deepsouth* issue in which only tangible subject matters were involved, the statute

⁵³ *Union Carbide Chemicals & Plastics Tech. Corp. v. Shell Oil Co.*, 425 F.3d 1366 (Fed. Cir. 2005).

⁵⁴ *Eolas Technolgies, Inc. v. Microsoft Corp.*, 399 F.3d 1325, 1339 (Fed. Cir. 2005).

⁵⁵ *Union Carbide*, 425 F.3d at 1378-79.

⁵⁶ *Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437 (2007).

⁵⁷ *Cardiac Pacemakers, Inc. v. St. Jude Med., Inc.*, 576 F.3d 1348, 1352 (Fed. Cir. 2009).

⁵⁸ *Id.* at 1364.

⁵⁹ *Id.* at 1364 (stating that even *Cardiac Pacemakers* entities did not dispute this position in their appellate brief).

⁶⁰ *NTP, Inc. v. Research in Motion, Ltd.*, 418 F.3d 1282, 1322 (Fed. Cir. 2005).

should not cover process claims unless Congress passed another law.⁶¹ Based on the reasons above, the Federal Circuit took a practical approach to decide that § 271(f) does not apply to process patents because intangible steps cannot be supplied abroad.⁶²

VI. PRESUMPTION AGAINST EXTRATERRITORIALITY AND OTHER POSSIBLE FACTORS

Following the *AT&T SC* decision, the Federal Circuit also adopted a presumption against extraterritoriality to support its decision. The presumption against extraterritoriality, which is based on the theory that a country's laws cannot reach beyond its sovereignty, presumes that U.S. legislation applies only within the domestic jurisdiction, unless a contrary intent appears.⁶³ The burden of overcoming this presumption lies with the party asserting application of U.S. laws to events that occurred abroad.⁶⁴

In *AT&T SC*, the Supreme Court had taken a narrow view of § 271(f) by stating that the presumption against extraterritoriality still applies to § 271(f), even though that section specifically extends the reach of U.S. patent law in a limited manner.⁶⁵ In light of the near complete absence of any Congressional intent to protect patented processes under § 271(f) and the explicit Congressional purpose of overruling *Deepsouth's* holding, this presumption compelled the Federal Circuit to limit the reach of § 271(f) to tangible patent claims.⁶⁶

The Federal Circuit may have also considered the potential economic effects of the high-tech industry in the United States while considering the *Cardiac Pacemakers* case. In *Cardiac Pacemakers*, most of the amicus briefs taking the position that § 271(f) should not cover process claims were prepared by high-

⁶¹ *Microsoft Corp.*, 550 U.S. at 457-58.

⁶² *Cardiac Pacemakers*, 576 F.3d at 1365-66.

⁶³ See *United States. E.E.O.C. v. Arabian American Oil Co.*, 499 U.S. 244 (1991); see also *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285 (1949).

⁶⁴ See *Labor Union of Pico Korea, Ltd. v. Pico Prods., Inc.*, 968 F.2d 191, 194 (2d Cir.), *cert. denied*, 506 U.S. 985 (1992).

⁶⁵ *Microsoft Corp.*, 550 U.S. at 454-56.

⁶⁶ *Cardiac Pacemakers*, 576 F.3d at 1365.

tech companies.⁶⁷ These companies sought to exclude process claims to make the risk of patent infringement more manageable and predictable.

VII. IMPLICATIONS OF THE *CARDIAC PACEMAKERS* DECISION

Although it is too early to say whether there is a clear trend toward limiting patent rights, *Cardiac Pacemakers* clearly reduces rights provided by process claims. Process claim patent owners and related legal practitioners should be aware of this reduced scope of patent protection. For instance, those who have process inventions may need to consider whether they want to also include tangible apparatus claims in their patent application, in order to obtain § 271(f) protection.

Because § 271(f) provides a very limited protection against acts giving rise to foreign commercial activity that would infringe if performed in the United States, it is likely that patent attorneys have rarely made a priority of drafting claims that could support a cause of action under § 271(f). Nevertheless, for those cases where it is difficult or impossible to win allowance for claims drawn to a tangible apparatus, *Cardiac Pacemakers* indicates that in lieu of or in addition to drafting method claims, patent attorneys may consider drafting claims for some tangible combination of physical elements that occurs during the performance of the method.

