

# Entertainment, Arts and Sports Law Journal

A publication of the Entertainment, Arts and Sports Law Section  
of the New York State Bar Association

## Remarks from the Chair



Alan D. Barson

It is an honor and a privilege to be elected as your new Chair of the Entertainment, Arts and Sports Law Section. I realize that many others could have fulfilled this role, but somehow it has come to me for the next two years. For those of you who do not know me, I practice entertainment law in New York City and have been actively involved with the EASL Section for over

fifteen years. I have served as Assistant Secretary, Secretary and, most recently, as Vice-Chair during Elissa Hecker's remarkable term as Chair these past two years.

I also serve as one of the Section's delegates to the House of Delegates along with Steven Richman, and co-chair the Section's Music and Recording Committee with Stanley Schneider and Alasdair McMullan. In my law practice, I represent creative and executive talent in the motion picture, television, home video, book, recording, music publishing, merchandising and touring, theatre, new media and intellectual property industries. I spent some time as Senior Vice President/Head of Business and Legal Affairs and General Counsel at the London/Sire Records Group, then a Time Warner affiliate, and before that was an attorney with Franklin Weinrib Rudell & Vassallo, the renowned New York based entertainment law boutique. I occasionally lecture on a variety of topics at my *alma mater*, Benjamin N. Cardozo

## Inside

Editor's Note .....	3
(Elissa D. Hecker)	
Law Student Initiative .....	4
ADR Awards .....	5
Trouble in Parodyse .....	6
(Jerome Glasser)	
Art as Wealth: Basic Estate Planning for Visual Artists .....	13
(Gerald Morlitz and Elizabeth E. Nam)	
Rights of Lenders Accepting Works of Art as Collateral .....	20
(Dean R. Nicyper and Lissa C. Gipson)	
"Diploma Mills"—Am I Buying? An Education Problem, Not an Athletic Problem .....	33
(Mark A. Hicks)	
Why No Poker? .....	38
(Bennett Liebman)	

Artistic Expression or Unfair Exploitation: The Right of Publicity, the First Amendment and Fair Use in Films and Fine Art .....	41
(Jason Sanders)	
The Legalities and Realities of Control Within Artist-Driven Nonprofit Organizations .....	50
(Sharon Connelly)	
International Commercial Arbitration in the Entertainment Industry .....	70
(Adam Kagan)	
Music, Rootkits and Copy Protection Don't Mix Well for Consumers .....	78
(Stacey L. Lager)	
Entertainment, Arts and Sports Law Section Annual Meeting .....	81
The Phil Cowan/BMI Scholarship .....	119

[WWW.NYSBA.ORG/EASL](http://WWW.NYSBA.ORG/EASL)



School of Law, and elsewhere. I am as passionate about snowboarding as I am about the latest technology, electronic gadgets, and, of course, my two teenage children.

Elissa Hecker's term began in 2004 with a far-reaching, inward look at our Section. The result was implementation of a strategic, two-year plan, during which each and every aspect of the Section came under scrutiny, an effort in which I assisted and unreservedly supported. The results are manifold: The members of the Executive Committee, who now chair its committees, comprise a "who's who" of leading entertainment, art and sports law practitioners, and each committee hosts frequent, outstanding, and frequently oversubscribed CLE programs and seminars. New initiatives have been implemented through our Pro Bono Committee. A new committee—an ADR Committee—was formed, which is growing rapidly and has already held several programs, all of them complete sellouts. Our website (<http://www.nysba.org/easl>) has been upgraded and streamlined and many more useful resources have been added. Through the efforts of our Membership Committee, retention has increased and membership is growing. This publication, one of the EASL Section's crown jewels, continues to be a forum for first-rate scholarly journalism on topics of interest to our members, and its readership is up like never before. (Indeed, at over 100 pages, this is the largest issue ever.) In short, the Section is firing on all cylinders. So, what lies ahead?

In the almost twenty years since the EASL Section was formed, the needs of those who practice entertainment, arts and sports law have evolved as dramatically as the needs of their clients, the practice of law and the law itself. Therefore, to continue being effective as a bar organization, the EASL Section must not only meet the needs of its increasingly specialized and sophisticated membership by providing the best CLE programs, but also fulfill its role as advocate for its members' interests, promote professional responsibility and emphasize the

core values of our profession, often referred to as professionalism. While I intend to continue building on the accomplishments of past leadership, I have already begun work on a number of initiatives which I believe will accomplish these goals and further enhance the value of Section membership. One of my goals is to strengthen the Section's public image through increasing the visibility of our members in the media. Another is to improve communication between our District Representatives and members of the local bar associations around the state, with whom they are charged with keeping us connected. Although our membership numbers are concentrated in New York City, we are a statewide organization and I am committed to improving the ways we serve our regional membership.

Another of my goals is to encourage our members to join and become active in one or more of our fantastic committees. (I'll start now: If you are a Section member but have not joined *at least* one or two committees, you are really missing out! Visit our website at <http://www.nysba.org/easl> for a list of committees you may join. There is no additional fee for committee membership and no limit to the number you can join.) Another goal is to continue efforts to strengthen our finances through an increased emphasis on sponsorship and branding. Another is to improve our Section's visibility within the NYSBA through greater involvement of our Legislative Committee in the activities of the House of Delegates.

These are my preliminary thoughts about what we want to do and what we already have under way. I would greatly appreciate hearing what you think we should be doing and what we should be doing better, and I look forward to meeting those of you I do not already know very soon.

Alan D. Barson, Esq.  
<http://www.barsongs.com>  
E-mail: [barsongs@barsongs.com](mailto:barsongs@barsongs.com)

**Catch Us on the Web at  
[WWW.NYSBA.ORG/EASL](http://WWW.NYSBA.ORG/EASL)**



# Editor's Note

## A Museum Code of Conduct

There have been several recent news articles and reports regarding the possible lack of ethics and legal due diligence performed by major museums and galleries when dealing with the acquisition or retention of potentially illicitly obtained artwork.



Whether concerning antiquities, artwork stolen and repatriated during World War II, or works recently harvested from the war zones of the Middle East, many questions have arisen as to who owns what, where do the rights belong, and are there any reparations due, either to nations or individuals. The real question in this puzzle is who, if anyone, is a bona fide purchaser of art?

What is the duty of a gallery, museum or auction house to trace back the roots of art that it purchases or sells? If individuals with whom such institutions have a relationship are known to have questionable ties with those who may have acquired the artwork from their original owners, do the institutions need to take further steps in order to determine if transactions are legitimate?

Art attorneys and those who counsel institutions should be concerned with the decisions made in the past by museums. In their rush to acquire art to either anchor a collection or sell tickets to visitors, one must ask whether, in addition to the ethical issues, such transactions are of a legal nature.

On November 28, 2005, a *New York Times* Op-Ed piece mentioned that several prominent museums operate under the policy supported by the Association of Art Museum Directors, which allows for museums to acquire "undocumented antiquities if the museum believes the acquisition is justified." This is particularly troubling because it is very easy to create justifications for desirable and rare artwork, without wanting to really delve into the provenance of such work.

It is crucial that attorneys counsel museum clients to take extra steps not only to minimize liabilities that may crop up later on, but also because ethically, such extra steps should be built into the framework of acquisitions. Ultimately, a museum's public image and reputation are of the utmost importance.

The bottom line is this: Who is willing to take responsibility and not allow the continuing pillaging of a nation's historical objects, or even to return to survivors the artwork that had once been stolen from a family's valued collection, rather than make such work a museum's showpiece?

While there have been recent high-profile trials, negotiations and one major settlement, there is no established code to which museums in the United States adhere when investigating the potential acquisition. Such a standard would, at the very least, strengthen the museum's claim to bona fide ownership. A code would also standardize the investigations into the origin of the artwork and raise the possibility that the acquisition was truly procured by legitimate means. Finally, ethical behavior on a museum's part may ultimately be of major benefit to changing any public perception—as more than a mere silkscreen being pulled over the public eye.

**Elissa D. Hecker of the Law Office of Elissa D. Hecker, located at 90 Quail Close, Irvington, NY 10533, practices in the fields of copyright, trademark and business law. Her clients encompass a large spectrum of the entertainment and corporate worlds. In addition to her private practice, Elissa is Immediate Past Chair of the EASL Section. She is also a frequent author, lecturer and panelist, a member of the Copyright Society of the U.S.A. (CSUSA) and a member of the Board of Editors for the Journal of the CSUSA. Elissa is the recipient of the New York State Bar Association's 2005 Outstanding Young Lawyer Award. She can be reached at (914) 478-0457 or via e-mail at EHeckerEsq@yahoo.com.**

This article is reprinted with permission from the January 23, 2006 issue of the *New York Law Journal*, © 2006 ALM Properties, Inc. Further duplication without permission is prohibited. All rights reserved.

**Upcoming *EASL Journal* Deadline: Friday, May 19, 2006**

**Congratulations to the  
2005 Law Student Initiative Winning Authors:**

**Brian Danitz** of Fordham Law School, for  
“*Martignon and Kiss Catalog: Can Live Performances Be Protected?*”

**Julie M. Chelico** of St. John’s University School of Law, for  
“The Use of Intellectual Property Protection in the Jewelry Industry”

**and Congratulations to the  
Spring 2006 Law Student Initiative Winning Authors:**

**Adam Kagan** of Pace Law School, for  
“International Commercial Arbitration in the Entertainment Industry”

**Sharon Connelly** of Fordham University School of Law, for  
“The Legalities and Realities of Control Within Artist-Driven Nonprofit Organizations”

\*\*\*\*\*

New York State Bar Association  
Entertainment, Arts and Sports Law Section

**Law Student Initiative**

The Entertainment, Arts and Sports Law (EASL) Section of the New York State Bar Association has an initiative giving law students a chance to publish articles both in the *EASL Journal* as well as on the EASL Web site. The Initiative is designed to bridge the gap between students and the entertainment, arts and sports law communities and shed light on students’ diverse perspectives in areas of practice of mutual interest to students and Section member practitioners.

Law school students who are interested in entertainment, art and/or sports law and who are members of the EASL Section are invited to submit articles. This Initiative is unique, as it grants students the opportunity to be *published and gain exposure* in these highly competitive areas of practice. The *EASL Journal* is among the profession’s foremost law journals. Both it and the Web site have wide national distribution.

\*\*\*\*\*

To foster an interest in entertainment, art and sports law as a career path, the EASL Section invites law students who are Section members to participate in its Law Student Initiative:

**Requirements**

- **Eligibility:** Open to all full-time and part-time J.D. candidates who are EASL Section members.
- **Form:** Include complete contact information; name, mailing address, law school, law school

club/organization (if applicable), phone number and e-mail address. There is no length requirement. Any notes must be in *Bluebook* endnote form. An author’s blurb must also be included.

- **Deadline:** Submissions must be received by Friday, May 19, 2006.
- **Submissions:** Articles must be submitted via a Word e-mail attachment to [heckeresq@yahoo.com](mailto:heckeresq@yahoo.com) or via mail to:

Elissa D. Hecker, Esq.  
Editor, *EASL Journal*  
90 Quail Close  
Irvington, NY 10533

**Topics**

Each student may write on the subject matter of his/her choice, so long as it is unique to the entertainment, art and sports law fields.

**Judging**

Submissions will be judged on the basis of quality of writing, originality and thoroughness.

Winning submissions will be published in the *EASL Journal*. All winners will receive complimentary memberships to the EASL Section for the following year. In addition, the winning entrants will be featured in the *EASL Journal* and on our Web site, and all winners will be announced at the EASL Section Annual Meeting.



# Alternative Dispute Resolution Awards

The EASL Section congratulates Judith A. Bresler and Judith B. Prowda, Co-Chairs of EASL's Alternate Dispute Resolution ("ADR") Committee, on winning two of the esteemed NYSBA ADR Awards. The ADR awards are given to worthy recipients who have helped further the development of ADR in New York State.

Judith Prowda also serves as the Secretary of EASL's Executive Committee and is Chair of EASL's Art Law Committee. In her private law practice, she provides ADR services, focusing on intellectual property matters. Judith is a Member of the Roster of Neutrals, NYS Supreme Court Commercial Division ADR Program, is certified as a mediator by the Commercial Division of the NYS Supreme Court, and has received a Certificate in Media-



(l-r) Judith Prowda, Alan Barson and Judith Bresler.

tion from the World Intellectual Property Organization.

Judith Bresler is an attorney with the Entertainment Law boutique Cowan, DeBaets, Abrahams & Shepard, focusing on art law and intellectual property. She is a former EASL Section Chair, and formerly chaired EASL's Art Law Committee. Judith is a law professor and teaches Art Law at New York Law School. She has also taught Art Law at the University of Pennsylvania Law School. She is co-author of the authoritative, multi-volume treatise on Art Law called "Art Law, the Guide for Collectors, Investors, Dealers and Artists," published by PLI. Judith is also a Member of the Roster of Neutrals, NYS Supreme Court Commercial Division.



## Is someone on your case?



NEW YORK STATE BAR ASSOCIATION  
Lawyer Assistance Program  
1.800.255.0569 [lap@nysba.org](mailto:lap@nysba.org)

# Trouble in Parodyse

By Jerome Glasser

The Nineteenth Century French philosopher, Pierre-Joseph Proudhon, wrote that “property is theft”<sup>1</sup> partly based on his belief that the existence of private property could not be morally justified since its preservation serves as a form of “theft” from the common property belonging to humanity. It appears that there is a growing number of misguided souls embracing this quintessentially anti-American, anti-capitalist gibberish and espousing the notion that property, especially Intellectual Property (“IP”), should be free to everyone and owned by no one. Such individuals fail to comprehend and appreciate that the foundation of the “American Dream,” integrally responsible for making this country economically great, is predicated on the idea that by one’s own personal efforts and creativity, one may acquire exclusive, protectable IP rights, and through those ownership rights, consequently rise from “rags to riches.”

---

*“It appears that there is a growing number of misguided souls . . . espousing the notion that property, especially Intellectual Property, should be free to everyone and owned by no one.”*

---

It is specifically because IP rights are most often earned only through great expense, effort and sacrifice that it is entirely reasonable for owners of IP to wish to prevent its unauthorized appropriation—to *any* degree. IP owners deserve to exercise full control over and to earn the maximum profits possible from their often substantial investment in the development or acquisition of the IP they own—to the limits the law allows. IP owners operating within the arts, sports and entertainment industries, should recognize that their particular types of IP play prominent roles in American culture.

Such IP owners need to acknowledge that there is the propensity for their culturally pervasive IP to become so ingrained in American culture that the fans who are depended upon to maintain a property’s popularity, and hence its value, may—however inappropriately—delude themselves into believing that their borderline obsessive reverence for and devotion to a given property confers upon them some form of “ancillary rights” in the property. While that scenario may be dis-

concerting to IP owners, worse still would be fans advocating that their mere collective love of someone else’s IP could transform that property into a common, public property, and that any claim to private ownership and control of that beloved property would constitute a “theft from the common property belonging to them all.”

The fact is that, primarily as a result of technological advances in the fields of electronics and communications, the nature of the arts, sports and entertainment “fan” has already been transformed. Fans, now and increasingly in the future, will no longer be the mere “hands-off” spectators they once might have been. Consequently, given this changed nature, it is unrealistic for IP owners to expect to exert the degree of control over their properties that was once possible.

Fans of art, sports and entertainment properties feel compelled today to more than merely look at or watch—they want to participate. The compulsion to participate with culturally prominent IP is often induced by more than mere devotion, since the Internet affords fans the chance to earn money and perhaps even some modest online fame, by virtue of their own creativity. Furthermore, over the Internet, fans can become creatively involved with arts, sports and entertainment properties without significant start-up costs. If fans are denied access to interact with the culturally prominent properties to which they are devoted via officially sanctioned channels, many fans will “find a way,” nevertheless, to participate.

The “way” that fans will find to participate is through *parody*.

A tidal wave of parody products developed by fans who have not obtained permission to create properly authorized products, but whose parody products would still be introduced into the stream of commerce, has not yet overwhelmed U.S. markets. It is likely that such an influx in this category of saleable items will occur, though, as fans become more sophisticated. Parody is an exploitable breach in the defenses of many IP owners, and when executed “correctly,” parody products will be legally entitled not only to exist, but also to be sold in the stream of commerce. It is only relatively recently, as a result of a maturing Internet, that both motive and opportunity to seriously exploit the “parody breach” have evolved.

One example of a parody product which was deemed legal to be sold is the trading cards product around which the *Cardtoons, L.C. v. Major League Baseball Players Association* (“MLBPA”)<sup>2</sup> cases revolved. The Cardtoons company created its own set of trading cards, which critically lampooned actual Major League Baseball player/celebrities in a humorous manner. The basis on which Cardtoons believed its parodic, two-dimensionally illustrated printed trading cards could be sold legally was its interpretation of U.S. regulations governing parody. Cardtoons maintained that although its trading card deck was a collectible item, it still constituted a legal form of speech protected under the First Amendment.

Defining what actually constitutes “speech” can be a surprisingly complex task. Cardtoons believed that characterization as “speech” could extend not only to verbal speech and text, but even to an item which expresses a critical, parody message, as did its trading cards. The court concurred with Cardtoons’ analysis, stating that “even if the trading cards are not a traditional medium of expression, they nonetheless contain protected speech.”<sup>3</sup>

Perhaps even more interesting than the fact that items such as trading cards can be considered “speech” meriting First Amendment protections, is the impact of the ruling that established binding precedent in U.S. law for a parody product to be not only protected as speech, but also protected as speech entitled to be purposefully sold into the stream of commerce without consequently being transformed into speech that would be characterized as “commercial.” The court held that although the Cardtoons parody trading cards were sold for profit in the marketplace, the mere act of doing so did not, itself, transform the qualification of the parody trading cards’ speech into “commercial” speech. “Cardtoons need not give away its trading cards in order to bring them within the ambit of the First Amendment.”<sup>4</sup>

The reverberations of the impact of this decision with regard to U.S. commercial markets have not yet reached the critical point that they may be expected to achieve. The holding in *Cardtoons, L.C. v. MLBPA I* has laid the legal foundation for the legally supportable and significant development of the parody products marketplace, one in which a product with a person’s likeness—most notably a celebrity’s likeness—depicted in a mocking or otherwise critical manner, may be sold without first obtaining the express authorization or license from the celebrity to use his likeness.

A cursory review of *Cardtoons, L.C. v. MLBPA I* might suggest that the exclusive reason for Cardtoons having prevailed in court and consequently having been permitted to sell its parody product in commercial

markets is a result of the holding that a parody protected under the First Amendment trumps celebrities’ rights of publicity. “Elevating the right of publicity above the right to free expression would likely prevent distribution of the parody trading cards. This would not only allow MLBPA to censor criticism of its members, but would also have a chilling effect upon future celebrity parodies. Such a result is clearly undesirable . . .”<sup>5</sup>

The *Cardtoons* court expounded further upon the actual cultural value that celebrity parodies provide:

Parodies of celebrities are an especially valuable means of expression because of the role celebrities play in modern society. As one commentator in that case explained, celebrities are “common points of reference for millions of individuals who may never interact with one another, but who share, by virtue of their participation in a mediated culture, a common experience and a collective memory.” . . . Through their pervasive presence in the media, sports and entertainment, celebrities come to symbolize certain ideas and values. . . . Celebrities, then, are an important element of the shared communicative resources of our cultural domain. Because celebrities are an important part of our public vocabulary, a parody of a celebrity does not merely lampoon the celebrity, but exposes the weakness of the idea or value that the celebrity symbolizes in society. . . . In order to effectively criticize society, parodists need access to images that mean something to people, and thus celebrity parodies are a valuable communicative resource. Restricting the use of celebrity identities restricts the communication of ideas.<sup>6</sup>

Numerous legal treatises have been written addressing the fact that a “true” parody will be protected by the U.S. judicial system against attempts at suppression based on a claim of infringement of rights of publicity. With regard to Cardtoons’ parody trading cards, there is another, perhaps equally important yet sometimes overlooked, element that needed to be satisfied in order for them to be legally introduced into the stream of commerce. To a considerable degree, Cardtoons trading cards owe their legal existence in the stream of commerce to the court’s finding that the effect of the sales of the Cardtoons’ parody product would neither harm through usurpation, nor through supplan-



tation, either the primary, targeted marketplace of MLBPA for their authorized, licensed baseball trading cards, or a prospective derivative marketplace, which MLBPA may have intended for its own parody “send-up” of its own version of MLBPA parody baseball trading cards. Whether a parody usurps the marketplace for the original by depriving the original of its chance to “turn a profit”—if possible—when the parody is introduced into the stream of commerce, is important in determining whether a parody may be considered fair use under the fourth factor, pursuant to analysis under the Doctrine of Fair Use in U.S. Copyright Law.

The Doctrine of Fair Use enumerates four factors, all of which need to be considered when analyzing whether a use may be considered “fair”:

- 1) The purpose and character of the use, including whether such use is of a commercial nature or is for non-profit 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.<sup>7</sup>

In considering whether a use is infringing or fair, while all factors should be taken into consideration, the fourth factor is typically accorded the greatest weight as the most significant of the fair use factors, since it relates to the impact that a subsequent work has, or could have, in the marketplace on sales of the original work it targets. As the capitalist American culture is money- and consumer-oriented, it is reasonable that the fourth factor should be regarded as “undoubtedly the single most important element of fair use.”<sup>8</sup>

The fourth factor requires that the courts address the issue as to whether an allegedly infringing work replaces the original copyrighted work in the marketplace or fulfills the demand for the original. Under this factor, an allegedly infringing parody work is evaluated to determine whether it supplants or usurps from the original work the latter’s initially targeted marketplace, and/or any prospective derivative market for the original. The reason for this is that the author of the original work has exclusive rights to derivative works and markets. U.S. court rulings construe infringement as occurring when a parody fulfills the demand for the original by supplanting it in markets for which the original is intended, or in which the original is, or has reasonable potential to become, commercially valuable.