For example, in the case of a catalyst it may be possible to claim some intermediate compound—rather than merely patenting the method by which the catalyst performs a chemical rearrangement of an unpatentable beginning set of compounds to an unpatentable ending set of compounds. For instance, the combination of the catalyst and the compound to which it binds may be patentable—even for a brief moment in the catalytic process. This could render the catalyst a “supplied component” under § 271(f), permitting legal action against a competing U.S. supplier. In like manner, it may be possible to draft a claim for a cardiac device implanted in the body and stimulating the heart, whereby the

⁶⁷ For example, Cisco Systems, Inc., Intel Corporation, Apple Inc., Oracle Corporation, Microsoft Corporation, Symantec Corporation, and Research in Motion have filed amicus briefs to support Cross-Appellants St. Jude entities.

device in its dormant state could be considered a component of the implanted device in its stimulating state. In a case of the export of computer code, it may be possible to patent the computer code and intermediate results that occur during a state of mid-execution of the computer program. Although there is always an incentive for practitioners to define an invention in a robust set of claim variations, the *Cardiac Pacemakers* ruling provides a greater impetus and justification for this practice.

In addition, since the Federal Circuit expressly showed its appreciation to those who submitted amicus briefs, this is a signal affirming that supportive amicus briefs may affect the outcomes of the cases in the Federal Circuit.⁶⁸

CONCLUSION

The Federal Circuit expressly excluded process claims from the application of § 271(f) in the *Cardiac Pacemakers* decision. Based on the ordinary meaning, the context of the statute, and legislative history, the Federal Circuit reasoned that a component of a process claim is an intangible step, which cannot be exported abroad. Thus, the Federal Circuit ruled in a practical way that § 271(f) does not apply to process claims, and this decision was supported by the principle of the presumption against extraterritoriality.

After the *Cardiac Pacemakers* decision, process patent claim owners cannot rely on the U.S. legal system to enforce their process patent rights under the export restriction in § 271(f). Legal practitioners should consider the possible effect of this change on process claims under prosecution or litigation.

PRACTICE POINTERS

- Under *Cardiac Pacemakers*, § 271(f) prohibits exporting physical components for foreign assembly, but does not protect process patent holders from businesses that export intangible processes outside the United States. Expect to have a limited

⁶⁸*Cardiac Pacemakers*, 576 F.3d at 1359 n. 2 (stating that the court received a number of briefs amicus curiae on the § 271(f) issue and appreciated the contributions).

right of process claims and estimate possible influence for enforcement of existing patent portfolios.

- In many situations, it may not be possible to gain broad protection for an apparatus if that apparatus is solely intangible. Therefore drafters should consider opportunities for obtaining patent protection for the intermediate states of an apparatus that might occur during execution of the process. For new patent applications, consider opportunities for inserting at least one tangible apparatus claim.
- To protect process claims in jurisdictions outside the U.S., consider acquiring patents in those foreign jurisdictions rather than relying on the export restrictions of § 271(f). While setting up a patent protection strategy, consider the possibility of obtaining patents in different jurisdictions.
- Consider context an important factor when interpreting statutory provisions in patent law. Be prepared for the possible effects of multiple interpretations of undefined terms. Process claims and apparatus claim may have different applications. But when interpreting the statute, a plain reading may be the trend.

HOW MUCH IS TOO MUCH? COPYRIGHT PROTECTION OF
SHORT PORTIONS OF TEXT IN THE UNITED STATES AND
EUROPEAN UNION AFTER *INFOPAQ INTERNATIONAL A/S V.*
DANSKE DAGBLADES

*Connor Moran**

© Connor Moran

CITE AS: 6 WASH. J.L. TECH. & ARTS 247 (2011)
<https://digital.lib.washington.edu/dspace-law/handle/1773.1/563>

ABSTRACT

The recent case Infopaq International A/S v. Danske Dagblades Forening decided by the Court of Justice for the European Union could influence businesses that summarize or aggregate content. Under this ruling, excerpts of copyrighted material unproblematic in the United States could invite liability if reproduced in European Union member states. In the United States, copying words or phrases only infringes a copyright where those words or phrases are particularly unique or core to the original work. By contrast, the European Union Information Society Directive provides an exclusive right to even partial reproductions. In the Infopaq case, the European Court of Justice read the Directive to apply to eleven-word sentence fragments so long as those fragments demonstrated the author's intellectual creation. This article will examine the standards for copyright infringement of small sections of text in the United States and European Union after Infopaq.

* Connor Moran, University of Washington School of Law, Class of 2011. Thank you to Professor Anita Ramasastry for her expert guidance and to Stephanie Holmes, student editor.

TABLE OF CONTENTS

Introduction.....	248
I. Law in the United States Treats Copying of Words or Phrases as Non-Infringement in Most Cases.....	249
A. Copying Short Words or Sentences Ordinarily Qualifies as De Minimis.....	249
B. The Fair Use Doctrine Often Applies to Short, Copied Fragments.....	251
II. EU Copyright Directives Offer at Least as Much, and Probably More, Protection to Copyright Holders.....	252
III. The <i>Infopaq</i> Case.....	254
IV. Comparison of United States and EU Copyright Protection of Short Fragments After <i>Infopaq</i>	256
Conclusion: Excerpts In Europe May Infringe Copyright.....	258

INTRODUCTION

In the United States, copyright law generally does not protect against fragmentary copying of single words or short phrases. The recent Court of Justice for the European Union (“ECJ”) decision in the case *Infopaq International A/S v. Danske Dagblades Forening*¹ indicates protections in the European Union (“EU”) may apply to such fragmentary copying. That case interpreted the EU Directive 2001/29/EC on the harmonization of certain aspects of copyright and related rights in the information society (“the Information Society Directive”) to apply to eleven-word fragments copied from news articles where those fragments demonstrated the intellectual creation of the author. Because this ruling eliminates the possibility of a *de minimis* defense, EU protection of short text fragments is likely greater than that in the United States. However, disputes as to what qualifies as “intellectual creation” leave the exact contours of the right unclear.

This Article will examine treatment of fragmented copying in the United States, consider the EU Information Society Directive and the

¹ Case C-5/08, *Infopaq Int’l A/S v. Danske Dagblades Forening* [2009] ECR I-6569, available at http://curia.europa.eu/jcms/jcms/j_6 (search case no. c-5/08; then follow hyperlink labeled Judgment 2009-07-16).

impact of *Infopaq*, and compare the United States and EU approaches.

I. LAW IN THE UNITED STATES TREATS COPYING OF WORDS OR PHRASES AS NON-INFRINGEMENT IN MOST CASES

Under United States copyright law a defendant who copies short fragments of text can make two primary arguments that are based on the brevity of the copied material. First, a defendant could argue copying is *de minimis* and therefore the plaintiff cannot show substantial similarity necessary to support an infringement claim. Second, a defendant could argue that copying, although “substantial” for the purposes of the *de minimis* test, qualifies as fair use. This section will consider these two arguments in turn.

A. *Copying Short Words or Sentences Ordinarily Qualifies as De Minimis*

To make a prima facie case of copyright infringement in the United States, the plaintiff must show a defendant actually copied protected elements of copyrighted work and that defendant’s product is “substantially similar” to the original work.² When copying is so minor the works are not substantially similar, the copying is *de minimis* and the prima facie case fails.³

Copyright does not protect all elements of a work, and therefore not all elements are considered when determining if copying rises above *de minimis*. Copyright only protects elements of a work that demonstrate some minimal creativity.⁴ Copyright protection also extends to expression of ideas and facts, but not those ideas and facts themselves.⁵ Factual works such as news articles demonstrate

² 4 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 13.03 (Matthew Bender, Rev. Ed. 2010).

³ *Newton v. Diamond*, 349 F.3d 591, 595 (9th Cir. 2003) (“To say that a use is *de minimis* because no audience would recognize the appropriation is thus to say that the works are not substantially similar”).

⁴ *Feist Publ’ns, Inc. v. Rural Tel. Serv. Co., Inc.*, 499 U.S. 340, 345 (1991).

⁵ *Int’l News Serv. v. Associated Press*, 248 U.S. 215, 234 (1918); *Chicago Record-Herald Co. v. Tribune Ass’n* 275 F. 797, 798-799 (7th Cir. 1921).

originality, if at all, with expressive factors such as arrangement and choice of words.⁶ When a work contains both protected expressive elements and unprotected elements such as facts, a court determines whether the new work infringes by considering what elements are similar between the two and then determining whether copyright protects the similar elements.⁷

In practice, similar or identical words or phrases, without more, generally qualify as *de minimis* and therefore not infringement.⁸ However, courts have held works infringing based on single brief sentences when those sentences demonstrate particular originality or form the core of the protected work. For example, one court held it violated copyright law to use a sentence from the *Night of the Living Dead* screenplay—“When there is no more room in hell . . . the dead will walk the earth”—in the promotional material of a competing film.⁹ Other courts, while holding short copied sections not to infringe, have suggested particularly original or important segments or even single words might merit protection.¹⁰

⁶ *Int'l News*, 248 U.S. at 234; *Chicago Record-Herald*, 275 F. at 799.