One of the primary reasons that U.S. courts often find that parodies are non-infringing fair use is based on the determination that it is unlikely that an allegedly

infringing parody will act as a substitute for the original, since the two works (parody and non-parody-original) usually address different markets. For instance, in *Fisher v. Dees*, the court concluded that:

We do not believe that consumers desirous of hearing a romantic and nostalgic ballad such as the composers’ song [“When Sunny Gets Blue”] would be satisfied to [instead] purchase the parody [a 29-second recording concerning a woman who sniffs glue, which “ends with noise and laughter mixed into the song.”] Nor are those fond of parody likely to consider “When Sunny Gets Blue” [“a lyrical song concerning or relating to a woman’s feelings about lost love and her chance for . . . happiness again”] a source of satisfaction. The two works do not fulfill the same demand. Consequently, the parody has no cognizable economic effect on the original. . . . This is not a case in which commercial substitution is likely.<sup>9</sup>

In *Campbell v. Acuff-Rose Music, Inc.*, the Court found, similarly, that there was an absence of evidence or affidavits addressing the effect of 2 Live Crew’s song on the derivative market for a non-parody rap version of “Oh, Pretty Woman.”<sup>10</sup> The holding of the Court seems to suggest that despite its finding of the song to be a parody, the outcome of the case could very likely have been the reverse. Had Acuff-Rose Music, Inc. presented convincing evidence that 2 Live Crew’s parody song version harmed the market potential for the original or usurped the marketplace for a derivative version of “Oh, Pretty Woman” for either the parody marketplace or the non-parody rap marketplace, a finding of infringement as “unfair use” might possibly have been determined.

Thus, although Cardtoons trading cards were, indeed, recognized by the court to be parody<sup>11</sup> and, as such, entitled at least to be distributed freely as protected speech under the First Amendment, they owed their right to enter the stream of commerce to the fact that their sales could not be shown to be usurping the marketplace for the original MLBPA trading cards. As in *Campbell v. Acuff-Rose Music, Inc.*, attorneys for MLBPA could not or did not demonstrate that members of the target market for MLBPA’s licensed cards would buy the Cardtoons cards *instead* of MLBPA’s licensed baseball cards, thereby causing a diminution in sales in the primary, originally targeted marketplace for MLBPA’s original cards. In addition, MLBPA counsel did not suggest that Cardtoons trading cards were usurping or would usurp the marketplace for an MLPBA parody version of its own cards. “Indeed, the director of licens-



ing for MLBPA testified that MLBPA would never license a parody which poked fun at the players.”<sup>12</sup>

What happens, though, in the instance in which playing cards are created that:

- 1) Bear the recognizable likenesses of celebrities who are clearly portrayed in a critically disparaging manner, thereby affording this depiction protection under the First Amendment as parody expression; and also
- 2) Satisfy all the requisite elements to be considered “fair use” under the first three prongs but which may not be evaluated at all under the fourth factor, the potential for market harm—arguably the most important—because no original product sold in the stream of commerce exists with which to make a comparison?

A consideration of the following hypothetical scenario may reveal an answer to this question.

Jeanie Yiss, a stunning, aspiring actress, was frustrated that she still had not yet caught her “big break” despite having achieved some professional success playing a few roles on Broadway and in a few television commercials. It was evident to Jeanie that her significant and continuous efforts to showcase her extensive talents on the silver screen by landing even *one* starring role in a widely distributed U.S. motion picture had been and were continuing to be thwarted primarily as a result of the selfishness of already wealthy and famous film “stars” who accepted more than their “fair share” of lucrative film roles.

In Jeanie’s opinion, the reasonable action that should be taken by already rich and famous movie celebrities was to gracefully “bow out” of their profession, having made both their marks and their fortunes.

In this way, “wannabes,” such as Jeanie, who are waiting tables and tending bar trying to eke out a meager existence while attempting to obtain even *one* starring role, would get their own chances to achieve financial and professional success.

Jeanie knew that in the U.S. she was entitled to her opinions and that under the First Amendment to the U.S. Constitution she was entitled to express those opinions. One evening, Jeanie had finally tired of fuming only to herself regarding the fact that it was virtually always the same crop of actors and actresses in the U.S. who were to blame for the plateau she perceived in her career. It seemed obvious to her that the “stars” and their agents had conspired to arrange for “A-List” talent to switch-off working with each other. In that way, they monopolized available roles in “important” U.S. motion picture projects.

Deciding that the time for decisive action had arrived, and in a grand gesture of frustration, Jeanie swept away her cardboard dinner table, which accidentally had been slashed to pieces by a sharp kitchen knife. Looking on the floor at the pieces of her then-shredded table, Jeanie had a flash of inspiration and realized her answer: she would try to effect change in the movie industry by educating people using . . . PLAYING CARDS! In the spirit of “A spoonful of sugar helps the medicine go down,”<sup>13</sup> Jeanie was convinced that since the best way to educate people was in a manner that was engaging and entertaining, she needed to produce a game that was as enjoyable to play as it was educational. By playing her game, she felt certain that people would come to appreciate the inherent message that she intended the game to convey: a paltry few actors and actresses can be so readily linked to each other as co-stars in films, that it was obvious that this tiny minority of entertainers was “hogging” the majority of lucrative American movie roles.

Dipping into her modest savings, Jeanie hired a spectacular caricature illustrator, and then commissioned the professional printing of thousands of decks of playing cards featuring the likenesses of Hollywood’s “A-List” actors, whom she directed to be depicted in the various scenes of the caricature illustrations on the cards as greedy people hoarding scripts and money, thereby preventing aspiring, competing performers from access to film roles. Jeanie’s intent was for her criticism to educate and influence to remedial action: a) the movie-going public, b) her fellow thespians, and c) executives in the movie industry, regarding the inequity she believed existed in a motion picture industry in which “role-hogs” got the glory, and struggling, and often more-talented unknowns got the shaft.

The game she invented was played in manner similar to Gin Rummy or Poker, in which the only winning hand was a royal flush. From a shuffled card deck, players would be dealt cards, each of which had the image of a lampooned, real-life movie performer on it. Players would try to link the cards on the basis of motion pictures in which the performers participated together. For example, if a player was lucky enough to receive cards that indeed linked, such as Tom Hanks and Meg Ryan (*Sleepless in Seattle*, *You’ve Got Mail*, *Joe vs. The Volcano*), and the player had the requisite knowledge relating to how the two performers’ cards linked, that is to say, via which films, then a series of linking cards could be created. Just as in Gin Rummy, the winning player would be the first to assemble a hand having a series of linking actor and/or actress cards—perhaps seven—not necessarily all linking via the same film.

Although Jeanie had considered printing cards having only the block text real names of the actors and actresses, rather than the performers' likenesses as well as their block text names, she felt that it was important that the cards display the images of the performers in order to better identify them. She was concerned that many players might recognize an actor by sight, but not recall the actor's name, or vice versa. She also believed that including parody illustrations might more effectively shame the actors into changing their ways. By not including the images of the actors, she felt the game would simply be relegated to the status of "yet another pleasurable, challenging diversion, entirely devoid of meaningful social commentary." For Jeanie, the lampooning of the real-life actors and actresses in a visual medium was essential to communicating the message of the game.

A patent attorney helped Jeanie to file a U.S. Non-Provisional Patent Application for the method for playing Jeanie's educational game, and she eventually received a patent for her game.<sup>14</sup> Jeanie further realized that since her game was new and unobvious, there had never before been the need to compile a guidebook from which players could consult listing which actors and actresses performed together in which films. It took Jeanie about three months to compile this cross-referencing informational guidebook, which she felt was important to the game in the same way that a dictionary functions in the popular game, SCRABBLE.<sup>®15</sup> She subsequently submitted her guidebook to the U.S. Copyright Office and was granted a U.S. Copyright Registration Number.<sup>16</sup>

Jeanie then started selling her game, rather than giving it away for free, because a marketing expert friend of hers suggested that people in America tend to discard things that are free, and do not accord as much respect to messages that are given away as to things and messages for which they have to pay. Whether this was actually true or not, Jeanie was disposed towards selling rather than giving away her game since her own, personal cash flow had taken a considerable hit as a result of the costs of producing her message in a game format.

In creating her game, Jeanie's intention was to critically lampoon celebrities; however, even had she created the game for financial gain, Jeanie learned that the "First Amendment is not limited to those who publish without charge . . . [An effort to produce an expressive work] does not lose its constitutional protection because it is undertaken for profit."<sup>17</sup> The fact that Jeanie initially produced a playing card set having 125 cards would not preclude her from selling, for instance, 125 T-shirts as a game unit so that her game could be enjoyed by players in T-shirts, or even from selling 125 paper dinner plates as a game unit. Nor would her game have to

be sold necessarily in conjunction with her specially written guidebook, which Jeanie realized would have to be updated at least annually in order to reflect the new links between the actors and actresses as they completed new films.

If she had wanted to, Jeanie could have sold only her guidebook and given away for free the illustrated parody playing card deck as a promotional gift-with-purchase of the guidebook. In doing so, she certainly would hinder any claims by the parodied celebrities suggesting that she was trading on the "goodwill" inherent in the fame of the celebrities, since nothing with a celebrity likenesses would then be *sold*; the sole item for sale would, in that case, be Jeanie's copyrighted, block-text book—sold at a greatly inflated price to cover the costs of the "free" gift-with-purchase playing card deck.

What would, *perhaps*, be unfair for Jeanie to do would be to sell each card individually without the others. Doing so would not readily permit someone to discern the same message that the playing of her game conveyed. It was through the playing of the game itself that players could readily appreciate the greed exhibited by the actors and actresses parodied on the cards, and the exclusionary relationship they perpetuated in relation to aspiring talent. Jeanie did intend to sell additional "booster" cards individually to augment the deck as she identified new, greedy actors and actresses whom she felt deserved to be parodied. She felt that booster cards would be the exception to her own self-imposed rule barring individual card sales of her main "starter" deck. Jeanie considered that, irrespective of her own self-imposed ban on individual card sales, though, she would probably be entitled to sell the cards individually, anyway, despite her intention not to, since each scene on each card depicted each targeted performer on the cards in an unflattering, critical manner as a greedy and selfish person. Thus, each card served as its own self-contained parody.

It may take a Jeanie Yiss to invent such a parody game as just introduced, but one does not need to be a Jeanie Yiss to see that her parody product does not infringe celebrities' rights of publicity, since a claim could not be supported that the actors and actresses featured on the cards are commercially promoting anything; the game's critical speech targets the celebrities parodied, does not use more than is required to conjure up the image of each celebrity and does not focus on any one celebrity in particular; the game is not intended primarily as a commercial product, but rather, as an educational aid; and since celebrities typically do not parody themselves, no market harm to celebrity products can be demonstrated. A conclusion might reasonably be deduced, therefore, that a parody product that does not reference an original product gets a "free pass"

into the stream of commerce—*no license required*. The “power to license is the power to suppress.”<sup>18</sup> Jeanie’s parody speech, conveyed in the form of an item sold in the marketplace, is protected from suppression under the First Amendment of the U.S. Constitution.

In the field of patents, exclusive rights exist within the scope of the claims. Even trademark dilution laws today afford reasonably effective protections against those who would wish to capitalize on the “goodwill” of a trademark through tarnishment by parody. The framers of the U.S. Constitution provided for a breach in the defenses of copyright owners. IP owners must contend with the reality of the existence of this breach, and come to grips with the fact that—from their perspective—like an unhealing wound, it may be a chronic condition.

Most attorneys who represent the interests of IP owners in the arts, sports and entertainment industries gravitate towards the traditional response model in reaction to actual or potential infringers by attempting to discourage offensive or unauthorized participation via the threat of legal action. While a campaign of dissuasion-through-scare-tactics may have proved effective in the past, this traditional response model may not have the same efficacy when employed in the face of an enormous pool of prospective defendants who are *entitled* to act in a manner which the courts recognize as distasteful to the IP owner. It is hard enough to prosecute actual, obvious misappropriation of IP. How much more difficult will it be for an IP owner to try to enforce rights when the manner in which fans participate by invoking parody rights is legally permissible, and the primary option for an IP owner’s counsel to generate the desired results is to depend upon the defendants’ inability or reluctance to commit the time and/or resources to mount their defenses?

A more enlightened and pro-active approach is available to protect IP. It consists of pre-emptively “fighting fire with fire.” In order to remove a scathing parody product from the stream of commerce, the first step would be for an IP owner, such as a celebrity, to commission his or her own *self-parody* product, and then to sell it, thereby creating a presence in a derivative marketplace. By selling at least one, relatively mild self-parody product into the marketplace, and not necessarily in enormous volumes (but surely in an amount sufficient to demonstrate at least a valid intent to exploit the parody marketplace), a celebrity could, perhaps, establish a valid, legal foundation from which to assail a scathing parody product on the basis that the scathing parody product was usurping the market for the celebrity’s self-parody products.

Such a strategy would not necessarily eliminate a celebrity parody product that is given away at no cost

to consumers. In cases of unquestionably noncommercial parodies, “the First Amendment hurdle will bar most right of publicity actions against those activities.”<sup>19</sup> However, curbing the opportunity for a scathing parody product to be sold on the basis that it usurps or has the potential to usurp the market of the celebrity’s own, original self-parody product, could appreciably reduce the number of parody products introduced into the stream of commerce that are, in actuality, purely attempts to capitalize on the “goodwill” inherent in the fame of a celebrity or a property. This strategy might be dubbed the “use-it-or-demonstrate-intent-to-use-it or lose it” business/legal method.

It is ironic to note that the “goodwill” claimed to be inherent in the names and likenesses of motion picture celebrities which the celebrities and their representatives constantly refer to, does not appear to be of sufficient import to many of the most prominent celebrity citizens of Tinseltown to merit their applying for federal trademark protection for their own names. Frankly, it is incredible that, as of this writing, out of more than one hundred of the most popular film actors and actresses in the U.S. commonly considered to be “A-List,” only sixteen have taken steps to register their valuable names with the U.S. Trademark Office.<sup>20</sup>

It is unlikely that the parody form of expression will lose its right to exist anytime soon. To the contrary, it is far more likely that a considerable increase in parody products—celebrity parody products particularly—will enter the stream of commerce in the future. Celebrities or IP owners attempting to prevent the introduction of parody products into the stream of commerce by seeking protection under the right of publicity umbrella will find no shelter. “When a work contains significant transformative elements, it is not only especially worthy of First Amendment protection, but it is also less likely to interfere with the economic interests protected by the right of publicity.”<sup>21</sup>

Where no original celebrity self-parody product exists in the parody marketplace which sales could be harmed by the sales of a scathing celebrity parody product, a presumption of fair use should result, since with no original in existence, a showing of market harm to the celebrity self-parody borders on the impossible. Conversely, it would be logical to interpret that the introduction of a scathing celebrity parody which would have a deleterious impact upon the market for a celebrity’s own self-parody product would result in a finding *against* fair use.<sup>22</sup>

A celebrity’s mere dissatisfaction at being lampooned will not serve as an adequate basis for an attempt at suppression. “Without First Amendment protection, . . . irreverent commentary . . . cannot be freely distributed to the public. . . . The potential for



suppression [of parody] is even greater in the context of publicity rights because the product involved is the celebrity's own persona."<sup>23</sup> Moreover, it is likely that the court would readily interpret any such attempt for what it would be: an outright attempt to suppress distasteful, critical speech. The courts have already categorically stated that the "last thing we need, the last thing the First Amendment will tolerate, is a law that lets public figures keep people from mocking them."<sup>24</sup>

The best hope for a celebrity's suppression of parodies sold in the stream of commerce and whose primary *raison d'être* is really to trade on the "goodwill" inherent in the fame of the celebrity is, perhaps, to try to remove the profit motive from the equation through a showing of market harm. To do so, however, a celebrity must create and introduce into the marketplace his or her own self-parody products.

If celebrities cannot learn to laugh at themselves *by themselves*—and profit from doing it—surely others will gladly show them the way. Perhaps the lesson to be learned is:

If you can't beat 'em, join 'em . . . *then* beat 'em at their own game!

## Endnotes

1. Proudhon, Pierre-Joseph, *Qu'est-ce que la propriété? What is Property? An Inquiry into the Principle of Right and of Government*. Trans. Benjamin R. Tucker: (New York: Dover, 1970).
2. *Cardtoons, L.C. v. Major League Baseball Players Ass'n*, 95 F.3d 959, (10th Cir 1996).
3. *Id.* at 969.
4. *Id.* at 970.
5. *Id.* at 973.
6. *Id.* at 972.
7. 17 U.S.C. § 107 (2000).
8. *Harper & Row, Publ's, Inc. v. Nation Enters.*, 471 U.S. 539, 566 (1985).
9. *Fisher v. Dees*, 794 F.2d 432, 438 (9th Cir. 1986).
10. *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 571 (1994).
11. *Cardtoons, L.C. v. Major League Baseball Players Ass'n*, 208 F.3d 885, 887 (10th Cir. 2000).
12. *Id.* at 972.

13. *A SPOONFUL OF SUGAR*. U.S. Copyright Registration No. RE-548-531, Registered October 21, 1991, Wonderland Music Company (PWH).
14. U.S. Patent No. 6,017,035 (filed August 15, 1997).
15. U.S. Trademark Reg. Nos. 524, 505 and 1,136,336, Assignee: Hasbro, Inc.
16. *REEL RELATIONS GUIDE: 2001B*. U.S. Copyright Registration No. TX-5-995-224, Registered June 1, 2001, Jerome Glasser.
17. *Comedy III Prods. v. Saderup*, 21 P.3d 797, 802 (2001).
18. *Cardtoons, L.C. v. Major League Baseball Players Ass'n*, 868 F. Supp. 1266, 1275 (1994).
19. *Samsung Electronics America, Inc. v. White*, 971 F.2d 1395 (9th Cir. 1993), *cert. denied*, 508 U.S. 951 (1993).
20. United States Patent and Trademark Office, Trademark TESS Database results:
 

Sandra Bullock	Bette Midler
Leonardo DiCaprio	Eddie Murphy
Michael Douglas	Rosie O'Donnell
Clint Eastwood	Meg Ryan
Mel Gibson	Will Smith
Whoopi Goldberg	Kevin Spacey
Tommy Lee Jones	Sylvester Stallone
Madonna	John Travolta
21. *Comedy III Prods.*, 21 P.3d at 808.
22. *Fisher v. Dees*, 794 F.2d 432, 438 (9th Cir. 1986).
23. *Cardtoons, L.C.*, 95 F.3d at 972.
24. *Id.* at 973.

**Currently a first-year student attending Touro College Law Center in New York, Jerome Glasser is a Certified Paralegal and former Senior Intellectual Property Paralegal with Sills Cummis Epstein and Gross P.C. Prior to working at Sills Cummis, Jerome spent many years living in Asia, much of that time in China, working to identify factories manufacturing products without proper authorization. Although he is not Asian, Jerome speaks fluent Mandarin Chinese. In addition, he speaks fluent French, as well as conversational Japanese and Spanish. An inventor with multiple patents pending, he writes and files his own patent applications pro se. He is a graduate of Rutgers College, Rutgers University in New Jersey where he majored in French Language and Literature.**

**Get CLE Credit:  
Write for the *EASL Journal*!**



*The following is the first of a two-part series. Part 1 focuses on the needs of the artist-client, whose wealth is concentrated in his or her own artwork. Part 2, which will appear in the Summer issue of the EASL Journal, will focus on the needs of high-net-worth individuals who are collectors of fine art.*

# Art as Wealth: Basic Estate Planning for Visual Artists

By Gerald Morlitz and Elizabeth E. Nam

In May 2005, *The New York Times'* Arts section featured an article about the intestacy of Joe Nash, a luminary of the arts community, whose estate consisted of letters, books, papers and other archival materials documenting the complete history of modern African American dance.<sup>1</sup> Mr. Nash died with neither a Will nor heirs.

Although friends and scholars note that Mr. Nash would have wanted his collection to be available to the community for study and research, because he left nothing in writing to that effect, the one-of-a-kind cache was subject to auction by the Manhattan public administrator. Under those circumstances, items would be sold to the highest bidder, with all proceeds payable to the State of New York. As a result, there was no telling where Mr. Nash's collection would end up. Stanford law professor John Henry Merryman wrote aptly, "... if you want a bad contract instead of a good one, the law will supply it for you. If you want a good one, you must make it."<sup>2</sup> The estate of Joe Nash is a true-to-life example.

Estate planning can be a prickly subject because it forces people to acknowledge mortality. At the risk of making a blanket generalization, individuals who make their livelihoods from their creative talents, such as artists, writers and musicians, seem to be especially prone to ignoring the consequences of death with respect to their property. This is not at all surprising; after all, matters of law and taxation might represent the most mundane, least interesting, and least creative aspects of life to many—and not just artists.

The process of creating art can be characterized as an intellectual or spiritual pursuit, so a painter or sculptor, for example, may not necessarily consider the fruits of his or her labor as "property," per se. Indeed, many artists are likely to consider themselves to be of modest means with little to no "net worth." Figures from the U.S. Bureau of Labor Statistics indicate that the average annual wage of a "fine artist" in 1999 was \$35,370.<sup>3</sup>

This helps to explain why many artists may not even know to ask how probate, tax or intellectual property laws affect them. Advisors such as attorneys and accountants are well positioned to help their artist-clients focus on their work as valuable property that deserves protection and planning. Teaching an artist-client to take affirmative actions to protect property interests in his art will help to minimize the chance that default intestacy and tax

laws will erase a lifetime's worth of creativity and hard work.

Just like everyone else, artists need estate planning. However, because of the unique nature of their work and assets, additional complexities are involved. This article focuses on the tax and non-tax aspects of estate planning for a visual artist.<sup>4</sup>

## Artwork as the Artist's Property: Worthy of Protection

A visual artist has several property interests in his work. One interest is a moral one: The artist's personality and philosophy is projected in his work and his reputation is forever attached to each piece he creates. Another is an economic one: The artist's creative capital, financial resources, time and energy are invested in his work, and as a result, he has a legal right to protect those investments against economic exploitation by others. Modern copyright law protects these interests, at least in part. When an artist dies, his estate will "step into the shoes" of the artist and manage the estate, which will be comprised of the artwork and the copyrights of those works.

The challenge of estate planning for a visual artist comes from making a "best guess" as to what his assets will be worth at death, and arranging to distribute or manage the estate property while (1) maximizing the estate's value; (2) minimizing estate taxes; and (3) protecting the artist's legacy.

## First Step: Inventory

An excellent starting point for the estate planning process is to take a comprehensive inventory of the artist's artwork. The artist should review all works remaining on-hand and organize them. Works should be catalogued chronologically (i.e., early works, mid-career works, later works), and perhaps by size, medium, or subject matter. Importantly, the artist should determine where particular works belong in relation to the artist's other works.