⁷ *Tufenkian Import/Export Ventures, Inc. v. Einstein Moomjy, Inc.*, 338 F.3d 127, 134-35 (2d Cir. 2003).

⁸ *CMM Cable Rep, Inc. v. Ocean Coast Props., Inc.*, 97 F.3d 1504, 1519-20 (1st Cir. 1996) (no substantial similarity based on identical words describing similar radio call-in competition); *Alberto-Culver Co. v. Andrea Dumon, Inc.*, 466 F.2d 705, 711 (7th Cir. 1972) (denying protection to the phrase “the most personal form of deodorant”); *Brainard v. Vassar*, 625 F. Supp. 2d 608, 620-21 (M.D. Tenn. 2009) (finding that no reasonable jury could find substantial similarity between defendant’s and plaintiff’s song in spite of one nearly identical line presented in a musically similar way); *Stratchborneo v. Arc Music Corp.*, 357 F. Supp. 1393, 1404 (S.D.N.Y. 1973) (song lyric “Got my mojo working but it just won’t work on you” is a neither particularly unique nor qualitatively important and so will not support a finding of substantial similarity).

⁹ *Dawn Assocs. v. Links*, 203 U.S.P.Q. (BNA) 831 (N.D. Ill. 1978). *See also* *Universal City Studios, Inc. v. Kamar Indus., Inc.*, 217 U.S.P.Q. (BNA) 1162 (S.D. Tex. 1982) (copying “E.T. Phone Home” and “I Love You, E.T.” onto coffee mugs qualifies as copyright infringement).

¹⁰ *Narell v. Freeman*, 872 F.2d 907, 912 (9th Cir. 1989) (suggesting that copying of poetic recitation of history, in contrast to ordinary phrases describing history involved in the case, might qualify as infringement); *Heim v. Universal Pictures Co.*, 154 F.2d 480, 487 n.8 (2d Cir. 1946) (commenting in passing that highly evocative short phrases could constitute copyright infringement even if small quantitatively); *Life Music, Inc. v. Wonderland Music Co.*, 241 F. Supp. 653, 656

When applying these rules to news article summaries, the United States Court of Appeals for the Second Circuit held one paragraph literally translated from a six paragraph foreign-language article was non-infringing, but held other summaries that copied more than half of articles to be infringement.¹¹ Protection for short text fragments has varied in different courts and cases in the United States.¹² Nonetheless, it appears that most United States courts would treat an eleven-word fragment copied from a news article as non-infringing absent special circumstances.

*B. The Fair Use Doctrine Often Applies to Short, Copied
Fragments*

Unlike a *de minimis* defense, which challenges the elements of copyright infringement, fair use is an affirmative defense. It provides that certain otherwise infringing uses of copyrighted work are valuable and protected from liability. Four statutory factors determine applicability of fair use: “(1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work.”¹³ These factors are not isolated from each other but operate together in light of the purposes of copyright.¹⁴ Brevity of copying impacts the first, third and fourth fair-use factors, although there is no amount of copying so small as to be presumptively fair use.¹⁵

The key question in the first fair-use factor is the degree to which defendant’s work is “transformative” of the original, whether it adds

(S.D.N.Y. 1965) (protection for single word “SUPERCALAFALISTICK-ESPEEALADOJUS” “conceivable” if it were original to plaintiff).

¹¹ *Nihon Keizai Shimbun, Inc. v. Comline Bus. Data, Inc.* 166 F.3d 65, 71 (2d Cir. 1999).

¹² *Compare Dawn Assocs.*, 203 U.S.P.Q. (BNA) at 831 *with Stratchborneo*, 357 F. Supp. at 1404.

¹³ 17 U.S.C § 107 (2006).

¹⁴ *Campbell v. Acuff-Rose Music, Inc.* 510 U.S. 569, 578 (1994).