Any contractual obligations the artist has with galleries and art-dealers should be reviewed, and fractional ownership interests given to third parties should be flagged. Any written contracts and licensing agreements should be reviewed carefully to see if the estate will be bound after the artist's death (it usually is.) Licensing and

sales arrangements made by the artist during his lifetime may trigger special estate and income tax consequences, so it is important for fiduciaries to be aware of them.<sup>5</sup>

If works have been loaned to museums, those arrangements should be noted as well, so that the fiduciary knows to contact the museums upon the artist's death to renegotiate loans or retrieve the loaned pieces for distribution pursuant to the terms of the artist's Will or Trust.

It is also helpful, from a valuation perspective, for works to be signed and even explained by the artist. If a piece is left unsigned, it will have to be authenticated posthumously as having been created by the artist. In many cases, an "estate stamp," made with a facsimile of the artist's signature, may be applied to unsigned works. Other times, an unsigned work may be signed by a qualified third party. Clearly, neither the "estate stamp" nor the third party signature will be as valuable as the artist's own signature. Generally, the more information there is about a work, the better.

One more step that might facilitate administration is for the artist to attempt to price his art. Of course, pricing should be realistic and take into account current retail and wholesale markets. If the artwork is priced too high, the artist will lose credibility. If it is priced too low, the artist will lose money.

This rudimentary groundwork will help to avoid unnecessary delay, additional expense and, most significantly, minimize the likelihood of contentious, protracted and disruptive litigation. The paper trail will guide executors and trustees who will ultimately be responsible for disposing of the estate's property and, if necessary, paying estate taxes.

### **Next Step: A Well-Drafted Will or Trust**

The cornerstone of just about any estate plan is the Will. A Will empowers any person to tell the world where his assets should pass upon his ultimate demise, and who should oversee the disposition of his estate.

Without a Will, state intestacy law will govern the disposition of an estate, regardless of the artist's interests. In New York, if a person dies without a Will, a surviving spouse is entitled to the entire estate if the decedent dies without descendants. If there are surviving descendants, then the surviving spouse is entitled to the first \$50,000, plus one-half of the remaining estate. In the absence of a surviving spouse, the estate will pass to the following collateral relatives: First, to the decedent's descendants, by right of representation; failing that, to the decedent's parents, equally; followed by the decedent's siblings; followed by grandparents, aunts and uncles, cousins and so on.<sup>6</sup> The law of intestacy gives no standing to significant others, friends, or cultural institutions.

Preparing a Will can be intensely emotional because the artist will be forced to consider how he wishes to preserve his long-term creative legacy. It will be up to the artist's attorney to take his client's wishes and translate them into an estate plan that will address the particulars.

A Will controls "probate assets." Typically, these are assets that are owned in the decedent's name alone, not jointly owned with survivorship rights, and not owned by a Trust. Probate assets do not include those that pass by beneficiary designation, such as life insurance policies and retirement accounts with named beneficiaries. In New York, effective January 1, 2006, probate assets also do not include stock securities registered with beneficiary designations.<sup>7</sup> For the most part, artwork is a probate asset.

Once submitted to probate, a Will becomes part of the public record. On the other hand, Trusts that stand apart from Wills do not become public documents, and their administration is not subject to probate court supervision. If the artist wishes his estate matters to be kept private, he can have a very simple "pourover Will" that bequeaths all of the artist's property to a separate non-testamentary revocable Trust, of which the artist can be the initial trustee. The artist can then assign his art collection (and any other assets he wishes) to the Trust and manage his inventory through the Trust during his lifetime. The Trust will become irrevocable on the artist's death, when successor trustees will assume responsibility for carrying out the Trust's dispositive terms. (The Trust's terms would be similar to what a Will would have provided.) The Trust assets will not be subject to disclosure in the public probate record.

Preparing an artist's Will (or Trust, as the case may be) requires special consideration. For example:

- What will need to be done to protect the art collection immediately upon the artist's death?
- How valuable is the artwork, and how will the estate be able to dispose of it for the best price?
- What contractual obligations exist between the artist and third parties that might limit the artist's ability to dispose of artwork?
- Considering the relative illiquidity of artwork and the time it may take to liquidate, will there be cash flow problems for the survivors? If so, what measures can be taken to mitigate those problems?
- Will there be transfer and income tax issues?
- Who is best equipped to manage the artwork? Who is best equipped to manage the rest of the estate? Are they the same or different people?

**Unique Drafting Issues.** As far as property is concerned, artwork has unique attributes which require spe-

cial attention when drafting Wills and Trusts. Here are a few.

**Appointing Fiduciaries.** An executor's or trustee's job is to manage the estate entrusted to him or her. A visual artist whose estate is concentrated in unsold artwork would do well to appoint a competent team of fiduciaries to ensure that decisions are made in the best interests of the artist's estate and its beneficiaries. The team should include a person who understands the artist, his work and the complexities of dealing with artwork and the art market (an "Art Executor" or "Art Trustee"), and another unrelated person who is skilled with respect to other financial and tax matters. These fiduciaries should be expressly nominated and appointed in the Will or Trust.

Unrelated co-fiduciaries can act as "checks and balances" to safeguard the best interests of the estate. The artist must avoid making fiduciary appointments that invite conflicts of interest, as illustrated by the notorious *Estate of Rothko* case.<sup>8</sup> In *Rothko*, the renowned twentieth-century expressionist painter Mark Rothko appointed three co-executors by Will. One was a longtime friend and personal advisor who was also a stakeholder in the then-prestigious Marlborough Gallery, which purchased the artist's work from the estate at an unconscionably low price, under very poor contract terms. The second was a fellow artist (not-so-well-known) who negotiated an exclusive contract with the Marlborough Gallery on his own behalf with very favorable terms, but to the estate's detriment. The third co-executor was a layman with no specialized knowledge about the art market, who was adjudged as acting negligently by acquiescing to his co-executors' self-dealing practices. Surrogate's Court Judge Midonick cited the "curious atmosphere involving absence of hard bargaining, arm's-length negotiations, deliberate consideration and the presence of improvidence and waste verging upon gross negligence on the part of all the executors as well as breach of duty of disinterested loyalty on the part of the executor[s] . . ." and held that the estate's beneficiaries (Rothko's wife and children) were entitled to restitution for the decedent's paintings, including the value of those paintings that were sold by the Gallery for astronomical gain. When the case finally closed, the co-executors were held personally liable for millions of dollars in damages and fines.

Fiduciaries are entitled to compensation for their services. In New York, executors are generally paid based on a percentage of the probate estate.<sup>9</sup> Trustees are also paid based on percentages.<sup>10</sup> Where an artist's inventory of work comprises the principal asset, the governing instrument (Will or Trust) might specifically address the issue of fiduciary compensation to better reflect the realities of actual sales, royalty income, complications related to having to keep the estate open to control the sale of artwork over time, and other unique art-related quirks.

**Identifying Gifts of Work.** If an artist is giving specific artwork to individuals or institutions, the Will or Trust must be crystal clear when identifying the pieces so as not to be ambiguous. If works are named or numbered, the executor or trustee should have a reference catalog identifying specific works, variations and studies. If the artist is likely to change his mind about which pieces he wishes to give, the Will might state that with respect to each bequest, the executor has the discretion to select pieces within a fixed time period (no longer than nine months following death) and within certain descriptive parameters (e.g. size, medium, date), and the artist may give the executor a written "memorandum of wishes" from time to time for guidance.<sup>11</sup> Alternatively, the artist may let the legatee select the pieces he or she wishes to retain within a fixed time period.

**Copyrights.** Depending on when a work was created and how U.S. Copyright Law applies to that work, a copyright generally lasts for seventy years after the artist's death.<sup>12</sup> In the past, works created prior to 1978 were subject to a different set of laws concerning copyright renewal rights surviving the artist's death. Special care was thus required if pre-1978 works were part of an artist's estate. However, effective January 1, 2006, the renewal rights provisions under the old copyright law have sunsetted, and the "will bumping" issue has ceased to exist.<sup>13</sup>

An artist's copyright in a particular work is distinct from other ownership rights in the physical work.<sup>14</sup> Consequently, a Will specifically bequeathing artwork to individuals and organizations must be careful to state expressly whether the bequest includes the copyrights. A copyright owner has the power to control the reproduction of a work, giving rise to potential licensing opportunities (and royalty income). Ordinarily, an outright bequest of artwork should include language expressly bequeathing the copyright. An art museum might reject a bequest if it is not also given the copyright.<sup>15</sup> If a copyright is not expressly bequeathed along with the actual work, then it will pass as part of the residuary estate.

**Additional Administration Expenses.** An estate that is comprised of artwork, some of which is given away under the terms of the Will or Trust, will have special concerns about insurance and extraordinary storage, packing and shipping costs, especially when large or complex artworks and sculptures are involved. Security and insurance are particularly important, and the fiduciary in charge should make sure that sufficient coverage has been purchased to protect the interests of the estate and its beneficiaries. The Will or Trust should state expressly which party (i.e., the estate or the beneficiaries) will bear these costs. If the estate is to bear the burden, the expenses will be deductible against any estate tax liability under Internal Revenue Code ("Code") § 2053.



## Financial Matters: Appraisal, Valuation and Estate Taxes

**Appraisal and Valuation.** Overall, the goal of estate planning can be oxymoronic with respect to valuation: minimizing the value of an estate for estate tax purposes while maximizing value passing to estate beneficiaries. A visual artist's estate is complex, even if the artist considers himself to be of financially modest means. Not uncommonly, the artist's "net worth" is comprised primarily of his unsold artwork, and not much else. The value of this inventory of unsold artwork will vary depending on many factors, and although the artist could experience posthumous fame triggering instant appreciation in value, it is not unusual for the value of an artist's work to *fall* after death.<sup>16</sup>

For purposes of the federal estate tax, the value of a decedent's estate is the fair market value of all property he owns as of date of death, or if lower, fair market value on the date that is six months after the decedent's death (the "alternate valuation date").<sup>17</sup> The Code defines "fair market value" as "the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."<sup>18</sup> It follows that if a work is sold shortly after the artist's death, the estate tax value of that work is equal to the sale price, reduced only by expenses that would qualify as valid estate administration expenses under Code § 2053.<sup>19</sup>

Consequently, one of the executor's principal duties will be to obtain a professional appraisal of the artwork in the estate. A competent appraisal will consider the market demand for the artist's works in different mediums, in various sizes and proportions, and from different phases in the artist's career (e.g. Picasso's "Blue" or "Rose" period versus his later "cubist" work). To help the executor, the Will might suggest an appraiser with whom the artist has developed a relationship during his life. With art valuation being somewhat subjective (more of an art than a science, as many experts say), the Will might also require the executors to obtain a second appraisal for comparison.

The valuation must be based on the market for the artist's work at date of death, and if appropriate, should apply a "blockage discount" if the estate collection will cause the market to be "flooded" with a large number of the artist's work at one time. The theory is that, based on the general economic principles of supply and demand, if the public has access to a great supply of the artist's work, prices will be driven down. If the public's access is limited (that is, the supply is controlled over time), the prices are likely to be higher. Blockage discounts have been applied in several tax cases involving artists' estates.<sup>20</sup>

The *Estate of Smith* case illustrates some of the factors that should be considered when setting value. In addition to market conditions, relevant factors include the artist's reputation, the artist's sales history while living, and how the artist's death figures into valuation. The artist's death does not always mean automatic appreciation because, among other reasons, market prices can be depressed if there is a rush to sell a large portion of the inventory to raise cash to pay estate debts, expenses and taxes. Furthermore, the artist is no longer available to provide information about specific works.

Incidentally, the publicity that a Will may provide during the probate process has the potential to affect the art market. By informing the public of the estate's assets, the public has insight as to whether a large inventory of the artist's work will be put up for sale.<sup>21</sup> This could depress market values. Using a separate revocable Trust as part of the estate plan could mitigate this problem. In the event that a Trust has not been used and publicity issues might arise, it may be possible for the fiduciary to request that probate records be kept sealed.

**Estate Taxes.** Valuation is key when estate taxes are payable. The Internal Revenue Service ("IRS") has a special "art advisory panel" that reviews appraisals of substantial collections of art and checks valuations based on its own independent research.

If an estate exceeds the federal estate tax exemption amount, which is \$2,000,000 in 2006 and, under current law, increasing to \$3,500,000 by 2009, a federal estate tax return (IRS Form 706) and possibly a state estate tax return (as would be the case in New York State), will be due nine months after the date of death. State estate tax laws vary, but in New York, estates in excess of \$1,000,000 will be subject to tax. The federal estate tax is levied at a rate of approximately forty-five percent, and if there are state taxes as well, the total estate tax cost may be closer to fifty-five percent or more.

Given the increases in the federal estate tax exemption, only a small number of artists' estates should be federally taxable. The state estate tax will be the more pressing tax problem for artists living in states such as New York who have "decoupled" their estate tax regimes from the federal system.

There are some basic ways a Will can address the problem of estate taxes. By including provisions that utilize the estate tax exemption, the marital deduction (if the artist is married),<sup>22</sup> and the charitable deduction (if the artist wishes to donate his work to museums and cultural institutions), the portion of the estate wasted to taxes can be kept to a minimum.

**Planning for the Married Artist.** Generally, an estate planner will prepare a Will to avoid estate taxes on the



death of a decedent who leaves a surviving spouse. The goal is to defer taxes until the death of the surviving spouse using the “estate tax marital deduction” for property passing to a spouse. The marital deduction is available if the surviving spouse is a U.S. citizen, and special measures must be taken if the surviving spouse is a non-citizen.<sup>23</sup> By claiming the marital deduction, the property passing to (or for the benefit of) the surviving spouse will be taxed upon that spouse’s subsequent death. Consequently, a tax plan for a married individual calls for a bifurcation of the estate assets into two parts: a marital disposition (in Trust or outright) qualifying for the marital deduction, and a so-called “credit shelter” disposition (usually in Trust) using the decedent’s estate tax exemption.

By using formula language in the Will or Trust, the “credit shelter” amount is typically funded with assets equal to the estate tax exemption amount, and this amount is often held in Trust. Depending on the size of the artist’s estate, the primary tax concern may in fact be state estate taxes rather than *federal* estate taxes. As such, the Will’s funding language might opt to fund the Credit Shelter Trust with a lesser amount, such as the state estate tax exemption amount, so as to avoid state taxes at the first death. (Funding a Credit Shelter Trust with the full federal exemption amount will cause state estate taxes to be payable on the death of the first spouse to die.)

Assets not funding this “Credit Shelter Trust” fund the marital disposition. Marital deduction property can pass to the surviving spouse outright, or when appropriate, by way of a marital Trust that qualifies for the estate tax marital deduction.<sup>24</sup> Code § 2056(b) sets forth the different types of Trusts that qualify. In qualifying Trusts, the surviving spouse is given a substantial interest—almost equal to an outright ownership interest—in the Trust assets.<sup>25</sup> Sometimes an outright marital bequest is best from a planning perspective because it is simpler to administer, and the surviving spouse may, under the terms of his or her own Will, leave artwork to a museum or private foundation (or other charity) and benefit from the estate tax charitable deduction at death (as discussed below), reducing the overall tax bill.

The Credit Shelter Trust, on the other hand, can be much more flexible with its terms. It can be administered for the benefit of whomever the artist wishes. The Credit Shelter Trust is often called the “Family Trust” because it is usually for the benefit of the surviving spouse and living descendants. Drafted properly, the property of the Credit Shelter Trust can avoid taxation in the surviving spouse’s estate, as well as the children’s estates.<sup>26</sup> The Credit Shelter Trust is best funded with assets likely to appreciate in value over the longterm.

A common way to structure married clients’ estates to preserve tax planning opportunities is to bequeath the entire estate to the surviving spouse, and then to provide

that if the spouse “disclaims” part or all of the bequest, the disclaimed property will pass to a Family Trust. When a person disclaims an interest in property, the interest passes as if it had never been transferred to that person.<sup>27</sup>

Disclaimers are creatures of both state and federal law. To be valid for federal transfer tax purposes, the disclaimer must be valid under state law and written and delivered to the executor or trustee within nine months of date of death. In addition, the disclaimant must not have “accepted” the property or any of its benefits, and the property disclaimed must pass to a successor beneficiary without any direction by the disclaimant.<sup>28</sup>

Disclaimer-based estate planning has become very popular because it allows the family to wait until after the death of the first spouse to die to determine how much property should fund the Family Trust. There is no need for highly technical formula funding clauses in the instruments, and as such, no need to amend documents when the tax law changes. This estate planning approach can be particularly useful for artist-clients because of its flexibility. Most times, the value of the artist’s estate cannot be known until after death, and, as the federal estate tax exemption increases, most artists’ estates will not actually need the added complexities of tax-planning Trusts. After all, Trusts require trustees, administration and separate tax compliance, all of which translate to additional expense.

**Using the Charitable Deduction.** If the artist is not married, or is widowed, and estate taxes are likely to be an issue upon the artist’s death, then planning that utilizes the estate tax charitable deduction under Code § 2055(a) may be useful, particularly if some or all of the artwork will be given to museums, private foundations and other charitable institutions. In the context of the estate tax, the charitable deduction is a dollar-for-dollar reduction of the gross estate in the amount of the date of death fair market value of property passing to qualified organizations. It is not limited to cost basis or subject to percentage limitations, as is the case in the income tax context.<sup>29</sup>

Property being given to the charitable organization must represent the artist’s complete ownership interest in the property given to charity, and not a partial interest, if it is to qualify for the estate tax charitable deduction. For example, unless given in the form of a charitable remainder unitrust or annuity Trust, the artist cannot give an income interest in property to a non-charitable beneficiary, and the remainder interest to a museum.<sup>30</sup>

That is not to say, however, that the artist cannot donate all of his right, title and interest in an *undivided fractional interest* in a work to a museum. For example, suppose that the Will gives a museum an undivided 50 percent interest in a given painting. Such a transfer will

qualify for the charitable deduction. The remaining undivided fractional interest (here, 50 percent) may be separately bequeathed. The caveat is that each co-owner of the work must be expressly given a proportionate right to possess the work.<sup>31</sup>

Some museums will only accept a fractional interest gift if the donor gives them some assurance that they will eventually receive the remaining interest. It is also not unusual for some cultural institutions to refuse a gift of art without a companion gift of cash or other liquid assets that can “endow” the gift. Clearly, this can be an unexpected and disappointing result if the charitable deduction was needed to reduce estate taxes and proper arrangements were not made in advance. If testamentary charitable gifts will be a key component of a plan, the artist and his advisor ought to contact charitable beneficiaries during the planning phase and discuss any technicalities with them to make sure the tax strategy will work.

As an alternative, many artists have established private foundations during their lifetimes. A private foundation is ideal if the artist and his creative contributions are well-known and the artist wishes to make his work accessible to the general public over the long term. Most are nominally funded “standby foundations” until after the artist’s estate has been administered. If the private foundation complies with the exempt organization rules of the Internal Revenue Code, the estate will receive an estate tax charitable deduction for artwork distributed to it. Once a private foundation receives the artist’s collection from the estate, the foundation board can decide to exhibit pieces from it, loan it to museums, issue licenses or do whatever may be appropriate to continue promoting the artist’s legacy. Again, care is required to appoint board members who will not have conflicts of interest. The foundation’s tax exemption is jeopardized if the IRS finds board members and other disqualified persons engaging in acts of self-dealing.<sup>32</sup>

**Liquidity Concerns.** Because of the irregularity of their income stream, many artists are cash-strapped, particularly in years when they have not had a gallery exhibit or a major sale. This reality continues after the artist dies and the estate is comprised of valuable artwork and few liquid assets. How will the debts and expenses be paid? How will the taxes be paid by the estate tax filing deadline? Will a “fire sale” be needed to raise the necessary cash? As discussed above, distress liquidations result in lower sales prices, especially when artwork is concerned.

Section 6166 of the Code allows for deferred payment of federal estate taxes for estates holding substantial small business interests. However, under ordinary circumstances, it is unlikely that 6166 relief will be available to an artist’s estate, unless the artist forms a qualifying “active trade or business” (i.e., not a passive business

managing investment property). The better deferral provision can be found in Code § 6161(a)(2), which gives the IRS broad discretion to extend the time for payment of taxes for up to ten years if the estate has “reasonable cause” for being unable to pay. If the assets of the estate must be liquidated at a sacrifice price to pay the estate tax, the estate has reasonable cause to request an extension.<sup>33</sup> Of course, interest will accumulate over the time period when any tax is outstanding.

If the artist is facing a potential estate tax problem, he is one of the wealthy few. If taxes are a certainty, he should consider purchasing life insurance to provide liquidity for taxes and other expenses at death. If the artist is married and the estate is planned so that no tax will be payable on the death of the first spouse, perhaps a less expensive joint-and-survivor (“second to die”) policy would be a cost-effective option. Of course, life insurance is an additional asset that, if owned by the artist, will be subject to taxation in his estate. Fortunately, policies may be owned by an irrevocable life insurance Trust established by the artist, providing shelter from additional estate taxes.

The artist should also consider transferring appreciating assets during his lifetime in an effort to reduce his estate for estate tax purposes. Many of the sophisticated gift-giving techniques that estate planners generally recommend (such as gifts to irrevocable Trusts, family limited partnerships, Grantor Retained Annuity Trusts and the like) may be appropriate, but if the property being transferred is the artist’s own artwork, special tax issues will arise.

When donating artwork to a charitable institution during lifetime, for example, the artist-donor’s income tax deduction will be limited because of the artwork’s status as “ordinary income property” (as opposed to a capital asset), and unfavorable basis limitation rules applicable to that property.<sup>34</sup> Moreover, any lifetime transfers should be made with the understanding that (a) gifts to individuals in excess of the federal gift tax annual exclusion (currently \$12,000 per donee per year, \$24,000 if the donor is married and the spouse consents to gift-splitting) will require a federal gift tax return (IRS Form 709) to be filed; and (b) gifts of property other than cash and marketable securities (artwork) must be professionally appraised to meet the IRS’s “adequate disclosure” requirements and a qualified appraisal must accompany the federal gift tax return.<sup>35</sup>

Drafting a Will for an artist-client may seem like a simple matter because, at first blush, it might appear that the artist only has limited assets. The simplicity is deceptive, however, and a savvy advisor would do well to guide an artist-client through the myriad issues while designing an appropriate estate plan. Although the process may be tedious and emotionally taxing, the artist’s interests will be well served.