¹⁵ *See id.* at 577 (citing *Harper & Row, Publishers, Inc. v. Nation Enters.*, 471 U.S. 539 (1985) (fair use is not to be determined on the basis of bright line rules)).

something to the original or uses it for a different purpose or in a different manner.¹⁶ Short excerpts from copyrighted works tend to be more transformative than longer sections.¹⁷ The third factor, amount and substantiality of portion used, directly relates to brevity but is not merely quantitative. Courts consider whether the amount copied is reasonable in light of the purpose and character of the alleged fair use.¹⁸ The quantity copied also impacts the fourth fair-use factor, the effect of the use on the potential market for plaintiff's work, because a longer section is more likely to fulfill the market demand for the original.¹⁹

Overall, under United States law, short fragments of copied text do not ordinarily infringe copyright. The *de minimis* defense created by the requirement of substantial similarity allows many short copies to defeat a prima facie showing of copyright infringement. Even when the prima facie case can be made, the fair use defense is often available in cases involving short fragments of text. The result is that copying short fragments, without more, is rarely copyright infringement in the United States. The EU does not offer similar defenses in its copyright harmonization.

II. EU COPYRIGHT DIRECTIVES OFFER AT LEAST AS MUCH, AND PROBABLY MORE, PROTECTION TO COPYRIGHT HOLDERS

In 2001, the European Union mandated strong copyright protections in all member states by adopting the Information Society Directive.²⁰ Previously the EU adopted only piecemeal directives

¹⁶ *Campbell*, 510 U.S. at 578-79 (use of elements of original song for parody is transformative); *See, e.g., Perfect 10, Inc. v. Amazon.com, Inc.* 508 F.3d 1146, 1165 (9th Cir. 2007) (thumbnail images used to point to web sites are transformative compared with the same images used for their aesthetic characteristics).

¹⁷ *Campbell*, 510 U.S. at 587-88; Johnathan Dowell, *Bytes and Pieces: Fragmented Copies, Licensing, and Fair Use in a Digital World*, 86 CALIF. L. REV. 843, 871 (1998).

¹⁸ *Compare Campbell*, 510 U.S. at 588 (parody did not appropriate more than necessary to "conjure up" the object of the parody), *with Harper & Row*, 471 U.S. at 564-565 (relatively short copied passage not fair use because it appropriates "heart of original work").

¹⁹ *Campbell*, 510 U.S. at 587-88.

²⁰ Council Directive 2001/29, 2001 O.J. (L 167) 1, 16 (EC). A directive is a

targeted at areas such as computer programs and databases, but the Information Society Directive addressed all creative works. The Information Society Directive requires member states to grant authors the exclusive right of reproduction of their works in whole or in part.²¹

The exceptions to this exclusive reproduction right are limited, with one required under the Information Society Directive and an exclusive list of exceptions that may be provided at the discretion of member states. The only exception required by the Information Society Directive is for transient copying that occurs as part of a technical process, such as the loading of Web pages into a computer's memory to browse the Internet.²² The Directive also allows member states to provide certain specific exceptions to the exclusive reproduction right. Permissible exceptions include use for teaching or research so long as credit is given, quotations for review or criticism, incidental use in other works, or other "minor" exceptions already existent in member states.²³ As these exceptions are permissive rather than mandatory, persons copying protected works in these ways must look to national law for protection. The Directive does not permit any exception not listed.

Read literally, the Information Society Directive could forbid the copying of even the smallest amount of text, as it provides for exclusive reproduction rights of works "in part" and provides no limit on how much copying is required to qualify as an impermissible "reproduction in part." There is no equivalent to the American substantial similarity test in the Directive. It also lacks an originality requirement, which could provide a limit on liability. Previous EU directives concerning databases and computer programs required originality as a prerequisite for protection, defining originality based on whether the work demonstrated intellectual creation.²⁴ With no

binding act of a EU body that creates an objective member states must work to achieve with national legislation. Unlike regulations, directives create direct effect upon the legal relations between individuals as well as obligations for member state governments. 1 A. G. TOOTH, *Directive*, in THE OXFORD ENCYCLOPAEDIA OF EUROPEAN COMMUNITY LAW (1990).

²¹ Council Directive 2001/29, art. 2, 2001 O.J. (L 167) 1, 16 (EC).

²² *Id.* at art. 5.