## Endnotes

1. Wakin, Daniel J., "When Death Means the Loss of a Cultural Archive," *The New York Times*, May 18, 2005.
2. See Merryman and Elsen, *Law, Ethics and the Visual Arts*, 4th Ed. (Kluwer Law International, 2002), p. 716.
3. Merryman and Elsen, *supra* at p. 746.
4. In-depth discussions about intellectual property concerns are largely beyond the scope of this article, as are the issues of artists who are not United States citizens or lawful permanent residents of the U.S.
5. These arrangements may generate income that will be includable in the estate for estate tax purposes as "Income in Respect of the Decedent," and also be subject to taxation as ordinary income. See Internal Revenue Code § 691(a); see also Priv. Ltr. Rul. 7830022, 9549023, 9549001, 9326043.
6. New York EPTL 4-1.1.
7. New York EPTL 13-4.1–13-4.12.
8. *In re Estate of Rothko*, 84 Misc. 2d 830, 379 N.Y.S.2d 923 (New York County Surrogate's Court 1975).
9. New York SCPA § 2307.
10. New York SCPA § 2309.
11. In many jurisdictions, including New York, a "memorandum of wishes" separate from the Will is not binding on the executor and will not be "incorporated by reference." Nevertheless, it is a practical way to minimize amendments to the Will. If the fiduciary or the beneficiary is given the discretion to choose works to be distributed from the estate, such selections must be complete prior to the filing of the federal estate tax return if the Will or Trust provides for charitable bequests for which the value of the estate tax charitable deduction must be determined.
12. 1976 Copyright Act, 17 U.S.C. § 302(a).
13. For a succinct summary of intellectual property-related estate planning considerations and specifically, a discussion of the "will bumping" problem applicable to pre-1978 work, see Hader, Cheryl E., "Making the Intangible Tangible: Planning for Intellectual Property," *Estate Planning Journal*, Nov. 2002.
14. 1976 Copyright Act, 17 U.S.C. § 202.
15. Also, if a work is bequeathed sans copyright to a charitable organization whose principal purpose is not related to displaying art (e.g., a hospital), there is a risk that the gift is of something less than the decedent's entire interest in the work and therefore fails to qualify for the estate tax charitable deduction under Internal Revenue Code § 2055(e).
16. Lerner and Bresler, *Art Law: The Guide for Collectors, Investors, Dealers and Artists*, 2nd Ed. (Practising Law Institute, 1998), p. 135.
17. Internal Revenue Code § 2032(a).
18. Treas. Reg. § 20.2031-1(b).
19. But note that cases hold that neither art dealer commissions on sales, nor buyers' premiums at auction, qualify as valid deductions that would reduce estate tax valuation. *Smith Est. v. Com'r*, 57 T.C. 650, 658 (1972), *aff'd*, 510 F.2d 479 (2d Cir. 1975); *Scull Est. v. Com'r*, T.C. Memo 1994-211.
20. See *Smith Est. v. Com'r*, *supra*; *O'Keeffe Est. v. Com'r*, T.C. Memo 1992-210, 63 T.C.M. 2699.
21. New York Surrogate's Court Rule § 207.20 requires the estate to file a list of assets (inventory) that shows the value of the gross estate. It may also be necessary to file a copy of the estate tax return at court, if a return is due, depending on whether the specific surrogate's court has adopted a filing requirement. New York Surrogate's Court Rule § 207.43.
22. Note, however, that same-sex marriage does not qualify for purposes of federal tax law. Estate planning techniques for same-sex couples is beyond the scope of this article.
23. Property passing to a noncitizen spouse must be held in a "qualified domestic Trust," subject to strict statutory rules set forth under § 2056A and related Treasury regulations.
24. Internal Revenue Code § 2056 sets forth the requirements for property to qualify for the estate tax marital deduction.
25. Examples: Spouse is given a life estate with a testamentary general power of appointment; or, at a minimum, a so-called "QTIP Trust" where spouse is given mandatory income interest with a right to compel the trustee to make property productive, and principal payable to no one except the surviving spouse (a QTIP election must be made on the federal estate tax return). If a QTIP Trust is to be funded with mostly unsold artwork, there may be a problem with the marital deduction, because the artwork is unproductive property which, until sold, generates no income for the surviving spouse.
26. If the Trust continues for the benefit of grandchildren, it can also be a way to use the artist's available Federal Generation Skipping Transfer Tax exemption under Internal Revenue Code § 2631. The GSTT is not discussed in detail in this article.
27. Code § 2518(a).
28. Code § 2518(b); Reg. § 25.2518-2; New York EPTL 2-1.1.
29. Qualified organizations are listed under Section 2055(a).
30. Internal Revenue Code § 2055(c)(2).
31. Reg. § 20.2055-2(e)(2)(i).
32. Code § 4941 and related regulations.
33. Reg. § 20.6161-1(a), Ex. 2.
34. Code § 170(a) and related regulations.
35. Reg. § 301.6501(c)-1(f).

**Gerald Morlitz is a solo practitioner and Director of Cowan Financial Group in New York City. He concentrates in estate and financial planning. Mr. Morlitz is a member of the Trusts and Estates Law, Family Law and Elder Law Sections of the New York State Bar Association. He is also a member and past Director of the Estate Planning Council of New York City, and a member and past President of the Financial Planning Association of New York City.**

**Elizabeth E. Nam is an advisor at RSM McGladrey, Inc., New York City (Westside office). Having practiced trusts and estates law for several years as a law firm attorney, Ms. Nam counsels high-net-worth individuals and their families with respect to estate planning, estate administration and related tax compliance matters. A member of the Trusts and Estates Law Section of the New York State Bar Association, Ms. Nam is admitted to practice law in New York and Massachusetts.**

In compliance with Treasury Department Circular 230, unless stated to the contrary, any federal tax advice in this article is not intended or written to be used and cannot be used for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.



# Rights of Lenders Accepting Works of Art as Collateral

By Dean R. Nicyper and Lissa C. Gipson

In recent years, art dealers and collectors have been pledging works of art as collateral for loans and financing with increasing frequency.<sup>1</sup> The informality of many art transactions,<sup>2</sup> however, at times can lead to uncertainty regarding whether a dealer or collector has sufficient rights in a work of art to pledge it as collateral for a loan. The extent of a borrower's rights becomes critical when a lender has to enforce a loan agreement by selling a work of art that the borrower had pledged as collateral. What rights does the lender have, however, in a work of art pledged as collateral if a dealer defaulting on a loan has not paid for it? In those circumstances, can the lender's rights to the artwork be superior to those of an unpaid seller?

In certain circumstances, a lender's rights are superior to the rights of a seller who has not been paid by an intermediary dealer. Some of those circumstances will surprise those not familiar with the law in this area. For example, a lender is likely to have greater rights if the dealer who pledged a work of art as collateral sent a bad check to the seller or if the dealer defrauded the seller, than the lender would if the dealer merely had not yet reviewed and approved the work of art.

Questions like these concerning a lender's rights in works of art arose in several cases we handled during the past few years—a period in which the law applicable to these issues was in the process of transformation. A series of cases involved an art dealer named Michel Cohen, who sold several paintings, allegedly selling each to several different purchasers. Cohen allegedly never paid the sellers for paintings he acquired from them and allegedly never delivered the paintings to purchasers, even though multiple purchasers for each of the paintings had paid Cohen the full purchase price.<sup>3</sup> Cohen's activities reportedly caused the numerous buyers and sellers aggregate losses that totaled at least fifty million dollars.<sup>4</sup> The buyers and sellers asserted competing claims to the works of art, as did a lender to which certain of the works had been pledged as collateral for loans the lender made to Cohen, the dealer. Resolution of the multiple legal actions that ensued required a careful analysis of complex, multiple legal theories in the many, often long-running, court battles.

Any determination of who, among sellers, consignors, buyers and lenders, has superior rights in works of art begins with an analysis of various provisions of the Uniform Commercial Code ("UCC"). The UCC contains different sections respectively covering sales of goods, rights of secured lenders, and rights arising out of consignments to dealers. Lenders accepting

works of art as collateral may have rights under UCC sections 9-319, 2-326 and 2-403. More specifically, if a transfer from the owner to the dealer is a consignment, as defined by the UCC, section 9-319 may apply. If the transfer is a sale or for an intended sale, sections 2-326 or 2-403 may apply. Section 2-326 applies to goods delivered to a dealer for sale or return. Section 2-403 addresses several types of transfers, such as where the transfer is a sale, a transfer for the purpose of a sale or an entrustment. If a work of art is physically stolen, no rights will be transferred with the property, and no one subsequently in possession of it will have any ownership rights in it unless it is first returned to, and then sold by, the owner.

This article addresses the potential rights of lenders accepting works of art as collateral that have been transferred in each of the above circumstances. The UCC sections discussed set rules for determining the respective rights of parties where there are two consecutive transfers of a particular item of property. The sections apply to sales and consignments of goods generally, not only of works of art. The provisions address situations in which "person A" (who, for example, might be the owner of a work of art who wants to sell it) transfers property to "person B" (who, for example, might be a dealer or other person who facilitates art transactions) and "person B" subsequently transfers it, whether through an intended sale, consignment or pledge as collateral, to "person C" (who, for example, might be a lender accepting the art as collateral or a buyer who then pledges the art as collateral). These UCC rules were designed, among other things, to resolve whether "person C's" rights to the property are superior to those of "person A" in situations in which "person B" has not paid "person A" for the property.

## The UCC Article 9 Statutory Scheme

### Background

In recent years, states have adopted the relatively new UCC section 9-319. Provisions concerning a secured creditor's rights in consigned goods which previously resided in section 326 of Article 2 (the article concerning sales of goods) have been appropriately moved to section 319 of Article 9 (the article concerning secured transactions).<sup>5</sup> Since UCC section 9-319 is relatively new, many courts applying it have referred to case law construing former UCC section 2-326, which contained many provisions that are nearly identical to provisions in the new section 9-319. The new section 9-319 articulates more clearly than the former section



2-326 the rights of a “consignee’s creditors.”<sup>6</sup> The aim and effect of the revision is to simplify the former UCC section 2-326 analysis by expressly giving to a consignee’s creditor rights that are identical to those of the consignor.<sup>7</sup> As many of the provisions of former section 2-326 have been incorporated into the Article 9 criteria for a “consignment” and because there are a limited number of cases in which courts have applied the revised section 9-319, we at times in this portion of the article refer to courts’ interpretations of the similar provisions of former 2-326. UCC section 2-326, as currently drafted, is discussed more fully in the part of this article that addresses UCC Article 2’s provisions.

### UCC Section 9-319 Consignment Provisions

As UCC section 9-319 applies exclusively to creditors of, and people who purchase from, a consignee, the first step in the section 9-319 analysis is to determine whether the transfer from “person A” (e.g., a seller) to “person B” (e.g., a dealer) is a “consignment” as defined by the UCC. If not, then section 9-319 will not apply to the transaction and it will be necessary for conflicting claimants to determine whether either of the Article 2 provisions, namely, section 2-403 or section 2-326, applies. Those Article 2 sections are discussed later in this article.

#### a. The Nature of the Transaction

Most of the criteria for the application of the UCC section 9-319 statutory scheme are contained in UCC section 9-102(a)(20)’s definition of the term “consignment.” Notably, the definition does not require that the terms of the consignment be contained in a writing.

The first, and arguably most important, criterion for a UCC section 9-319 consignment is that the transfer from “person A” to “person B” must be “for the purpose of sale.” This is a common requirement of both the Article 9 and Article 2 statutory schemes discussed in this article.<sup>8</sup> The effect of the clause is that person B will obtain section 9-319 rights in the property only if the property is transferred to person B with the understanding between the parties that the property will be sold. Transfers of artwork that are not “for sale,” such as the transfer of a painting for the purpose of restoration or framing, will not be a “consignment” for purposes of Article 9. A theft of the artwork by person B, of course, also would not satisfy this criterion.

Another criterion is that the nature of the transaction must not “create a security interest that secures an obligation.” In other words, there will be no UCC Article 9 “consignment” where person A transfers the property to person B with the purpose of pledging the property as security for a loan or other obligation.

If in applying these first two criteria it is determined that the transfer from the seller (person A) to the dealer (person B) is a “for sale” transaction and not a transfer of security for an obligation, then the additional criteria in UCC section 9-102(a)(20) must be considered.

#### b. The “Merchant” Requirements

The next set of criteria focus on person B (e.g., the dealer) who is receiving the property. First, person B must be a “merchant,” which is defined as someone who deals in goods of the type being transferred—for our purposes, someone who buys, sells or otherwise deals in works of art.<sup>9</sup> Former section 2-326 similarly had required that the person receiving the goods maintain a place of business at which he dealt in goods of the kind being transferred to him.<sup>10</sup>

In addition, the merchant must not be an “auctioneer” and must conduct his business “under a name other than the name of the person making the delivery” or transfer. Person A (e.g., the seller) and person B (e.g., the dealer) therefore cannot be doing business under the same name. Former section 2-326 also had included this “different name” requirement.<sup>11</sup>

The Article 9 rules adopted from former section 2-326 the additional requirement that the merchant “not be generally known by its creditors to be substantially engaged in selling the goods of others.” Essentially, therefore, Article 9 requires person B to have acquired goods of others for the purpose of a sale, but creditors generally cannot know that person B is substantially engaged in making sales such as this of other people’s property. In construing this requirement, many courts have applied what has been termed the “majority test” in weighing the proof offered by the consignor to attempt to show that the person to whom he transferred goods was “generally known by his creditors to be substantially engaged in selling the goods of others.”<sup>12</sup> In other words, courts hold that a consignor must prove that a majority of the consignee’s creditors knew the consignee was substantially engaged in selling the goods of others.

Commenting on the type of evidence necessary to support this “generally known” standard, one court explained:

[Consignor] has submitted sworn statements from [affiant], the owner of a jewelry store that had consigned goods to [consignee] in the past and [another affiant], a former employee of [consignee]. Both men state that taking jewelry on consignment is a common practice in their business and that it was

generally known among creditors that [consignee] was substantially engaged in such practice. . . . The problem with this evidence, however, is that neither [of the affiants] is a creditor of [consignee]. Nor does either offer any but conclusory statements to suggest that he knows any such creditors, or purport even in conclusory fashion to have any first-hand experience in the relevant lending market. . . . In short, their statements shed no light on the operative question . . . namely, whether [consignee's] creditors generally knew that it was substantially engaged in selling consigned goods.<sup>13</sup>

Another court, in concluding that a consignor in the case before the court failed to meet its burden of establishing that the debtor was generally known by his creditors to be substantially engaged in selling the goods of others, explained that

[t]he only evidence presented at the hearing which bears some relevance to this issue was that approximately 250 of debtor's suppliers (which numbered approximately 600) provided goods to debtor on a consignment basis. Although this may indicate that some (but not most) of debtor's suppliers tendered goods to debtor on a consignment basis, and therefore perhaps one could infer that these consignment suppliers knew that debtor was substantially engaged in selling the goods of others, this does not prove that most of debtor's creditors knew that debtor was substantially engaged in selling the goods of others.<sup>14</sup>

As these cases demonstrate, the "generally known" standard is a difficult standard for litigants to satisfy. The difficulty is appropriate, however, because if this criterion is satisfied it will prevent person C from obtaining rights in the property on the premise that person C should have realized that the property was not owned by person B. In other words, where a majority of creditors knew person B dealt in consigned property, this UCC criterion draws the conclusion that the person C creditor similarly should have known that the property he received was consigned to, and not owned by, person B. The criterion significantly narrows the window of applicability of section 9-319 and should not be broadly construed.

### c. The Type of Goods Requirements

The definition of "consignment" under Article 9 further requires that the aggregate value of the property being transferred be at least \$1,000 and that "the goods [were] not consumer goods immediately before delivery." Article 9 defines "consumer goods" as "goods that are used or bought for use primarily for personal, family, or household purposes."<sup>15</sup> At least one court has held that where goods, such as automobiles, are held on the debtor's property as inventory for sale at a business, such goods are not held for a personal or household purpose and, therefore, they are not consumer goods for the purposes of Article 9.<sup>16</sup> Another court, noting that the paintings at issue in the case before the court were purchased for use in a business, found that that fact weighed in favor of a ruling that the paintings were not consumer goods.<sup>17</sup>

### d. Section 9-319

If the above criteria are satisfied, the transfer from person A to person B is a "consignment" under UCC Article 9. If the transfer qualifies as an Article 9 consignment, the provisions of section 9-319 can be applied to determine whether the consignor (person A) on the one hand or the consignee's creditor or good faith purchaser (person C) on the other hand has the superior interest in the consigned property. We will now discuss the analysis for making that determination.

The determination under section 9-319 is dependent upon whether the consignor "perfected" his security interest in the property. Perfection of a security interest is accomplished by either (i) possession of the goods or (ii) filing a UCC financing statement, which has the effect of giving public notice of the secured party's interest in the goods.<sup>18</sup> As a consignor generally relinquishes possession when consigning goods, under UCC section 9-319 it is incumbent upon consignors to file UCC financing statements to protect their interests in consigned goods upon consigning those goods to a dealer. If the consignor has not filed a UCC financing statement with respect to the property,<sup>19</sup> and if the lender has complied with the UCC rules for attaching a valid security interest—such as executing a signed security agreement with a debtor who has power to transfer rights in the property for value given by the lender—the lender is likely to prevail over the unpaid seller/consignor. The filing of a UCC financing statement therefore is the principal mechanism for a transferor/consignor to protect his interest in property he transfers to a dealer.

Whether pursuant to former UCC section 2-326 or the more recent section 9-319, courts have specifically rejected arguments that a consignor who has not been

paid for the property he transferred should prevail over a creditor with a perfected security interest in the property by merely claiming that the consignor is “the owner” of the property.<sup>20</sup> Courts explain that a party transferring his property to another for sale “could always have availed itself of greater protection” by filing a UCC financing statement and thereby recording its interest.<sup>21</sup> Finding in favor of a creditor with a perfected security interest over a consignor who failed to file a UCC financing statement is “consistent with the overall plan of the UCC, which generally favors good faith purchasers and encourages notice filing of security interests.”<sup>22</sup> Similarly, because another purpose of section 2-326 (and current section 9-319) is “to protect the debtor’s [*i.e.*, the consignee’s] creditors who may be misled by the secret reservation of title to the consigned goods,” the section 2-326 rule (and current section 9-319 rule) places the onus on the transferor/consignor to take certain steps to give notice to third parties (namely, potential creditors) if the transferor/consignor wishes to retain title in the goods after shipping them to another to be sold.<sup>23</sup>

Section 9-319 is the provision on which creditors most likely will rely for claims involving consigned goods because of its simplicity. If, however, the transfer to the debtor cannot satisfy the Article 9 consignment definition, provisions of Article 2 might provide alternative legal theories for lenders seeking to demonstrate a superior interest in property. The following portions discuss the applicability of UCC sections 2-326 (as currently drafted) and 2-403 to transactions involving loans for which works of art are accepted as collateral.

## The UCC Article 2 Statutory Scheme

If the criteria for a “consignment” under the Article 9 statutory scheme cannot be met, sections 326 and 403 of UCC Article 2 may provide creditors with legal arguments that would allow them to prevail against a person who transferred property to a debtor.

### Section 2-326

The amended UCC section 2-326 has been applied to transfers that have characteristics of many consignments, but do not satisfy all elements of the very specific definition of “consignment” contained in Article 9. Section 2-326 applies to “sale” transfers where the goods may be returned. The UCC provision has two categories: (1) transfers which are a “sale on approval” and (2) transfers which are a “sale or return” transaction.<sup>24</sup> Sales “on approval” occur in circumstances where goods are “delivered primarily for use” by the buyer. Under the “sale on approval” provision, the goods will not be subject to the claims by the buyer’s creditors until the buyer fully approves and accepts the goods.

“Sale or return” transactions are those in which the goods are “delivered primarily for resale” to another party. In other words, in these transactions, an owner (person A) delivers goods to person B primarily so that person B can resell them to a third party. As such, a “sale or return” transaction is likely also to satisfy some or all of the criteria for a UCC Article 9 consignment. Under section 2-326, goods that are sold in a “sale or return” transaction will be subject to the claims of creditors (*i.e.*, person C) while the goods are in person B’s possession.

The comments to section 2-326 explain that a “sale or return” typically is a sale of a volume of goods to a merchant where the merchant wishes to return the amount of goods he cannot sell. At least one court, however, has applied the new section 2-326 to consignment sales.<sup>25</sup> That court found that “the goods consigned to the debtor clearly were delivered on a ‘sale or return’ basis” where the debtor owned a shop that was engaged in the business of selling to retail customers various expensive items such as jewelry, art, collectibles and furniture that it held on a consignment basis. The shop was authorized to sell the consigned pieces by private sales or, in its discretion, by auctions. The shop filed for bankruptcy protection. The bankruptcy court held that the shop’s bankruptcy trustee could include consignment goods in the debtor’s possession as property of the debtor’s estate, which would be subject to the claims of the debtor’s creditors. The court noted that “[t]his may strike the consignors as grossly unfair, but that is the balance that the State of New York reached among competing parties.”<sup>26</sup> The court further explained that the consignors were “under constructive notice of the provisions of the UCC that subordinated their rights to the return of any of their goods to the superceding claims of the creditors of the debtor.”<sup>27</sup> A consignor’s only recourse therefore is to perfect its security interest in property—*i.e.*, by filing a UCC financing statement—so that the claims of the consignee’s creditors will not prevail.

A court in another jurisdiction reached the same result, finding that “[w]ith regard to consigned goods, there is a presumption that goods are being held by the debtor ‘sale or return’; therefore, the goods are subject to the claims of the debtor’s creditors.”<sup>28</sup> The court relied on Florida’s version of section 2-326, although apparently the older version.

Therefore, although there is little case law applying the recently amended section 2-326, it appears that the section can serve as an alternative method to give creditors rights in a debtor’s goods being held on consignment even where the “consignment” may not satisfy all of the criteria for an Article 9 “consignment.”



## Section 2-403

Under UCC section 2-403, a person purchasing artwork from a dealer acquires whatever title the dealer has or whatever title the dealer has the power to transfer. Subsections (1) and (2) of UCC section 2-403 both may be applicable to resolve competing claims in circumstances in which a dealer (person B) to whom works of art are transferred in turn transfers them to a third-party purchaser or lender (person C), but fails to pay the person (person A) who sold or transferred the artwork to the dealer.<sup>29</sup> To determine whether the third party has acquired good title, the criteria that are applied to the transaction between the seller (person A) and the dealer (person B) are different than the criteria that are applied to the subsequent transaction between the dealer (person B) and the acquiring third party (person C). We therefore will analyze the two transactions separately.

Under section (1) of UCC section 2-403, if a seller (person A) delivers the artwork to a dealer (person B) in what is referred to as a “transaction of purchase” (the definition of which is discussed below), the dealer has the power to transfer good title to a buyer or lender (person C) if the buyer or lender qualifies as a “good faith purchaser for value” (the definition of which also is discussed below). UCC section 2-403(1) permits a dealer even with “voidable title” to pass “good title” to another despite the dealer’s fraud or payment for the artwork with bad checks. In other words, even if the dealer does not pay the seller, or even if he defrauds the seller, the dealer can transfer good title to someone else, such as a buyer or a lender.

If, however, person B steals the artwork from person A in an actual theft, as distinguished from a voluntary but fraudulent transfer, person B only obtains what is referred to as “void” title, meaning no title at all, so that person B cannot transfer any title or rights in the stolen property to person C.<sup>30</sup> Even if an innocent buyer pays full value for a previously stolen work of art, and regardless of the number of innocent purchasers through whose hands the work of art already has passed, the buyer does not receive good title to it. The owner from whom it was stolen and her heirs often are able to take back the stolen artwork without having to compensate any of the innocent purchasers.<sup>31</sup>

In subsection (2) of UCC section 2-403, the Code covers additional circumstances in which good title can be transferred, but, unlike subsection (1), subsection (2) requires that the dealer receiving the work of art from person A be a Code-defined “merchant” to whom the artwork was “entrusted” and who, in turn, transfers the artwork to a Code-defined “buyer in the ordinary course.” A buyer may receive good title from the dealer based on either subsection (1) or subsection (2) of UCC section 2-403, or based on both sections if the criteria for

both sections are met. The sections are not mutually exclusive.<sup>32</sup>

The “entrustment” section, UCC section 2-403(2), however, does not apply directly to a lender who is the “person C” recipient of the work of art because a lender to which a work of art is pledged is not considered to be a “buyer in the ordinary course”—an essential element for application of section 2-403’s subsection (2).<sup>33</sup> Section 2-403(2) accordingly is applicable only indirectly to lenders (*i.e.*, if they lend to people who are deemed to be buyers in the ordinary course), and therefore we will discuss the criteria for that section only briefly before following with a more detailed discussion of lender’s rights under section 2-403(1).

### a. Application of UCC Section 2-403(2)

#### (1) The “Entrustment” Criterion

The “entrustment” requirement of subsection (2) of UCC section 2-403 is more encompassing than the parallel “transaction of purchase” requirement in subsection (1) of section 2-403. “Entrusting” is defined in section 2-403(3) to include “any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties. . . .” The definition of entrustment is very broad. As one court stated, “entrusting” can include “everything short of armed robbery.”<sup>34</sup> A transfer can be an entrustment even if the tactics used to procure the entrustment could be deemed “larcenous under the criminal law.”<sup>35</sup> The definition may include a sale arrangement or a “transaction of purchase,” which is the type of transfer required for subsection (1) of section 2-403 (discussed in greater detail in the next part of this article),<sup>36</sup> a consignment, which is the type of transaction addressed in section 9-319 (discussed earlier in this article) or even an owner’s leaving goods with a dealer so that they can be cleaned or repaired.<sup>37</sup>

#### (2) The “Buyer in the Ordinary Course” Criterion

While an “entrustment” under section 2-403(2) will include more types of transfers from person A to person B than a section 2-403(1) “transaction of purchase,” the requirement of section 2-403(2) for the transfer from person B to person C—*i.e.*, that person C be a “buyer in the ordinary course of business”—is narrower than section 2-403(1)’s requirement that person C be a “good faith purchaser.”<sup>38</sup> A “buyer in the ordinary course of business” is defined as a person who buys goods from a person who is in the business of selling goods of that kind.<sup>39</sup> The buyer must buy in good faith, without knowledge that the sale violates someone else’s rights in the goods. The good faith standard is more onerous for dealers than for ordinary buyers and requires dealers to make inquiries into the ownership of the goods being sold, as is also required under the “good faith purchaser” element of subsection (1). This distinction

regarding dealers is discussed in greater detail later in this article in the section addressing the “good faith purchaser” criterion of subsection (1).

The definition of a “buyer in the ordinary course” excludes people who buy from pawnbrokers and excludes buyers who acquire the goods in a bulk transfer.<sup>40</sup> The definition also expressly excludes buyers who acquire the goods as security for a money debt.<sup>41</sup> It is this last criterion that precludes lenders accepting works of art pledged as collateral for a loan from qualifying as buyers in the ordinary course of business.

Since, as a result of this last criterion, subsection (2) is not directly applicable to lenders, we will not discuss it in any greater detail. Instead, we focus next, and in much greater detail, on subsection (1), which can apply directly to lenders.

#### **b. Application of UCC Section 2-403(1)**

Like section 2-326, section 2-403(1) favors innocent purchasers over unpaid sellers. As one court explained, the policy of favoring innocent purchasers:

[R]ests on the premise that it is cheaper for an owner to take precautions against giving title to a defrauder than it is for a [third-party] purchaser to research the chain of title of every good he purchases . . . [because] the original owner has an opportunity to take precautions against fraud, bad credit, and related commercial problems. The buyer may be lying to the owner, or may be using a bad check to pay for the goods. These are things an owner can, at least in theory, take precautions against. If, on the other hand, the person who later becomes a seller breaks into the owner’s house and steals the good . . . the owner cannot take precautions as easily.<sup>42</sup>

For this reason, courts’ decisions in this area generally follow the principle that a voluntary “transferor [seller] ought to run the risk of the purchaser’s fraud as against innocent parties.”<sup>43</sup>

#### **(1) The “Transaction of Purchase” Criterion**

Under UCC section 2-403(1) “[w]hen goods have been delivered *under a transaction of purchase*” to the dealer, the dealer receives “voidable title,” giving him the ability to transfer good title to a good faith purchaser. If the dealer himself is buying the artwork in a simple purchase and sale transaction, the transfer unquestionably constitutes a “transaction of purchase.”<sup>44</sup> In such a transaction, even where the dealer gives the seller his own checks and the seller accepts those checks as

payment for the goods but the checks are later dishonored, there can be a “transaction of purchase” under section 2-403(1).<sup>45</sup> Similarly, even if the dealer acquires the works of art from the seller under false or fraudulent pretenses, the transaction can qualify as a “transaction of purchase.”<sup>46</sup>

The transfer need not be a direct purchase and sale between the seller and the dealer, but the extent to which other types of transfers might qualify as “transactions of purchase” is less clear. The UCC defines “purchase” broadly to include any “taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property.”<sup>47</sup> If the dealer and seller arrange to have the dealer sell the painting to a third person, but not pay the seller until after the dealer is paid by the buyer, the transaction can qualify as a transaction of purchase. As one court held, a transferee receives the requisite “interest” in the property to constitute a “transaction of purchase” under section 2-403(1) where the transferor “voluntarily delivered” the goods to the transferee “for conversion and sale,” notwithstanding that the transferee subsequently was to “sell [the goods] to its customers” and “[o]nly when the unit had been sold was [the transferee] obligated to remit the original purchase price to [the transferor].”<sup>48</sup> The fact that the dealer will owe no money to the seller until after the dealer sells the goods to a third party therefore will not prevent the dealer from receiving “voidable title” under section 2-403(1) at the time the goods are delivered to him.

What transfers do not qualify as “transactions of purchase”? Clearly, as we explained earlier, an involuntary transfer, such as a theft, will not give the thief any rights in the property and therefore the thief will not have the ability to transfer any legal rights in the property to others. Also, if goods are delivered for storage, cleaning or repair, the transaction would not be considered a transaction of purchase, although such transfers of property may qualify as “entrustments” under subsection (2) on 403. Instead, the “transaction of purchase” requirement under the Article 2 statutory scheme requires that the transfer be associated with a purchase and sale. That requirement of section 2-403(1) is, therefore, similar to the requirement for either an Article 9 “consignment” or a section 2-326 “sale or return,” which, as we discussed above, requires the transfer from person A to person B to be “for the purpose of sale.”

The discussion in the preceding paragraphs focuses on the transaction between the seller (person A) and the dealer (person B). If the seller-to-dealer transaction is deemed to be a transaction of purchase, the next step in determining whether the rights of a lender or purchaser (person C) under UCC section 2-403(1) are superior to

those of an unpaid seller (person A) is to analyze the transaction between the dealer and the buyer or lender (*i.e.*, the person B-to-person C transaction). The following paragraphs address the criteria of section 2-403(1) applicable to that second transaction.

## **(2) The “Good Faith Purchaser for Value” Standard Under UCC Section 2-403(1)**

For a buyer or lender (person C) to obtain good title from a dealer (person B) who acquired a work of art in a transaction of purchase, the buyer or lender must qualify as a “good faith purchaser” and must have given “value” in exchange for acquiring the work or rights to it. The UCC does not specifically define “good faith purchaser,” but a definition can be derived from its various definition provisions.

“Good faith” is defined in the UCC as “honesty in fact in the conduct or transaction concerned.”<sup>49</sup> The UCC defines “purchaser” as “a person who takes by purchase,”<sup>50</sup> and defines “purchase” to include “taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property.”<sup>51</sup> Applying the UCC’s definition of “value,” courts have explained that “[a] binding commitment to extend credit or to extend a pre-existing indebtedness, accepting delivery under a pre-existing contract, or any other consideration sufficient to support a simple contract, all may constitute value.”<sup>52</sup> Accordingly, courts have held that a secured creditor generally can be a “purchaser” for purposes of being a “good faith purchaser for value” under UCC section 2-403(1).<sup>53</sup>

### **(i.) Honesty in Fact in the Conduct or Transaction Concerned**

To be accorded “good faith purchaser” status, a buyer or secured creditor must be found to have been “honest[] in fact in the conduct or transaction concerned.”<sup>54</sup> This criterion, at the very least, should prevent a buyer from colluding with a dealer in a scheme to obtain a work of art from the seller without paying for it. It is clear, therefore, that to qualify as a good faith purchaser, the buyer cannot know of, or knowingly participate in, any improper scheme to obtain the work of art from the seller. Even if the buyer does not have direct knowledge, the buyer will not be considered a good faith purchaser if the transaction raises obvious red flags so that the buyer should have known the transaction involved dishonesty.

This is where the law enters a gray area. If the transaction raises flags that are not reasonably recognizable, a private buyer generally will not have an obligation to make inquiries or conduct due diligence regarding the honesty and good faith of the transaction.<sup>55</sup> There is a different standard, however, for buyers who are art merchants, as is discussed in the next part.

### **(ii.) Merchants Have a Duty to Inquire About Ownership of the Works Being Acquired**

UCC section 2-103(1)(b) contains a separate definition of “good faith” that applies to people and entities deemed to be merchants under the UCC. The UCC broadly defines “merchant” as “[i] a person who deals in goods of the kind or [ii] otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or [iii] to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.”<sup>56</sup> The separate definition of “good faith” for merchants provides that in the case of merchants, “good faith . . . means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.”<sup>57</sup> That definition has been construed by certain courts to impose on merchants a duty to inquire into the legitimacy of the transaction and the parties’ rights in the property being sold.<sup>58</sup> Under such courts’ analyses, those who could be considered “art dealers” or “art merchants” must undertake such an inquiry when works of art are purchased.

There are several cases regarding buyers and sellers of artwork where the buyers were deemed merchants and, because of the higher standard for merchants, the courts evaluated whether the merchants made appropriate inquiries into title and ownership of the works of art they were buying. For example, in *Porter v. Wertz*,<sup>59</sup> the court held that a gallery buying and reselling a Maurice Utrillo painting failed to make the sufficient inquiries required of a merchant to qualify as a “good faith purchaser.”

In that case, the plaintiff Samuel Porter sought to recover the value of a Maurice Utrillo painting. Porter was an art collector who bought the Utrillo painting. Subsequently, an individual who used the name Peter Wertz, but whose real name was Harold Von Maker, told Porter he was interested in possibly buying the Utrillo. Porter permitted Von Maker to have the Utrillo painting temporarily with the understanding that Von Maker would hang it in his home pending Von Maker’s decision whether to buy it.<sup>60</sup> A couple of months later, Porter sought to retrieve the Utrillo from Von Maker, but was unable to reach Von Maker. Porter investigated and determined that he had not been dealing with Peter Wertz, but instead had been dealing with Harold Von Maker, a person who was subject to various court judgments, had an arrest record and had been convicted of crimes including a scheme to defraud Chase Manhattan Bank.

Porter’s attorney then negotiated an agreement with Von Maker’s attorney specifying that the Utrillo belonged to Porter, that it was on consignment with Von Maker’s client, and that Von Maker would either



pay for it or return it within ninety days. Unbeknownst to Porter, however, Von Maker already had sold the Utrillo to art dealer Richard Feigen and the Feigen Gallery by using the real Peter Wertz to effect the sale to the Feigen Gallery. The Feigen Gallery had found a buyer for the Utrillo, named Irvin Brenner, who had his own gallery. Brenner then had sold it to a buyer who transported the Utrillo to Venezuela.

Porter sued Wertz, Brenner and the Feigen Gallery. The court rejected the Feigen Gallery's defense that it was a "good faith purchaser." Determining that the Feigen Gallery was an art merchant, the court applied the "good faith" standard applicable to merchants, and admonished that the standard "should not and cannot be interpreted to permit, countenance or condone commercial standards of sharp trade practice or indifference as to the 'provenance,' i.e., history of ownership or the right to possess or sell an object d'art, such as is present in the case before us."<sup>61</sup> The court found that the Feigen Gallery had conducted no investigation regarding the status of Wertz. Had the Feigen Gallery done so, the court said, it would have found that Wertz was a delicatessen employee and not an art dealer.

The court also found that the Feigen Gallery made no effort to determine whether Wertz was the owner or authorized by the owner of the Utrillo painting to sell it. The court suggested that if the Feigen Gallery had found that Wertz was a delicatessen employee, it would have suspected that Wertz was not authorized to sell the painting. The court also explained that the gallery had available to it an expert book on the painter Maurice Utrillo which included in its catalogue the Utrillo painting at issue in the lawsuit. It was the court's view that the book "could have raised a doubt as to Wertz's right of possession, calling for further verification before the purchase by Feigen was consummated."<sup>62</sup> The court, however, acknowledged that the book "alone might not have been enough to put Feigen on notice that Wertz was not the true owner at the time."<sup>63</sup>

The court never explained why the book or its availability should have raised doubt in gallery employees' minds about the transaction. Generally, provenance descriptions, including those in catalogues raisonn  , do not identify the complete history of ownership of a work of art. They merely include some of the better-known prior owners of the work of art whose prior ownership is of sufficient significance to affect the value of the work. The expert book on Utrillo to which the court in *Porter v. Wertz* referred did not identify Porter as the current owner of the painting. Nonetheless, the court held that because the gallery failed to investigate, failed to find out that Wertz was a delicatessen employee and failed to review the Utrillo book which was available to it, the gallery could not qualify as a good faith purchaser.

The gallery argued that its failure to check Wertz's authority to sell the painting was consistent with the practice of art dealers. The court responded that mere consistency with the practice of the trade "does not excuse such conduct."<sup>64</sup> On appeal, the appellate court also harshly criticized the gallery's assertion that its actions were consistent with industry practice. The appellate court repeated an observation of the trial court, which had stated: "'in an industry whose transactions cry out for verification of . . . title . . . it is deemed poor practice to probe. . . .'" The court then admonished that "commercial indifference to ownership or the right to sell facilitates traffic in stolen works of art. Commercial indifference diminishes the integrity and increases the culpability of the apathetic merchant. In such posture, Feigen cannot be heard to complain."<sup>65</sup>

The *Porter v. Wertz* decision, and other court decisions in this area,<sup>66</sup> indicate that where art merchants are involved there is a shift away from the UCC's policy favoring innocent purchasers and toward a policy of placing the onus on the purchaser if he is an art dealer. The question that arises is how much investigation is enough? There are questions a gallery or dealer can ask and documents a gallery or dealer can demand, such as a bill of sale or a consignment agreement, to check the authority of a person selling a work of art. It is not clear that asking those questions or obtaining such documents, however, will expose someone else's deception. For example, a person engaging in the deception may not answer the questions truthfully or may produce a fraudulent bill of sale.

In a California case titled *Morgold, Inc. v. Keeler*,<sup>67</sup> the court ruled that an art dealer who purchased a painting that was the subject of a title dispute qualified as a good faith purchaser for value. The court found that the dealer/purchaser conducted a sufficient investigation to satisfy any concerns it should have had, based on the circumstances. The plaintiff contended that there were two red flags that should have raised concerns in the purchasing dealer's mind. One was that the prior owner had obtained the painting in exchange for a debt forgiveness. The other was that the purchaser had negotiated a dramatic reduction in the seller's asking price. In response, the dealer stated that it conducted an investigation that included discussions with a gallery that previously held the painting for sale, discussions with someone who was an expert concerning the artist of the painting, and research into the value of the painting itself by looking at publications of Sotheby's, Christie's and Butterfield & Butterfield. Through those investigations, the dealer did not discover the title dispute. The court ruled that the purchasing dealer's investigations were adequate for it to qualify as a good faith purchaser.<sup>68</sup>

In another recent case in Connecticut Superior Court, titled *Lindholm v. Brant*,<sup>69</sup> the court found that the defendant, Peter Brandt ("Brant"), who was the purchaser of a painting by Andy Warhol titled "Red Elvis," satisfied the art merchant standard by taking all reasonable steps to investigate the title to the painting when Brant purchased it from an art dealer named Anders Malmberg ("Malmberg"). The facts of the case are somewhat complex. Without recounting the facts in full, we summarize them here because they illustrate practices in which art dealers often engage and the complexity of applying the UCC rules to art transactions.

In *Lindholm*, Brant had been a collector of works of art by Andy Warhol and had at one time owned and sold the "Red Elvis" painting. Years later, after the painting had been purchased and sold several times, the plaintiff K. Lindholm, wife of M. Lindholm, purchased "Red Elvis" for \$300,000 from Malmberg, a Swedish art dealer, on whose advice K. Lindholm had relied for years. Ten years later, in 1998, K. Lindholm lent "Red Elvis" to the Guggenheim Museum for a Warhol exhibition. Brant, a member of the Board of Trustees of the Guggenheim, had told the exhibition's curator that the curator might be able to locate the "Red Elvis" painting by contacting a Swedish art dealer named Stellan Holm ("Holm"), because Brant was aware that Holm had business dealings with Malmberg and Brant remembered that Malmberg was associated with "Red Elvis" and its owner. Brant also was aware that Malmberg enjoyed a reputation as a well-respected art dealer.<sup>70</sup> Through the efforts of Holm, who contacted Malmberg, the Guggenheim was advised that K. Lindholm was willing to loan "Red Elvis" to the Guggenheim for the exhibition. Malmberg assisted K. Lindholm with the loan of the painting. On the loan form, K. Lindholm requested that the exhibition display "Red Elvis" with an identification plaque that read "Private Collection, Courtesy Anders Malmberg, Malmo, Sweden."

In 1998, M. Lindholm filed for divorce. In December 1999, after K. Lindholm attempted to sell various paintings that were in the home she had shared with M. Lindholm, the Family Court enjoined K. Lindholm from selling any property without a court order.

Throughout 1999, K. Lindholm maintained close contact with Malmberg. At approximately that time, however, Holm told Brant, based upon a conversation with Malmberg, that Malmberg had purchased "Red Elvis." Brant met with Holm and Malmberg, at which time both of them told Brant that Malmberg had purchased "Red Elvis" from K. Lindholm. This was a false representation. Brant indicated that he would be interested in purchasing the painting. On February 2, 2000, Brant agreed to pay Malmberg \$2.9 million for "Red Elvis." Malmberg gave Brant an invoice for the sale and

Brant wired a \$900,000 deposit to Malmberg. Brant, however, objected to the invoice's provision which required payment of the balance of the purchase price prior to delivery of the painting.

Brant therefore retained counsel who drafted a formal contract. One of the reasons for Brant's actions was that he was concerned M. Lindholm would claim the painting because the Lindholm divorce was a bitter one.<sup>71</sup> Numerous drafts of the purchase contract were exchanged between Brant and Malmberg. One of the terms in dispute was the location at which the painting would be delivered. Brant ultimately acquiesced to Malmberg's insistence that the painting be delivered in Denmark in a bonded warehouse. During the negotiations, Brant's lawyers conducted a UCC lien search and a search of the Art Loss Register. Neither of those searches indicated any claims to or liens concerning "Red Elvis."

Brant's attorney was uncertain whether Malmberg at that time already had title to "Red Elvis," or whether this transaction would be a "flip" transaction, *i.e.*, that Malmberg would take title from K. Lindholm and simultaneously transfer title to Brant, a procedure that is not uncommon in transactions involving art dealers. Brant's attorney therefore asked Malmberg to produce a copy of the invoice from K. Lindholm to Malmberg, but Malmberg refused on the ground that such invoices are not customarily disclosed in art transactions.

The Guggenheim prematurely ended the Warhol exhibition and contacted K. Lindholm for instructions concerning where to send the "Red Elvis" painting. The Guggenheim asked K. Lindholm to lend "Red Elvis" to the Guggenheim Museum in Spain. Malmberg, however, advised K. Lindholm that "Red Elvis" would receive better exposure in Denmark, and K. Lindholm therefore agreed to send the painting to Denmark.

As Brant had heard the Guggenheim's Warhol exhibition was ending prematurely, Brant also had discussions with the Guggenheim and asked the Guggenheim about the status of the "Red Elvis" painting. The Guggenheim told Brant that "Red Elvis" was being returned to K. Lindholm, who was identified as the lender on the loan forms. Brant told the Guggenheim that K. Lindholm no longer owned the painting and that Malmberg was now the owner. Brant also told the Guggenheim that Malmberg wanted the painting to go to Denmark. The Guggenheim contacted K. Lindholm who, after Malmberg had convinced her to send the painting to Denmark, told the Guggenheim that she had decided to send the painting to Denmark and that the painting should be released to Malmberg's custody for him to make the shipping arrangements. K. Lindholm sent a letter to the Guggenheim confirming those instructions.

Brant and Malmberg then finalized the purchase contract, and Brant wired the remaining purchase price amount to Malmberg's bank and took title to "Red Elvis" in Copenhagen. A year later, K. Lindholm read a magazine article that reported that Malmberg had sold "Red Elvis" to Brant. K. Lindholm commenced the *Lindholm v. Brant* lawsuit in Connecticut and asked Swedish authorities to prosecute Malmberg in Sweden. Two months later, Malmberg was convicted in Swedish court of gross fraud and embezzlement and judgment was entered requiring him to pay K. Lindholm.