²³ *Id.*

²⁴ GUY TRITTON ET AL., INTELLECTUAL PROPERTY IN EUROPE 534 (3d ed.

requirement that copied sections demonstrate any amount of originality, in theory even the most minimal amount of copying could be actionable.²⁵

Even were the Information Society Directive to apply the intellectual creation requirement as a prerequisite for protection, the exact meaning of this standard would be unclear. Courts and commentators interpreting intellectual creation in the context of previous EU directives have come to various conclusions.²⁶ Some have considered it the equivalent of the very low standard previously adopted in the United Kingdom and Ireland, which requires only that the work not have been copied.²⁷ Others took the standard to be closer to the old continental standards requiring an author's distinctive stamp to be on the work in order to qualify for copyright protection.²⁸ Several commentators have argued that the best understanding of this standard is as equivalent to the United States originality requirement articulated in *Feist Publications, Inc. v. Rural Telephone Service Co.*, that the element of the work allegedly copied demonstrate some "minimal level of creativity."²⁹

III. THE *INFOPAQ* CASE

The European Court of Justice ("ECJ") addressed the question of how much copying could be actionable under the Information Society Directive in the case of *Infopaq International A/S v. Danske Dagblades Forening*.³⁰ Infopaq is a Danish media monitoring company.³¹ The company scans news media into a computer database

2008).

²⁵ *Id.*

²⁶ Joris Deen, *Originality in Software Law: Belgian Doctrine and Jurisprudence Remain Divided*, 2 J. INTELL. PROP. L. & PRAC. 692, 694 (2007).

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*; Estelle Derclaye, *Software Copyright Protection: Can Europe Learn from American Case Law?* 22 EURO, INTELL. PROP. REV. 56, 65-66 (2000).

³⁰ Case C-5/08, *Infopaq Int'l A/S v. Danske Dagblades Forening* [2009] ECR I-6569, available at http://curia.europa.eu/jcms/jcms/j_6 (search case no. c-5/08; then follow hyperlink labeled Judgment 2009-07-16).

³¹ *About Infopaq*, INFOPAQ, <http://www.infopaq.net/about.pab> (last visited Jan. 21, 2011).

and searches for keywords clients ask them to monitor. Infopaq then provides clients with “summaries” of news articles, consisting of the keyword and the five words before and after.³² Danske Dagblades Forening, an association of Danish newspapers, approached Infopaq and asserted that Infopaq required permission to copy the works of its members.³³ Infopaq disagreed and sued for a declaratory judgment that it had the right to capture data from newspapers.³⁴

The lower court denied the claim for declaratory judgment.³⁵ Infopaq appealed to the Dutch Supreme Court, the Højesteret, which referred several questions to the European Court of Justice.³⁶ The court asked whether eleven-word fragments like the ones Infopaq generated could qualify as reproduction in part for the Information Society Directive.³⁷

The ECJ concluded that eleven-word fragments can constitute impermissible reproduction in part, so long as those fragments convey the intellectual creation of the original author. The ECJ first held that the Information Society Directive required interpretation in light of the general purposes of international copyright protection.³⁸ The court then argued that the Berne Convention embodies the principle that protecting a work presupposes that the work is an “intellectual creation,” and also pointed to the use of this “intellectual creation” standard in previous EU directives.³⁹

Based on this analysis, the ECJ held that although the term does not appear in the Information Society Directive, the directive protects

³² Opinion of Advocate General Trstenjak, Case C5/08, *Infopaq International A/S v. Danske Dagblades Forening* http://curia.europa.eu/jcms/jcms/j_6 (search case no. c-5/08; then follow hyperlink labeled Opinion 2009-02-12), para. 9-15.

³³ *Id.* at para. 16.

³⁴ *Id.* at para. 17.

³⁵ *Id.*

³⁶ *Id.* at para. 20. This is a procedure known as a referral for a preliminary ruling, wherein the ECJ provides responses to questions concerning the interpretation of Community law in the context of ongoing national litigation. It is an interim step; after the issuance of the preliminary ruling, the national court will determine the disputed issues in light of the ECJ’s ruling. 1 TOTH, *supra* note 20, at 415-16.

³⁷ *Infopaq*, [2009] ECR I-6569 at para. 26.

³⁸ *Id.* at para. 32 (Citing Case C-306/05, *Sociedad General de Autores y Editores de España (SGAE) v. Rafael Hoteles SA*, 2006 ECR I-11519 (2006)).

³⁹ *Id.* at para. 34-35.

works only to the extent that they represent the author's intellectual creation.⁴⁰ The Information Society Directive treats parts of works in the same way as it treats whole works.⁴¹ Therefore the ECJ held that the exclusive reproduction right applies to parts of works if and only if those parts manifest intellectual creation.⁴²

The court provided some guidance as to what this intellectual creation requirement would mean in the context of a news article. Such intellectual creation would be manifested, if at all, in the form and manner of the subject's presentation and the author's linguistic expression.⁴³ Individual words could not manifest this intellectual creation, but the arrangement or selection of such words could.⁴⁴ The court refused to rule out the possibility that an eleven-word fragment could manifest intellectual creation.⁴⁵ However, the ECJ left final determination of whether, as a factual matter, the eleven-word fragments in this case manifested intellectual creation with the national court.⁴⁶

IV. COMPARISON OF UNITED STATES AND EU COPYRIGHT PROTECTION OF SHORT FRAGMENTS AFTER *INFOPAQ*

Because final determination of whether the fragments in question manifested intellectual creation rests with the national court, the exact meaning of intellectual creation remains unclear. The court's discussions of the selection and arrangement of words supports the idea that this intellectual creation standard may be very similar to the originality requirement articulated in the United States Supreme Court's opinion in *Feist Publications*.⁴⁷ Like the ECJ in *Infopaq*, the United States Supreme Court in *Feist Publications* looked to selection and arrangement of unprotected elements—in that case phone numbers—to determine whether any minimum level of

⁴⁰ *Id.* at para. 37.

⁴¹ *Id.* at para. 38.

⁴² *Id.* at para. 39.

⁴³ *Id.* at para. 44.

⁴⁴ *Id.* at para. 45.

⁴⁵ *Id.* at para. 47-48.

⁴⁶ *Id.* at para. 51.

⁴⁷ *Feist Publ'ns, Inc. v. Rural Tel. Serv. Co., Inc.*, 499 U.S. 340 (1991).

originality existed in the original work.⁴⁸

If the intellectual creation standard used in EU law is equal to or lower than the originality standard applied in the United States, then *Infopaq* means that short fragments of text will be subject to much stronger protection in Europe than in the United States. In the United States, the originality question is only the first part of the infringement analysis for short fragments of text. *Infopaq*, by contrast, does not apply any substantial similarity requirement as part of the definition of reproduction in part—if the originality threshold is met, reproduction is proven.

EU protection of copyright for short fragments would also be stronger than equivalent protections in the United States because of the different treatment of fair use under the Information Society Directive. While the equivalent of a fair use defense is determined at the national level, national discretion in that area is limited to the list of allowable exceptions the Information Society Directive. This is in contrast to the open-ended four-part test used in the United States, which allows many uses of short fragments of text as fair use even if they rise above the level of *de minimis*.

The intellectual creation requirement may be somewhat helpful, however, to persons excerpting news articles. Because intellectual creation in news articles can only be demonstrated by selection or arrangement of words, a summary of a news article that paraphrases the original should not violate the exclusive reproduction right.⁴⁹ If European courts interpret intellectual creation to require something more than the minimal creativity required in the United States, it is possible that treatment of small excerpts will be very similar in Europe and the United States. If a short segment is required to demonstrate some personal stamp of the author, as was required under the originality thresholds of several countries prior to the copyright harmonization directives, the treatment of short segments might also provide protection only when such short segments are especially unique. This would create protection very similar to that in the United States.

⁴⁸ *Id.* at 348.

⁴⁹ *Infopaq*, [2009] ECR I-6569 at para. 23 (“the parties in the main proceedings do not dispute that genuinely independent summary writing per se is lawful and does not require consent from the rightholders”).

CONCLUSION: EXCERPTS IN EUROPE MAY INFRINGE COPYRIGHT

While the precise contours of the exclusive reproduction right will not be clear until a consensus emerges as to the meaning of “intellectual creation,” *Infopaq* still suggests that EU copyright protections may be stronger than those in the United States. The *de minimis* defense in the United States will ordinarily allow copying of short fragments so long as they are not especially unique or key to the original work. Even if a copied section is too extensive to be *de minimis*, if the new work adds something or uses the section for a different purpose than the original, fair use will often apply. By contrast, the fact that the European Court of Justice does not apply any substantial similarity test to copying opens the door to national courts finding illegal reproduction when fragments of sentences are copied so long as the arrangement and choice of words demonstrates some minimal creativity.