In the *Lindholm v. Brant* action in Connecticut, K. Lindholm sued Brant for conversion of the "Red Elvis" painting. Brant argued in defense that he was a buyer in the ordinary course of business under UCC section 2-403(2) (the "entrustment" section). Finding that Brant was an art merchant, the court required Brant to satisfy the good faith standard for merchants, *i.e.*, to prove that he was honest in fact and observed the reasonable commercial standards of fair dealing in the art trade. The court held that "[w]here doubts or questions are raised in the merchant's mind regarding the seller's authority to sell, it is incumbent upon the merchant to seek 'further verification' before consummating the deal."<sup>72</sup>

The court found that there were several doubts and questions raised during Brant's extended acquisition of "Red Elvis." The court, however, found that with respect to each of these doubts and questions Brant, or his counsel, had taken reasonable steps to inquire into the title of the painting.<sup>73</sup> The court explained that Brant knew Malmberg had a good reputation as an art dealer; Holm, who was involved in the transaction and made the representation to Brant that Malmberg owned the painting, also was considered a reputable dealer; Brant retained counsel, which the court found to be an unusual step in art transactions; counsel engaged in due diligence including investigating UCC liens and checking with the Art Loss Registry; and Brant insisted on a formal contract rather than a simple invoice. The court further found: "it would have been an extraordinary measure for Brant to insist on seeing the signed invoice or letter from K. Lindholm to Malmberg," explaining: "As the experts, including plaintiff's expert Hoffeld testified, the vast majority of art transactions—worth millions of dollars—are completed on a handshake and an exchange of an invoice."<sup>74</sup> The court, accordingly, concluded that Brant "observed reasonable commercial standards of fair dealing in the art industry when he purchased 'Red Elvis' from Malmberg."<sup>75</sup> The court also found no evidence that Brant in fact knew Malmberg did not own the painting.

The different approaches by the courts in *Porter v. Wertz* and *Lindholm v. Brant* demonstrate that different facts can yield significantly different results when

courts apply the UCC standards. The fact that *Porter v. Wertz* was decided in 1979 and *Lindholm v. Brant* was decided in 2005 does not in any way indicate a shift in courts' analyses generally regarding this issue. In fact, it is the *Porter v. Wertz* opinion that is often cited by an intermediate New York appellate court. That decision, with its very strong language concerning art dealers' duties to inquire into a seller's title, was appealed to the New York Court of Appeals. Although the New York Court of Appeals affirmed the intermediate appellate court's decision, it did so on grounds other than the grounds relied on by the lower courts, which had focused on whether the purchasing art dealers had made sufficient inquiries regarding title and ownership of the painting at issue. With respect to the issue of whether art dealers have a duty to inquire into ownership and title of artwork being acquired, the New York Court of Appeals in its *Porter v. Wertz* decision expressly did not "reach the good faith question."<sup>76</sup>

As these cases collectively demonstrate, the extent to which the merchant's good faith standard will be applied to art transactions is unclear. Art professionals, however, should be aware that at least certain courts considering an appropriate set of facts are likely to require an art dealer to prove he or she took commercially reasonable steps to investigate the title and ownership of the work of art he or she purchased.

### (iii.) Should an Art Dealers' Good Faith Standard Be Applied to Lenders?

If a court were to require art dealers to investigate title prior to purchasing a work of art, should that same standard be applied to a lender accepting a work of art as collateral for a loan? In one of the cases we handled, the seller of a painting argued that a secured creditor to which a dealer had pledged works of art as collateral should have been held to the same standard as a gallery that buys and sells works of art and that the secured creditor should have undertaken an extensive investigation regarding ownership of the painting. Although the issue was never resolved, existing law suggests that while lenders may need to comply with practices common to the loan industry, they should not be required to make the same inquiries that art dealers are required to make.

Some courts have suggested that the extent of any "diligence" required by a secured creditor is simply to determine whether its security interest has effectively attached to the property and that no other party has already filed a UCC-1 financing statement that would put the lender on notice of another's interest in the property.<sup>77</sup> When an expectant lender checks for recorded filings in particular property and finds none, it can file its own UCC financing statement to record and give



notice of its security interest in the property. The lender should be able to safely rely on that filing to give it a superior interest in the property, provided that no one else has perfected a security interest in the property prior to the lender.<sup>78</sup>

The UCC, in addition to promoting the creditor's reliance on UCC financing statement filings, also is designed to promote the creditor's reliance on the fact that the debtor has possession of the property. As one court has explained, promoting that reliance furthers "the Uniform Commercial Code goal of efficient commercial transactions by allowing prospective creditors to safely rely on this logical inference [that because the debtor has possession of the collateral it "has the power to convey an interest in the goods as security for a loan"] without first undertaking time-consuming and costly searches for secret agreements purporting to deprive the [debtor] of the power to subject such goods to third-party claims."<sup>79</sup>

Lenders accepting collateral commonly check UCC filings for any recorded interests regarding that collateral. There would appear to be little to justify imposing on lenders accepting works of art as collateral a requirement that they also conduct the same investigation that art dealers must conduct. Lenders generally are not in the business of buying and selling works of art and therefore are not in the practice of researching the literature and other records regarding the provenance of a particular work of art. Financial institutions' expertise is in financial matters, whereas art dealers' and art merchants' expertise is in art sales, art markets and art history. Arguably, a financial institution's acceptance of works of art as collateral should not cause it to become an expert in the art market or history regarding a particular artist's works of art.<sup>80</sup> Law, policy and the usual practices of lenders therefore would appear to support the position that financial institutions accepting works of art as collateral for loans should not be required to make the same inquiries into art history and the ownership and provenance of artwork pledged as collateral as are art merchants and dealers when they acquire works of art.

## Endnotes

1. E.g., S. McGee, *Aesthetic Assets*, Art & Auction, Investment Annual 2005, at pp. 13-18. See E. Kinsella, *Using Artwork as Collateral: A Growing Trend*, ARTnewsletter, Vol. XXX, No. 18, Apr. 26, 2005.
2. See T. Robertson, *Theft Case Threatens The Art Of The Handshake*, Boston Globe, May 22, 2003. J. Bloom, *Buyers Beware: Protecting Against The Risk of Purchasing Stolen Art*, Entertainment, Arts and Sports Law Journal, Vol. 13, No. 2, Summer 2002.
3. A. Haden-Guest, *The Double Dealer*, New York Magazine, Aug. 6, 2001, pp. 28-33.
4. *Id.* at 30; A. Haden-Guest, *The Great \$50 Million Art Swindle*, forbes.com (Feb. 8, 2001).
5. See UCC section 9-319 and Official Comment. "[I]nsofar as creditors of the consignee are concerned, this Article to a considerable extent reformulates the former law, which appeared in former Sections 2-326 and 9-114, without changing the results." *Id.* Former section 9-114 entitled "consignment" has been repealed in light of the new section 9-319 statutory scheme.
6. See *In re Valley Media, Inc.*, 279 B.R. 105 (Bankr. D. Del. 2002) (purpose of new 9-319 is to protect consignee's creditors from claims of consignors that have undisclosed consignment arrangements with consignee).
7. Section 9-319 provides:
  - (a) Consignee has consignor's rights. Except as otherwise provided in subsection (b), for purposes of determining the rights of creditors of, and purchasers for value of goods from, a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to transfer.
  - (b) Applicability of other law. For purposes of determining the rights of a creditor of a consignee, law other than this article determines the rights and title of a consignee while goods are in the consignee's possession if, under this part, a perfected interest by the consignor would have priority over the rights of the creditor.
8. The first prong of the former section 2-326 analysis also required the court to determine whether the goods were delivered to a person "for sale." See former UCC section 2-326.
9. The Article 9 definitions section suggests referring to the Article 2 definitions sections to obtain the definition of merchant. See UCC section 2-104(1) ("Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.").
10. See *Nof v. Gannon (In re Gannon)*, 173 B.R. 313, 319 n. 6 (Bankr. S.D.N.Y. 1994) (bankruptcy debtor "did not maintain a place of business" where debtor was a salesman in another person's business).
11. See former UCC section 2-326.
12. *Valley Media*, 279 B.R. at 125 ("To satisfy the 'generally known' prong of the test, the [consignors] must prove that a majority of the [consignee's] creditors were aware that the consignee was substantially engaged in selling the goods of others, i.e., consignment sales . . . [and] [t]hat majority is determined by the number of creditors not by the amount of creditor claims.") (citing, *inter alia*, *In re BRI Corp.*, 88 B.R. 71, 75 (Bankr. E.D. Pa. 1988)).
13. *Berk v. State Bank of India*, 96 CIV. 4972, 1998 WL 567853, \*5 (S.D.N.Y. Aug. 28, 1998) (finding also the fact that the consignee was found to "have a substantial amount of consigned jewelry in its possession . . . reveals little about whether its creditors generally knew that it was engaged in selling consigned goods"). See also *Steege v. Affiliated Bank/North Shore Nat'l (In re Alper-Richman Furs, Ltd.)*, 147 B.R. 140, 150 (N.D. Ill. 1992) (finding majority of creditors test not met by evidence from consignor and employees of consignee (together representing 79 percent of creditor claims) that they "generally knew consignee to be substantially engaged in selling goods of others" because the test requires evidence from "outside" and "unrelated creditors," i.e., not consignor itself and employees of consignee).

14. *In re BRI Corp.*, 88 B.R. 71, 75 (Bankr. E.D. Pa. 1988) (citations omitted). See also *In re Tristar Automotive Group, Inc.*, 141 B.R. 41, 43 (Bankr. S.D.N.Y. 1992) (consignor could not meet burden of showing that the “generally known by his creditors” exception applied).
15. See section 9-102(23).
16. See *Automotive Finance Corp. v. Humberto Cornejo*, No. D044553, 2005 WL 1349904, \*7 (Cal. App. June 8, 2005).
17. See *Estate of Silver v. Wilson*, No. 237134, 2003 WL 21362809, \*2 (Mich. App. June 12, 2003) (holding that “trial court clearly erred in finding that the four paintings at issue were used by [purchaser] ‘primarily’ for person, family, or household purposes [under the UCC Article 9 definition of consumer good]”).
18. See UCC sections 9-310 and 9-313.
19. See UCC section 9-203.
20. See, e.g., *Automotive Finance*, 2005 WL 1349904, \*6.
21. *Mitsubishi Consumer Elecs. Am., Inc. v. Steinberg’s, Inc. (In re Steinberg’s, Inc.)*, 226 B.R. 8, 11 (Bankr. S.D. Ohio 1998).
22. *Automotive Finance*, 2005 WL 1349904, \*11.
23. *W.N. Provenzano v. Monahan & Co. (In re Monahan & Co.)*, 29 B.R. 579, 583 (Bankr. D. Mass. 1983), *aff’d*, 83-1610-MA, 1983 WL 160557 (D. Mass. Sept. 12, 1983).
24. Section 2-326 entitled “Sale on Approval and Sale or Return; Rights of Creditors” provides in relevant part:
  - (1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is
    - (a) a “sale on approval” if the goods are delivered primarily for use, and
    - (b) a “sale or return” if the goods are delivered primarily for resale.
  - (2) Goods held on approval are not subject to the claims of the buyer’s creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer’s possession.
25. *In re Morgansen’s Ltd.*, 302 B.R. 784, 788 (Bankr. E.D.N.Y. 2003).
26. *Id.* at 789-90.
27. *Id.*
28. *Furr v. Corvette Experience, Inc. (In re Corvette Collection of Boston, Inc.)*, 294 B.R. 409, 414 (Bankr. S.D. Fla. 2003).
29. Subsections (1) and (2) of UCC section 2-403 provide:
  - (1) A purchaser of goods acquires all title which his transferor had or had power to transfer . . . A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though
    - (a) the transferor was deceived as to the identity of the purchaser, or
    - (b) the delivery was in exchange for a check which is later dishonored, or
    - (c) it was agreed that the transaction was to be a “cash sale”, or
    - (d) the delivery was procured through fraud punishable as larcenous under the criminal law.
  - (2) Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in the ordinary course.
  - (3) “Entrusting” includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor’s disposition of the goods has been such as to be larcenous under the criminal law.
  - (4) The rights of other purchasers of goods and of lien creditors are governed by the Articles on Secured Transactions (Article 9), Bulk Transfers (Article 6) and Documents of Title (Article 7).
30. See *Kenyon v. Abel*, 36 P.3d 1161, 1166 (Wyo. 2001) (“It should be noted that Section 2-403(1) does not create a voidable title where the goods have been wrongfully taken, as by theft or robbery. If the goods have been stolen, the thief acquires no ownership and has no power, except in rare cases of estoppel, to pass a good title to a bona fide purchaser.”).
31. *O’Keeffe v. Snyder*, 83 N.J. 478, 488, 416 A.2d 862, 867 (N.J. 1980); *Erisoty v. Rizik*, No. 93-6215, 1995 WL 91406, \*9 (E.D. Pa. Feb. 23, 1995).
32. See, e.g., *Heinrich v. Titus-Will Sales, Inc.*, 73 Wash. App. 147, 160, 868 P.2d 169, 176 (Wash. Ct. App. 1994) (“Notwithstanding our affirmance of the trial court’s decision based on the [2-403(2)] entrustment doctrine, we also consider the voidable title doctrine [2-403(1)] . . . as an additional basis for recovery.”); *English v. Gateway Nat’l Bank*, 17 Cal. App. 3d 1038, 95 Cal. Rptr. 501 (Ct. App. Div. 3 Cal. 1971) (“[Transferor] either sold the car to [transferee under 2-403(1)] or it entrusted [transferee under 2-403(2)], a merchant of cars, with possession of the vehicle. In either event, [transferor’s] claim . . . in the vehicle could not prevail against the [plaintiffs] who were either [403(1)] good faith purchasers for value in the vehicle or [403(2)] buyers in the ordinary course of business.”).
33. See UCC section 1-201(9) and Annotations.
34. *Executive Coach Builders v. Bush & Cook Leasing, Inc.*, 81 Ohio App. 3d 808, 813, 612 N.E.2d 408, 411 (Ct. App. Ohio 1992).
35. UCC section 2-403(3).
36. *Heinrich*, 73 Wash. App. at 154, 868 P.2d at 173.
37. James J. White & Robert S. Summers, *Uniform Commercial Code*, pp. 190-92 (4th ed. 1995).
38. See comments to UCC section 2-403.
39. UCC section 1-201(9).
40. *Id.*
41. *Id.* See *Stellan Holm, Inc. v. Malmberg Int’l Art A.B.*, No. 1053, 2002 WL 392294, \*4 (S.D.N.Y. March 13, 2002).
42. *Welch v. Cayton*, 183 W. Va. 252, 257, 395 S.E.2d 496, 501 (1990).
43. *Kenyon*, 36 P.3d at 1166. See *Mid-Tenn. Ford Truck Sales, Inc. v. Lease Plan USA, Inc.*, No. 01-A-01-9302-CH00051, 1993 WL 266865, \*2 (Tenn. Ct. App. July 16, 1993) (under UCC section 2-403, “a good faith purchaser for value who acquires the goods from the dishonest middleman will acquire good title free of all claims [since] [t]his result ‘is predicated on the policy that where a transferor has voluntarily delivered the goods to a purchaser, he, the transferor, ought to run the risk of the purchaser’s fraud.’”).
44. *Sitkin Smelting & Ref., Inc. v. Wesgo Div. of GTE Prods. Corp.*, 648 F.2d 252, 254 (5th Cir. 1981).

45. *Heinrich*, 73 Wash. App. at 160, 868 P.2d at 176-77.
46. See UCC section 2-403(1)(d).
47. UCC section 1-201(32).
48. *Mid-Tenn.*, 1993 WL 266865, \*1-3 (court affirmed summary judgment because there was no "dispute of material fact on whether [transferee] acquired the goods in a transaction of purchase" under UCC section 2-403(1)).
49. UCC section 1-201(19).
50. UCC section 1-201(33).
51. UCC section 1-201(32).
52. *Harris Trust & Sav. Bank v. Wathen's Elevators, Inc. (In re Wathen's Elevators, Inc.)*, 32 B.R. 912, 919 (Bankr. W.D. Ky. 1983); UCC section 1-201(44).
53. See, e.g., *Quaker Oats Co. v. Affiliated of Florida, Inc. (In re Affiliated of Florida, Inc.)*, 237 B.R. 495, 497 (Bankr. M.D. Fla. 1998) ("It appears well-established that a secured creditor is a 'purchaser' for purposes of [UCC section] 403.>").
54. See UCC section 1-201(19) (defining "good faith" as meaning "honesty in fact in the conduct or transaction concerned"). See also *Sandoz Pharmaceuticals Corp. v. Blinn Wholesale Drug Co. (In re Blinn Wholesale Drug Co.)*, 164 B.R. 440, 443 (Bankr. E.D.N.Y. 1994).
55. *Graffman v. Espel*, 1998 WL 55371, \*6 (S.D.N.Y. 1998) (holding "[a]s a matter of law, [non-art dealers] had no obligation to investigate the provenance of the Painting . . . [because they] are not art dealers").
56. UCC section 2-104(1).
57. UCC section 2-103(1)(b).
58. See, e.g., *Porter v. Wertz*, 68 A.D.2d 141, 146, 416 N.Y.S.2d 254 (1st Dep't 1979), *aff'd on other grounds*, 53 N.Y.2d 696, 439 N.Y.S.2d 105 (N.Y. 1981). See also *Lindholm v. Brant*, 2005 WL 2364884 (Conn. Super. Aug. 29, 2005). But see *Interested Lloyd's Underwriters v. Ross*, 2005 WL 2840330 (S.D.N.Y. Oct. 28, 2005) (ruling that New York law is unclear with respect to whether an art dealer has a duty to investigate the provenance of a work of art being purchased).
59. *Porter v. Wertz*, 68 A.D.2d 141, 416 N.Y.S.2d 254 (1st Dep't 1979).
60. *Id.*, 68 A.D.2d at 143, 416 N.Y.S.2d at 255-56.
61. *Id.*, 68 A.D.2d at 146, 416 N.Y.S.2d at 257.
62. *Id.*, 68 A.D.2d at 146-47, 416 N.Y.S.2d at 257-58.
63. *Id.*
64. *Id.*, 68 A.D.2d at 149, 416 N.Y.S.2d at 259.
65. *Id.*
66. See *Cantor v. Anderson*, 639 F.Supp. 364, 367 (S.D.N.Y. 1986) (although the court did not expressly apply the standard of good faith applicable to art dealers, the court's analysis appears to be heavily influenced by a concern which is reflected in its statement that the "circumstances surrounding the Renoir placed a duty upon [the dealer acquiring the painting as payment for an antecedent debt] to inquire into the painting's ownership.>").
67. *Morgold, Inc. v. Keeler*, 891 F.Supp 1361 (N.D. Cal. 1995).
68. *Id.*, 891 F. Supp. at 1368-69.
69. *Lindholm v. Brant*, No. X 05 CV 020189393, 2005 WL 2364884 (Conn. Super. Ct. Aug. 29, 2005).
70. *Id.* at \*3.
71. *Id.* at \*5.
72. *Id.* at \*12.
73. *Id.* at \*13-15.
74. *Id.* at \*13.
75. *Id.* at \*15.
76. *Porter v. Wertz*, 53 N.Y.2d 696, 701, 439 N.Y.S.2d 105, 107 (N.Y. 1981).
77. See *Automotive Finance*, 2005 WL 1349904, \*6 (finding consign- or/prior owner of property "has not shown that [secured credi- tor] had any additional duty to check with the Department of Motor Vehicles regarding title to the consigned vehicles [to debtor]. The record shows [secured creditor] made a sufficient showing of diligence in determining whether the vehicles were subject to its security interests"); *J.R. Simplot Co. v. Sales King Int'l, Inc.*, 17 P.3d 1100, 1109 (Sup. Ct. Utah 2000).
78. See *J.R. Simplot*, 17 P.3d at 1109.
79. *Ciba-Geigy Corp. v. Flo-Lizer, Inc. (In re Flo-Lizer, Inc.)*, 946 F.2d 1237, 1240 (6th Cir. 1991).
80. See generally *Maryott*, 259 Neb. at 50-53, 607 N.W.2d at 827-29; *Harris Trust*, 32 B.R. at 919-21.

**Dean R. Nicyper and Lissa C. Gipson are partners at Flemming Zulack Williamson Zauderer LLP. They are in charge of the firm's Art Law practice, and both additionally handle general commercial litigation matters.**

**Catch Us on the Web at  
WWW.NYSBA.ORG/EASL**





# “Diploma Mills”—Am I Buying?

## An Education Problem, Not an Athletic Problem

*Why didn't someone tell me I could buy a diploma? Is it too late to purchase a JD? Maybe I can replace my 1L scores with a newly purchased 4.0 to land that high paying firm job!*

By Mark A. Hicks

### The Diploma Mill Superstar—University High School

In November, *The New York Times*<sup>1</sup> published an article detailing the problem of “diploma mills,” which is the business of providing fast, inexpensive, and in most cases, bogus diplomas. The article explained that in order to meet National Collegiate Athletic Association (“NCAA”) initial eligibility requirements, a number of current college athletes used correspondence classes<sup>2</sup> to raise their grade point averages (“GPAs”). While accurately describing how this important issue negatively affects both student-athletes and college athletics, the article failed to recognize that diploma mills have been a problem for many years, affecting not only amateur athletics, but also the educational integrity of athletes and non-athletes alike.

As the reporters highlighted, diploma mills harmfully impact intercollegiate athletics by leaving students unprepared for college and providing individuals the means to evade academic requirements. The student-athletes mentioned in *The New York Times* article were primarily interested in acquiring credit from “University High” that would have replaced previous scores. According to the article, Lorenzo Ferguson raised his GPA from 2.0 to 2.6 in one month, and Tavares Kendrick improved from 2.1 to 3.0 in about seven weeks.<sup>3</sup> The article also noted that regardless of how many courses were taken, a diploma could be purchased for \$399.

It is clear that University High and similar schools are not genuine educational institutions. Commenting on University High grading, one student said, “You take each course you failed in ninth or tenth grade. If it was applied math, you do them on the packets they give you. It didn’t take that long. The answers were basically in the book.”<sup>4</sup> The article also explained that grades received for such abbreviated coursework counted the same on transcripts as yearlong high school courses.<sup>5</sup>

In the days following the article, the powers that be in the world of intercollegiate athletics faced stinging criticism.<sup>6</sup> Right or wrong, the criticism was to be expected, and now the diploma mill dilemma, further exacerbated by the growth and increasing convenience of the Internet, requires immediate attention by intercollegiate athletic officials. More importantly, this problem

threatens to undermine education as a whole and thus requires direct action by a collective group of both education and government officials. Simply put, diploma mills are an education problem, and not just an athletic problem.

### An Education Problem, Not an Athletic Problem

Telecommunication and correspondence courses are an important and lucrative component in today’s educational climate. Not only do many highly regarded American institutions of higher education use distance-learning courses, but they also heavily market such curricula. Still, correspondence school fraud has existed for decades,<sup>7</sup> and has prompted a number of Congressional hearings, resulting in amendments to the Higher Education Act (“HEA”). Such language reflects concerns about the effects of fraud, abuse and wasting of financial aid, and has been amended to read:

A student enrolled in a course of instruction at an institution of higher education that is offered in whole or in part through telecommunications and leads to a recognized certificate for a program of study of 1 year or longer, or a recognized associate, baccalaureate, or graduate degree, conferred by such institution, shall not be considered to be enrolled in correspondence courses unless the total amount of telecommunications and correspondence courses at such institution equals or exceeds 50 percent of the total amount of all courses at the institution.<sup>8</sup>

Further, an institution cannot be considered an “institution of higher education” for the purpose of the HEA if the institution offers more than fifty percent of such institution’s courses by correspondence or enrolls fifty percent or more of the institution’s students in correspondence courses.<sup>9</sup>

On December 30, 2005, President Bush signed the Second Higher Education Extension Act of 2005, which continues both mandatory and discretionary HEA programs. Congress is also working on a bill that eliminates the “Fifty Percent” rule. Such a change will allow some

distance-learning institutions to offer student financial aid. "Under the conference report, a distance education program would be eligible for federal student aid purposes if a federally recognized accreditor . . . has determined that the institution has the capability to deliver effectively distance education programs."<sup>10</sup> These efforts confirm the growing trend that distance-learning schools are essential to the future of higher education.

Today, correspondence schools have grown beyond higher education and are surfacing in secondary education as well, an area lacking federal oversight. Unfortunately, these schools are bringing their problems with them. Obtaining a high school diploma through the Internet or via various correspondence schools is now as easy as obtaining a post-secondary degree through similar methods. In addition, factors, including the evolving nature of the diploma mill business, the fact that both college and homeschool students rely heavily on legitimate online courses, and the reality that educational institutions have heavily invested in the future of distance-learning education, further support the concept that policing the diploma mill problem is not merely an athletic issue.

Simple economics also support this conclusion. As reported in *The New York Times*, University High was purchased in 2004 for one million dollars and has maintained yearly revenues estimated at \$500,000.<sup>11</sup> Reporters uncovered only twenty-eight college athletes who claimed credits from University High. At the most, these athletes contributed only \$11,172<sup>12</sup> toward University High revenues. Therefore, if this is truly the case, there are *many* more non-athletes than athletes obtaining fraudulent credit.

However, due to minimum eligibility standards set by the NCAA and its member institutions, academic fraud and intercollegiate athletics are forever entwined. Furthermore, although the NCAA is not in the business of accreditation or classroom education, it shares the responsibility of helping to maintain the credibility of its student-athletes.

## The Role of the NCAA

The initial response is to cry foul and to blame the NCAA for failing to police the diploma mill problem. As any sports fan knows, the whistle is quickly blown on the NCAA the minute a scandal is exposed involving its athletes.<sup>13</sup> The natural impulse may be to blame the NCAA for the ills of college sports, as it does make for sensational news. However, a closer look at the process of initial-eligibility, combined with limitations placed on the NCAA, should cause readers to reevaluate claims that that organization, solely, lies at the root of the diploma mill dilemma.

Any student planning to participate in NCAA athletics must first register with the Initial-Eligibility Clearinghouse (the "Clearinghouse").<sup>14</sup> Located in Iowa City, Iowa, the Clearinghouse is an entity contracted by the NCAA to provide initial-eligibility oversight. For the graduating class of 2005, the Clearinghouse processed 142,383 new student release forms.<sup>15</sup> The certification process requires students to supply their complete educational record. The Clearinghouse then either certifies or denies a student's eligibility based on that information.<sup>16</sup> If a student's eligibility is denied, the university at which that student intends to matriculate may assist the student by submitting a "waiver." The waiver essentially acts as an appeal, and the student's eligibility is reconsidered, with the Clearinghouse often weighing extenuating circumstances.

Although it makes inquiries into particular schools and their courses, the Clearinghouse does not perform accreditation of schools and is careful not to delve too deeply into specific course curriculum. Roughly six years ago, faced with mounting criticism, it adopted a plan that shifted the responsibility of certifying core course curriculum to school principals.

In 1999, the NCAA received pressure from the secondary school community to reform its initial-eligibility guidelines. This pressure resulted in a hearing before the House Committee on Education and Workforce, where strong testimony criticized the NCAA's attempts at gauging the sufficiency of high school coursework:

And who is the NCAA to over-rule[sic] courses acceptable to universities like Yale, the Air Force Academy, or Harvard? Should the NCAA judge which high school courses are appropriate for college preparation? The National Association of State Boards of Education says, absolutely not. . . . A year ago the NCAA asked every high school in the nation to send in a description of each of its English, Social Studies, Math and Science courses. The NCAA's Clearinghouse, operated by the American College Testing Service, would decide which courses were acceptable. Imagine judging each core academic course offered by every high school in the country. It's clear why it takes a long time to get a response from the NCAA.<sup>17</sup>

Although Congress chose not to enact legislation on the matter, the Clearinghouse overhauled its core course system. Interestingly, seven years later the pendulum has made a full swing, and the NCAA now faces criti-

cism for its lack of involvement in determining the sufficiency of high school coursework.<sup>18</sup>

### **Accreditation as an Evaluation Tool**

One might argue that accreditation should be used as a tool to ensure the validity of schools. This will not work. Since educational authority is constitutionally reserved to the states, accreditation policies vary greatly throughout the country. Furthermore, many states do not require schools or school districts to obtain accreditation, although all states do assess *public* schools in some manner.

Assessment of non-public schools varies to an even greater degree than that of public schools. Under the Establishment Clause, federal and state governments are barred from (or are reluctant to) entering the realm of accrediting non-public schools. In addition, unlike higher education, where federal financial aid is contingent on accreditation, there is no federal control over non-public secondary schools. The use of accreditation as an evaluation tool, therefore, can realistically apply only to public schools, and fails to combat privately owned diploma mills.<sup>19</sup>

### **The Solution Team**

It is apparent that a solution to the diploma mill problem does not lie in the hands of one agency or association, but instead requires a combination of efforts. Although it can be expected that the NCAA will aid in stopping such abuse, its work can be enhanced with the help of both governmental intervention and assistance by membership institutions.<sup>20</sup> As noted previously, correspondence school fraud has existed for many years and it is unrealistic to expect an immediate resolution. Nevertheless, several actions and plans can help reduce this renewed problem. Such actions include:

#### **State Legislation**

States need to not only enact strong laws that target fraudulent schools, but collectively, they must work together to stop schools from migrating to those states with weaker educational laws.

#### **State Attorneys General**

State Attorneys General must make elimination of fraudulent schools a top priority. Until states take action to shut the doors of unlawful schools, this problem will continue to exist.

#### **Admission Counselors**

Admission counselors at NCAA member institutions can help curb the problem by scrutinizing applications, which include coursework from telecommunication or distance-learning secondary schools.

### **Stricter NCAA Clearinghouse Oversight**

The Clearinghouse should enact policies and procedures that call for tighter inspection of correspondence schools, including rigorous examination of such schools. However, with the growing viability and importance of online education, eliminating the use of correspondence coursework cannot be a solution.

### **Congressional Oversight**

With varying state education regulations, the interstate nature of the business, and the large revenues generated by diploma mills, Congressional oversight may also be needed. Congress should consider enacting legislation that specifically targets fraudulent schools and provides particular direction for the federal prosecution of such illegal action.

### **State Education Departments**

State Education Departments must be aware that diploma mills will be used by young high school students to dodge high school eligibility rules. State officials must recognize that this problem is not exclusive to only those students obtaining correspondence credit for college eligibility. It is highly probable that high school students will attempt to use correspondence resources to ensure their eligibility for high school activities. State officials must enact policies that aid school administrators in dealing with this problem.

### **Conclusion**

Stopping academic fraud is no easy task. If collective efforts are focused on eliminating diploma mills, some success can be achieved. Congress made an attempt in 1992 to eliminate such businesses with amendments to the HEA, which did help matters somewhat. However, with the convenience of the Internet, diploma mills have been given a new life. Innovations in technology now require new methods of policing, and both the educational sector and government, in addition to athletic organizations, must address this problem together.

### **Postscript**

Since the time this article was submitted for publication, a number of commentaries and news stories have addressed the diploma mill problem, calling into question several prep schools, the academic integrity of certain universities, the role of coaches in the recruitment process, and the eligibility policies of the NCAA.<sup>21</sup> While the unsuspecting reader may conclude that these later articles reveal new problems, they do little more than cast shadows on the already sad state of the diploma mill issue. These articles further support the conclusions of this writer—that the proper response to this



dilemma involves not only the NCAA, but falls squarely on the shoulders of all those involved in the business of education, as it relates to both intercollegiate and high school sports.

For example, Pete Thamel of *The New York Times* has written a comprehensive analysis of the complexity of this issue, revealing the nationwide (and perhaps international) scope of this problem. Thamel identifies several “so-called” prep schools, or learning centers, that awarded allegedly bogus diplomas. Such schools included Genesis One Christian Academy in Mendenhall, Mississippi; Boys to Men Academy in Chicago; Rise Academy in Philadelphia; God’s Academy in Irving, Texas; Redemption Christian Academy in Troy, New York; and Lutheran Christian Academy in Philadelphia (now notorious for Omar Williams and Maureece Rice, whom currently play for George Washington University).<sup>22</sup>

Although Thamel incorrectly asserts that the NCAA makes no inquiries into the authenticity of a high school’s curriculum,<sup>23</sup> he accurately describes the vast geographical depth of the diploma mill problem. Thamel illustrates that while some colleges admit students holding fraudulent diplomas, others do not. He also provides examples of college coaches who, while recruiting high school players, conveniently overlook a high school’s credibility, verifying the conclusion that accountability for the diploma mill problem lies in many hands, and not solely with the NCAA.

However, while maintaining that solutions must come from local, state, and national levels,<sup>24</sup> the NCAA has accepted its role at the center of this controversy and vows to reevaluate its current eligibility process. Early in 2006, the NCAA convened a special panel to review recent trends in secondary-school education, particularly the impact of diploma mills, and how initial-eligibility standards can be better aligned to address the problem. This group detailed a number of possible solutions, including:

- identifying prep schools that fall outside of state oversight or jurisdiction related to the quality and monitoring of the curricula, sorting out those schools that are not academically sound, and removing them from the list from which courses are accepted for review by the NCAA Initial-Eligibility Clearinghouse;
- limiting the number of NCAA-required core courses a student can take in his or her senior year of high school and beyond;
- examining the number of courses a high school student takes concurrently;

- considering whether to have testing agencies, such as those administering the ACT and the SAT, send results directly to the Clearinghouse; and
- requiring prospects to register with the Clearinghouse before or during their first official campus visits.<sup>25</sup>

Fortunately, the NCAA is not alone in its efforts to curb diploma mills, as some universities are now taking a stronger look at admission policies. For example, under mounting pressure over basketball players Omar Williams and Maureece Rice (who obtained diplomas through the allegedly fraudulent Lutheran Christian Academy in Philadelphia), George Washington University president Stephen Joel Trachtenberg announced that an internal review of the school’s admission policies has been initiated.<sup>26</sup>

In conclusion, tighter NCAA rules and reactive internal reviews alone are not enough to stop illegal schools. Accounts of academic fraud will continue to surface until collective action is equally assumed by the groups mentioned above. Plainly stated, student-athletes in pursuit of athletic stardom, and those in positions to gain from such individuals, will continue to use all possible means, both legitimate and illegitimate, in efforts to gain entrance to the courts and fields of intercollegiate play.

## Endnotes

1. Pete Thamel and Duff Wilson, *Poor Grades Aside, Top Athletes Get to College on \$399 Diploma*, N.Y. Times, Nov. 27, 2005, at A1.
2. For the purposes of this analysis, the terms correspondence schools, distance-learning schools, and telecommunication schools are considered synonymous.
3. Thamel & Wilson, *supra* note 1.
4. *Id.*
5. *Id.*
6. See Jim Gordon, *The Anti-Fan: NCAA Should Have Seen This Coming*, Santa Fe New Mexican, Dec. 7, 2005, at B1 (NCAA criticized for approving correspondence courses).
7. See, e.g., Bernard Harris, *A Question of Credentials*, Lancaster New Era, Oct. 25, 2005, at A1 (county official under scrutiny for obtaining doctorate degree from unaccredited institution); Paul Sperry, *Cut-rate diplomas: how doubts about the government’s own “Dr. Laura” exposed a resume fraud scandal*, Reason, Jan. 1, 2005, at 38 (federal employees caught in resume fraud based on bogus degrees); Dan Carnevale, *A Federal Rule Bedevils Online Institutions*, The Chronicle of Higher Education, Dec. 12, 2003, at 29 (article questions the wisdom of changing law that protects against correspondence school fraud); David Haldane, *Alleged Diploma-Mill Scam Netted \$10 Million; Correspondence school based in San Clemente gave students fake degrees, authorities say. Suspect is in prison on an unrelated matter*, L.A. Times, April 18, 2003, part 2, at 3 (arrests made in correspondence school scam); Daniel P. Finney, *Mailbox serves as college’s campus; West Des Moines example prompts a state review of registration rules*, Des Moines Register, Oct. 10, 1999, at 1A (P.O. box used as front for correspondence school scam).

8. Higher Education Act, 20 U.S.C. § 1091 (2005).
9. Higher Education Act, 20 U.S.C. § 1002 (2005).
10. Council for Higher Education Update, [http://www.chea.org/Government/HEAupdate/CHEA\\_HEA28.htm](http://www.chea.org/Government/HEAupdate/CHEA_HEA28.htm) (last visited, Jan. 24, 2006).
11. See Duff Wilson, *Owner Defends Florida School And Denies Any Wrongdoing*, N.Y. Times, Jan. 8, 2006, § 8, at 6.
12. This number is based on the average cost of course credit not exceeding a maximum amount of \$399 per student.
13. See, e.g., Fran Blinebury, *Players Always Seem to Lose NCAA Blame Game*, The Houston Chronicle, Mar. 13, 2003, at 2 (NCAA punishes innocent athletes while guilty parties walk free); Carol Slezak, *In His Defense*, Chicago Sun-Times, Sep. 15, 2002, at 117 (alleging NCAA contributed to University of Michigan student's infractions); Sam Smith, *NCAA's Stupidity Forcing Unprepared Players to NBA*, Chicago Tribune, Dec. 17, 2000, at C15 (suggests that NCAA rules are ruining young NBA players); Nick Doty, *SI is Right, but NCAA to Blame*, Minnesota Daily, June 16, 1999 (the NCAA and its rules are to blame for academic fraud at the University of Minnesota).
14. NCAA Initial-Eligibility Clearinghouse, [https://www.ncaaclearinghouse.net/ncaa/NCAA/student/index\\_student.html](https://www.ncaaclearinghouse.net/ncaa/NCAA/student/index_student.html) (last visited Jan. 25, 2005).
15. E-mail from Lisa Mills, NCAA Associate Director of Membership Services (Jan. 11, 2006 2:13 PM) (on file with author) (for the 2005 graduating class the Clearinghouse started a total of 152,648 student files).
16. To qualify for initial-eligibility, a student-athlete must possess a minimum level core course GPA and secure a qualifying SAT or ACT score.
17. *Education and the Workforce Early Childhood, Youth, and Families Education Program Restructuring: Hearing Before the H. Comm. on Education and the Workforce*, 104th Cong. (1999) (statement of Joe Nathan, Ph.D. and Director, Center for School Change, University of Minnesota Humphrey Institute of Public Affairs).
18. See, e.g., Ray Melick, *Colleges, Coaches Can Stop Diploma Mills*, Birmingham News, Dec. 4, 2005, at 4C (criticizing NCAA's role in diploma mills); Jim Gordon, *The Anti-Fan: NCAA Should Have Seen This Coming*, Santa Fe New Mexican, Dec. 7, 2005, at B1 (NCAA criticized for approving correspondence courses).
19. Fraudulent accreditation is a separate but important issue. Many correspondence schools have traditionally advertised their services as "accredited," even though accreditation had not been secured through reputable agencies.
20. See generally Duff Wilson, *Florida School In Sports Case Will Shut Down Under Pressure*, N.Y. Times, Dec. 24, 2005, D1 (school closed under pressure from Florida State Attorney's office); Duff Wilson, *N.C.A.A. Calls for Investigation Into Correspondence School*, N.Y. Times, Dec. 1, 2005, at D4 (additional steps proposed to combat diploma mills); Pete Thamel, *High School for Athletes Is Target of Florida Inquiry*, N.Y. Times, Nov. 29, 2005, at D2 (additional steps proposed to combat diploma mills).
21. See Pete Thamel, *Schools Where the Only Real Test Is Basketball*, N.Y. Times, February 25, 2006, at Section A; Column 1 (in-depth analysis of fraudulent prep schools geared toward basketball players only and how those schools arranged passing grades for NCAA eligibility purposes); Dan Steinberg, *Review Ordered At GW; Admissions Process For Athletes at Issue*, Wash. Post, Mar. 11, 2006, at Sports, E09 (George Washington University President Trachtenberg launches a review of the school's academic admissions process for athletes in response to a newspaper report questioning the academic background of the school's basketball players); Pete Thamel, *Nonaccredited Recruits Face New Scrutiny*, N.Y. Times, March 10, 2006, at Section D; Column 1 (NCAA and colleges to take stronger look at recruits from nonaccredited high schools); Mark Schlabach, *Testing Agency Reviewing Prep Coach's Status as Exam Proctor*, Wash. Post, Mar. 8, 2006 at Sports, E07 (American College Testing Inc. reviewing whether to continue allowing Darryl Schofield (who is part of an NCAA probe) and other coaches to administer the ACT. Schofield has administered the ACT and SAT more than a dozen times over the past two years); Mark Schlabach, *A Player Rises Through the Cracks; Academic History Of GW's Williams Reveals Flaws In NCAA Process*, Wash. Post, Mar. 5, 2006, at A Section, A01 (detailed account of several athletes who used fraudulent schools to circumvent NCAA eligibility requirements); Pete Thamel, *N.C.A.A. Wants to End Diploma Shortcuts*, N.Y. Times, February 28, 2006, at Section D; Column 1 (emergency NCAA legislation to be proposed in April to give the Association the power to do on-site visits at schools suspected of lacking sufficient academic rigor).
22. Pete Thamel, *Schools Where the Only Real Test Is Basketball*, N.Y. Times, February 25, 2006, at Section A; Column 1.
23. The Clearinghouse maintains a list of approved and non-approved high schools. Due to the Congressional pressure and demands from the secondary school community, in addition to an overwhelming number of schools, the Clearinghouse previously accepted self-reported information in an effort to gauge the validity of an educational institution. Fraudulent information provided to the Clearinghouse by certain high schools may provide one reason why some fraudulent schools went undetected by the NCAA.
24. *Eligibility panel plans prompt response to prep fraud issue*, The NCAA News, Vol. 43, No. 5, February 27, 2006, at 7; See also NCAA news release, *Eligibility panel plans prompt response to prep fraud issue*, US Fed News, February 27, 2006 ("At some point, we have to say that this is a joint effort among the NCAA, universities and colleges, secondary educators, state and federal government, and many others . . . [t]here is a certain responsibility that rests with our schools and many other organizations," J. Bernard Machen, President of the University of Florida).
25. *Id.*
26. Dan Steinberg, *Review Ordered At GW; Admissions Process For Athletes at Issue*, Wash. Post, Mar. 11, 2006, at Sports, E09 (George Washington University President Trachtenberg launches a review of the school's academic admissions process for athletes in response to a newspaper report questioning the academic background of the school's basketball players).

**Mark A. Hicks; J.D. Candidate 2006, Vermont Law School.** In the Fall of 2005, the author served a full-time externship with the NCAA's Office of the General Counsel. He is a trained mediator and clerked for McNeil, Leddy and Sheahan, P.C., in Burlington, Vermont. Prior to law school, the author had a lengthy career as an educator and coach, on both the college and high school levels. The author hopes to practice in the areas of Sports and Education Law. He would like to thank the generous attorneys and staff of the NCAA for their insight and assistance; Robin Barone, Adjunct Professor at Vermont Law School; and especially Nicole for her invaluable support. Mr. Hicks can be reached at [mhicks@vermontlaw.edu](mailto:mhicks@vermontlaw.edu).

# Why No Poker?

By Bennett Liebman

Numerous people in New York are confused about the legality of playing poker under the state's Las Vegas Night laws. After all, if you can play poker in Las Vegas, why can you not play poker at a Las Vegas Night held by a non-profit organization in New York?

The short answer is that it has traditionally been prohibited by New York law. Section 186.3 of the General Municipal Law in defining a game of chance states: "No game of chance shall involve wagering of money by one player against another player." This provision has been in the law since the inception of games of chance law in 1976.<sup>1</sup> Poker is not a banking game where the player plays against the house. Instead, the players play against each other. Thus, since the players in poker play against each other, the game is illegal under current New York law. In the 1976 legislative debate on games of chance, the Senate sponsor of the bill, Senator Rollison, noted, "In other words, all the wagering must be against the house."<sup>2</sup>

When asked by Senator Lewis—an opponent of the legislation—whether the bill would authorize poker, Senator Rollison specifically noted that poker was unauthorized. He said, "Poker is played player on player and this is only against the house."<sup>3</sup>

## Constitutionality of Poker as a Game of Chance

The more significant question is whether the legislature could constitutionally add poker to the category of games of chance. The short answer is that it was tried in 1977, but the legislation was vetoed by Governor Carey.<sup>4</sup>

In 1975, after a vote of the people, games of chance conducted by non-profit organizations were authorized as an exception to the general prohibition on gambling in the New York State Constitution. This constitutional exception allowed non-profit organizations to conduct "games in which prizes are awarded on the basis of a winning number or numbers, color or colors, or symbol or symbols determined by chance from among those previously selected or played, whether determined as the result of the spinning of a wheel, a drawing or otherwise by chance."<sup>5</sup>

Certain banking games were authorized by the legislature in 1976, but there was a belief that additional games needed to be authorized as well, to make games of chance opportunities work for the non-profits.<sup>6</sup> Assembly Bill No. 8647-A in 1977 added the games of

video poker and filmed horse racing games as authorized games of chance under section 186.3. In arguing for the legislation, Assemblyman Joseph Lentol stated that: "Poker is the backbone of the traditional Las Vegas Night and is the most lucrative game for the organization."<sup>7</sup>

On the other hand, the Attorney General and the State Racing and Wagering Board argued that poker and video horse racing were not legal games under the State Constitution. Attorney General Lefkowitz maintained that "poker and filmed horse races are not games of chance within the constitutional definition." He added that "these changes go beyond that which is authorized by Article I, section 9 of the Constitution. . . . The above comments raise serious constitutional questions which should be considered by Your Excellency."<sup>8</sup>

The Racing and Wagering Board also questioned the constitutionality of poker as a game of chance. It found that "a serious constitutional question . . . exists due to the inclusion of 'poker' and 'filmed horse racing' as authorized games of chance. In neither game are prizes awarded by the organization. Rather, the players wager against each other, while the organization simply extracts a percentage of the wagering pool."<sup>9</sup>

Governor Carey, acting on these recommendations, vetoed the bill. He stated that: "The Attorney-General has advised me that there are serious constitutional questions raised by this bill. Specifically, he states that poker and filmed horse races are not 'games of chance' within the definition contained in Article 1, Section 9, subdivision 2 of the New York State Constitution."<sup>10</sup>

## Further Inquiry

Yet should this be the end of the inquiry? The Attorney General and the Racing and Wagering Board cited almost no reasons for the opinion that poker was not a constitutional game of chance. They suggested that non-banking games were unauthorized by the Constitution, and the Racing Board suggested that in poker the prize was not properly awarded by the organization.

Yet, there was no discussion in the legislative sessions authorizing the games of chance constitutional amendment that only banking games were to be acceptable as games of chance.<sup>11</sup> If Assemblyman Lentol was correct that poker was the staple of the traditional Las Vegas Night, and it was the legislative intent to legalize



an ongoing practice, then it might have been assumed that poker would be a legitimate game of chance.<sup>12</sup>

While the Racing and Wagering Board suggested that prizes had to be awarded by the organization, the fact is that there is nothing in the language of the Constitution saying who must award the prize. It simply authorizes “games in which prizes are awarded on the basis of a winning number or numbers, color or colors, or symbol or symbols determined by chance.”<sup>13</sup> The Constitution never actually states that the organization must put up the prize.

Legislation passed on games of chance laws since 1977 would seem to suggest that the legislature surrendered whatever qualms it might have thought to exist which would prohibit non-banking games.

In 1988, the legislature authorized bell jars as games of chance.<sup>14</sup> A bell jar game—which in most states is known as a pull tab game—includes “games in which a participant shall draw a card from a jar, vending machine or other suitable device . . . which contains numbers, colors or symbols that are covered and which when uncovered, may reveal that a prize shall be awarded.”<sup>15</sup> In short, these tickets operate in the same fashion as an instant lottery ticket. The symbols on the tabs are pulled out revealing whether the participant has won a prize. Since the prizes are already predetermined based on the particular lot of tickets, the participants are playing against each other to determine who will win them. The bell jar deals are established in such a manner that a deal might typically sell to the betting public for approximately \$2,000 and would yield about \$1,600 in prize moneys. The participants play against themselves for the \$1,600 in prizes. It is not a banking game since the house has no interest in who wins the bell jar deals.

The same is true for the game of raffles that was legalized in 1994.<sup>16</sup> A raffle is a game of chance where participants pay money for tickets and the winners are determined based on the results of a drawing from among the previously sold tickets.<sup>17</sup> The General Municipal Law further provides that for raffles, “a series of prizes may include a percentage of the sum of cash received from the sale of raffle tickets.”<sup>18</sup> Thus, for raffles, not only are the players playing against each other to determine the winner, but the prize itself can be put up by the participants rather than by the authorized organization. The rationales proffered in 1977 for rejecting poker as a game of chance (player versus player and the prize coming from the players) have subsequently been rejected by the State in its authorization of both bell jars and raffles.

If poker is indeed an unauthorized game of chance under the Constitution because it is a game played

between players and not against the house, then raffles and bell jars suffer from this same constitutional defect. Similarly, if a prize has to be awarded by the house, then the game of raffles—when played traditionally as a 50/50 game—is similarly invalid.<sup>19</sup>

## Other Considerations

Even though poker is currently not an authorized game of chance under the General Municipal Law in New York, this has not stopped the National Indian Gaming Commission (“NIGC”) from authorizing poker at New York Indian gaming facilities. Class II gaming under the Indian Gaming Regulatory Act is regulated not by the State but by the tribe and the NIGC. Class II card games include non-banking card games that are not explicitly prohibited by the laws of the State, and are played at any location in the State, but only if such card games are played in conformity with those laws and regulations (if any) of the State regarding hours or periods of operation of such card games or limitations on wagers or pot sizes in such card games.<sup>20</sup>

In 1999, the NIGC concluded that poker in New York State was a Class II game.<sup>21</sup> It reasoned that because the playing of the game itself was not a crime in New York, the players are not subject to criminal penalty. Only the professional operators and promoters of the game are punished. Since New York does not make the playing of poker a criminal offense, the NIGC reasoned that New York regulated poker, and that non-banking poker was a valid Class II game in New York State. In other contexts, tribes are allowed to conduct gambling games because the non-profits can conduct them. However, in poker, the tribes conduct the games even though the non-profits cannot.

In dealing with the vetoed 1977 legislation, the Attorney General suggested that filmed horse racing could only be legal if run as part of the Constitutional provision for pari-mutuel racing.<sup>22</sup> Arkansas has authorized electronic gaming machines which show filmed horse racing. These machines—known as Instant Racing machines—base their results on the winners of filmed races.<sup>23</sup> They have been somewhat successful in producing revenue for the racing industry in Arkansas.<sup>24</sup> Arguably, as an addition to video lottery terminals,<sup>25</sup> or at racetracks not authorized to have video lottery terminals,<sup>26</sup> the racetracks could, under the 1977 opinion of the Attorney General, be authorized pursuant to statute to conduct wagering on filmed horse racing using Instant Racing machines in New York. Nonetheless, in certain jurisdictions, the legality of these Instant Racing machines has been questioned. The Attorneys General in Nebraska and Wyoming have informally ruled against these machines,<sup>27</sup> and one court has found these games to be unauthorized in

Wyoming.<sup>28</sup> Additionally, a bill to legalize Instant Racing in Wyoming was vetoed in 2005.<sup>29</sup> Although Attorney General Lefkowitz seemed to open the door to what has subsequently become Instant Gaming in his opinion letter in 1977, the constitutionality of this game in New York remains questionable.

In short, while New Yorkers have been playing legalized games of chance for three decades, the parameters of these legal games remain undefined. Specifically, the status of poker—even in the wake of its current massive popularity—as a permissible game of chance remains unresolved in New York. Most significantly, the initial rationales for not including poker as a game of chance have subsequently been rejected by the State legislature.

## Endnotes

1. Ch. 960, L. 1976.
2. Debate on A. 13022, June 26, 1976, Senate Debates at 9645.
3. *Id.* at 9648.
4. Vetoes #123 and 124, 1977.
5. Constitution Article 1, Section 9.2.(b).
6. See, for instance, Debate on A. 8467, June 6, 1977, Senate Debates at 6657–6658. See also Edith Evans Asbury, “Las Vegas Nights’ in New York Could See Light of Day on February 1,” *New York Times* November 4, 1976 p. 43.
7. June 30, 1977 letter of Joseph Lentol to the Honorable Judah Gribetz at page 3 in Veto Jacket #123.
8. June 27, 1977 memorandum of Louis J. Lefkowitz for the Governor at page 2 in Veto Jacket #123.
9. July 19, 1977 memorandum of Richard F. Corbisiero, Jr. to Judah Gribetz at page 1 in Veto Jacket #123.
10. Veto #123 *supra* note 4, *Public Papers of Governor Carey*, 435 (1977).
11. See Debate on A. 9686, Senate Debates of May 7, 1974, Debate on S. 2509, Senate Debates of June 19, 1975.
12. See Tom Buckley, “Professional Gamblers Copy Churches’ ‘Las Vegas Nites,’” *New York Times*, March 4, 1974 at p. 41 describing Las Vegas Nites as “weekend evenings of blackjack, craps, poker and wheel games.”
13. See *supra* note 5.
14. Ch. 46, L. 1988.
15. General Municipal Law § 186.3-a.
16. Ch. 550, L. 1994.
17. See General Municipal Law § 186.3-b.
18. General Municipal Law § 186.12.
19. In a 50/50 game, the participants buy raffle tickets at an event such as a Little League game. Fifty percent of the handle goes to the winning ticket holder, and the remainder goes to the non-profit organization sponsoring the raffle. As stated in note 18, this 50/50 game is specifically legalized under the General Municipal Law.
20. 25 U.S.C. § 2703(7)(A)(ii)(II).
21. <http://www.nigc.gov/nigc/documents/opinions/pokerclub.jsp>.
22. See *supra* note 8.
23. <http://www.instantracing.com/saying.html>.
24. Robert Yates, “Instant Racing Totals Prompt Oaklawn to Increase Purses,” *Arkansas Democrat Gazette*, February 24, 2005. See also Eugene Martin Christiansen, “Law and the Machine” <http://www.ateonline.co.uk/?showid=14&pageid=2313>.
25. Video lottery terminals were found constitutional at racetracks in New York by the Court of Appeals in *Dalton v. Pataki*, 2005 N.Y. Lexis 1059 (May 3, 2005).
26. Belmont Park, the Syracuse Mile, and the Saratoga thoroughbred track are not authorized to have video lottery terminals under Section 1617-a.a. of the Tax Law.
27. Juliette Rule, “Electronic Races to Stay Dark,” *Wyoming Tribune-Eagle*, June 18, 2005 Pg. A1; Robynn Tysver, “Replaying the ponies: Bill offers a bet twist,” *Omaha World-Herald*, February 15, 2005 p. 1A.
28. “State Shuts Down Instant Racing Machines,” *Uinta County Herald Online* at [www.uintacountyherald.com/main.php?story\\_id=2083&page=23](http://www.uintacountyherald.com/main.php?story_id=2083&page=23).
29. Wyoming H. B. 156 vetoed February 25, 2005.

**Bennett Liebman is the first Coordinator of the Government Law Center’s Program on Racing and Gaming Law at Albany Law School. He has held that position since February of 2002. He teaches courses on Sports and the Law and the Government and Gambling. He served as a commissioner at the New York State Racing and Wagering Board from 1988–2000. Prior to his service at the Racing and Wagering Board, Mr. Liebman served as Assistant Commissioner for Legal Affairs at the New York State Department of Taxation and Finance. He previously served as Special Deputy Counsel to the Governor and as Counsel to then-Lieutenant Governor Mario Cuomo. Mr. Liebman is a summa cum laude graduate of Union College and a cum laude graduate of New York University School of Law.**

**Upcoming EASL Journal Deadline: Friday, May 19, 2006**

# Artistic Expression or Unfair Exploitation: The Right of Publicity, the First Amendment and Fair Use in Films and Fine Art

By Jason Sanders

Between 1999 and 2001, Philip-Lorca diCorcia clandestinely photographed individuals as they waited on a street corner in New York City's Times Square. Using a very shallow focus and a spotlight flash, diCorcia was able to create striking portraits of unsuspecting individuals in pensive or solitary moments. These photographs were part of diCorcia's "Heads" series, which was exhibited at galleries in New York, Boston and elsewhere, and was published in a forty-page hardcover book.<sup>1</sup>

Several years later, Erno Nussenzweig, one of the individuals photographed, saw his picture in this series and was not pleased with his unauthorized and uncompensated presence in the contemporary art world. Mr. Nussenzweig hired an attorney, and in May 2005 he filed a lawsuit seeking two million dollars in damages based on his claim that the sale of the photograph violated his right of publicity.<sup>2</sup> Prior to any significant discovery, diCorcia moved to dismiss the complaint. On February 8, 2006, the court granted diCorcia's motion.<sup>3</sup> The court held, in part, that because diCorcia's photograph constitutes an "artistic use" of Nussenzweig's image, it is exempt from New York's right of publicity statute.<sup>4</sup> The court made the broad statement that New York courts "have consistently found" that artistic works are "exempted from action under New York States [sic] Privacy Laws."<sup>5</sup> However, the decisions upon which it relies are not so far reaching.

Only a few weeks before the *diCorcia* decision was issued, another New York State court reached a contrasting result. In *Nieves v. Home Box Office*, the court refused to dismiss a right of publicity claim brought by a woman who had been filmed while standing on a street corner in New York City.<sup>6</sup> The plaintiff objected to the use of her image in the HBO reality series *Family Bonds* and the accompanying commentary about her by the characters in the program. In refusing to dismiss the claim, the court held that it was too early to make the necessary factual determination regarding the content of the program and the use of her image. As discussed below, the *diCorcia* and *Nieves* decisions continue an often problematic trend in which courts rule on right of publicity claims by evaluating the content and merits, artistic or otherwise, of the expressive works at issue.

In essence, the right of publicity allows people "to profit from the full commercial value of their identi-

ties."<sup>7</sup> As of the beginning of 2005, twenty-eight states recognized some form of a right of publicity, either through common law or statute, with various formulations of the right.<sup>8</sup> In general terms, the right of publicity is often formulated to provide a remedy for the unauthorized use of a person's image or name for advertising, commercial or trade purposes.<sup>9</sup> As construed by at least one New York appellate court, a right of publicity claim has only two elements: "the commercial use of a person's name or photograph and the failure to procure the person's written consent for such use."<sup>10</sup>

Because a right of publicity claim does not require the alleged infringer to have made any express or implied claim of endorsement, its scope can be very expansive.<sup>11</sup> To control this breadth, courts have relied on the requirement that the use be for "commercial," "trade" or "advertising" purposes. As one court stated, this limitation was crafted "with the First Amendment in mind."<sup>12</sup> However, so crafting the limitation has saddled the claim with an element that is vague and unwieldy, if not entirely unworkable. Many commentators have questioned the commercial/non-commercial First Amendment distinction, and some courts, at least with respect to state protections, have begun to abandon the differentiated levels of protection for commercial and non-commercial speech.<sup>13</sup> Accordingly, defining the scope of the right of publicity has proved difficult, especially in the context of primarily expressive works such as films or fine art.

Almost twenty years ago, this exact issue arose in a dispute over the sale of copies of Alfred Eisenstadt's iconic V-J Day photograph of a sailor kissing a nurse in New York City's Times Square. In 1987, when *Life* magazine advertised that it would sell copies of that photograph, a man claiming to be the sailor brought a lawsuit alleging violations of his right of publicity. After the court refused to dismiss the action, there were no further published decisions in the matter.<sup>14</sup> In the twenty years since, there has been little further clarification of this issue.

Recent decisions have not only failed to provide a coherent test for right of publicity claims made in the context of expressive works, they have often focused upon the value of the content of the expressive work—an extremely problematic undertaking. Courts should



avoid such an inquiry and, as discussed below, use other methods to better balance the rights of individuals with the freedom for artists to create expressive content.

### **Commercial, Trade or Advertising Purposes: The Narrow Florida Interpretation**

At its extremes, the balance between the right of publicity and the First Amendment is clear. At one end of the spectrum, a newspaper article describing a person's role in current events will almost always fall outside the boundaries of right of publicity protections. On the other end of the spectrum, the unauthorized use of a person's name or image on product packaging or advertising will generally violate the individual's right of publicity. However, when courts must pass judgment on expressive commercial products that use people's names or images, such as films based on true stories or photographs taken in public, they are often asked to draw somewhat arbitrary lines between protected and non-protected expression.

Due to such difficulties in line-drawing, in April 2005, the Florida Supreme Court in *Tyne v. Time Warner Entertainment Co.* held that Florida's right of publicity statute—which by its terms encompassed using a person's identity for “any commercial . . . purpose”—did not apply to expressive products such as motion pictures.<sup>15</sup> The *Tyne* dispute was over the depictions of the lives and deaths of the crewmembers of the *Andrea Gail* in the film *The Perfect Storm*. Although Warner Bros. purchased the rights to produce a film based on the Sebastian Junger book *The Perfect Storm: A True Story of Men Against the Sea*, it did not compensate or obtain authorization from the family members of those portrayed in the film. Several family members of the deceased crewmembers brought an action against Warner Bros. pursuant to Florida's commercial misappropriation law.

This action reached the Eleventh Circuit Court of Appeals, which found a conflict between the broad language of the statute, which protects against unauthorized use of a person's name or identity for “any commercial . . . purpose,” and a previous decision by a Florida appellate court, interpreting the statute to apply only “in the context of an advertisement or promotion.”<sup>16</sup> The Eleventh Circuit reasoned that because the Florida statute specifically prohibits use of a person's identity for “trade,” “advertising” as well as “any commercial . . . purpose,” some use beyond that of pure trade or advertising must be prohibited, otherwise the phrase “any commercial . . . purpose” is meaningless. The Eleventh Circuit also reasoned that the statute's specific exemption for use “in news or other media if the use implicates public interest and is not for an advertising purpose,”<sup>17</sup> as well as for “artistic

works”<sup>18</sup> “makes little sense” if the statute applies only to promotional or advertising materials.<sup>19</sup> Believing such an interpretation could not be reconciled with the statute, the Eleventh Circuit certified the question to the Florida Supreme Court for a final determination.

The Florida Supreme Court disagreed with the Eleventh Circuit's interpretation of the statute. The court reasoned that if the statute applied outside the advertising context it would raise a “fundamental constitutional concern”<sup>20</sup> and might infringe upon “works [that] should be protected by the First Amendment.”<sup>21</sup> Thus, in order to avoid such a possible conflict, the court held in a 2-1 decision that notwithstanding the broad language chosen by the Florida legislature, the law applied only to works that directly promote an unrelated product or service.<sup>22</sup>

The court's reasoning is somewhat suspect. Even assuming one can distinguish primarily expressive works from promotional works,<sup>23</sup> it is neither necessary nor justifiable to entirely exempt expressive works from right of publicity claims under prevailing First Amendment jurisprudence.

### **Historical Application to Newsworthy and Artistic Works**

In 1977, in *Zacchini v. Scripps-Howard Broadcasting Co.*, the Supreme Court held that a primarily expressive work, a news broadcast, violated a performer's right of publicity notwithstanding the station's claim of First Amendment protection.<sup>24</sup> The Supreme Court reasoned that when the station broadcast the entire performance of Hugo Zacchini, the “human cannonball,” the station had essentially stolen the value Zacchini had built up in his performance, and the First Amendment did not excuse such a theft.<sup>25</sup> The Court reasoned that the unauthorized broadcast posed a “substantial threat to the economic value” in the performance,<sup>26</sup> and that “[n]o social purpose is served by having the defendant get free some aspect of the plaintiff that would have market value and for which he would normally pay.”<sup>27</sup> The Florida Supreme Court decision in *Tyne*, which strikes down all right of publicity liability for primarily expressive works, would appear to be much broader than this United States Supreme Court precedent justifies.

Though *Zacchini* affirmed that a primarily expressive work may violate an individual's right of publicity, it also provided the basis for exceptions to this rule. For example, the Court reasoned that a right of publicity claim would not prevent “reporting newsworthy facts” about a person or event.<sup>28</sup> Such a “newsworthy” exception has often been used to protect expressive works related to current events.<sup>29</sup> In the *Tyne* dispute, the district court held as an alternative ground for summary judgment that the film *The Perfect Storm* was protected

under the “current and legitimate public interest” exception to the statute.<sup>30</sup> This interpretation alone would have been enough to accommodate First Amendment considerations as well as to give logical meaning to all parts of the Florida statute.

The “newsworthy” exception may also include photographs which accompany articles in news-magazines, as long as they are included primarily for their “public interest aspect” to illustrate the article.<sup>31</sup> However, if the images are detached either physically or contextually from the newspaper or magazine, they may not be protected.<sup>32</sup> Further, while broadly protecting publishers, this exception may provide little solace to artists and photographers. For example, in one instance the publisher of a photograph was found to be exempted from liability based on the public interest exemption, but the photographer was not, as the court reasoned that his use of the photograph was merely a commercial sale to the magazine, and not commenting on newsworthy events.<sup>33</sup>

Photographs and other artistic works have their own protections, regardless of whether they are newsworthy. As stated by the Second Circuit, “[v]isual art is as wide ranging in its depiction of ideas, concepts and emotions as any book, treatise, pamphlet or other writing, and is similarly entitled to full First Amendment protection.”<sup>34</sup> In practice, however, courts have been inconsistent in the application of such First Amendment protections. Two New York decisions illustrate this inconsistency. In *Brinkley v. Casablancas*, model Christie Brinkley brought a lawsuit over the unauthorized use of her photograph on a poster.<sup>35</sup> Though she had posed for photographs to be used as a poster, she never gave her final consent for the poster’s creation. With little discussion, the court found that sale of the poster had violated her right of publicity.<sup>36</sup>

However, in *Simeonov v. Tieg*s, a more recent New York case, the court held that an artist who had created a sculptural mold in the likeness of model Cheryl Tieg would not necessarily have violated Tieg’s right of publicity by the sale of sculptures cast from the mold.<sup>37</sup> On facts similar to those of *Brinkley*, Tieg had posed for the mold to be cast, but had never consented for any sculptures to be made from the mold. The court stated that “[a]n artist may make a work of art that includes a recognizable likeness of a person without her or his written consent and sell at least a limited number of copies thereof” without violating New York’s right of publicity protections.<sup>38</sup> Thus, the reasoning in *Simeonov* seems to provide broad protection to works of fine art, at least if made in limited quantities.

It is difficult to reconcile the *Brinkley* and *Simeonov* opinions. The models posed for the creation of both works intending that the result would accurately re-

create the subject. While the *Simeonov* court seemed to limit its holding to situations with a “limited number of copies” being produced, this factor appears nowhere in the statute, and might prove quite difficult to apply. The salient factor distinguishing the two decisions seems to be that the *Brinkley* court implicitly viewed the poster as having little, if any, artistic value and to be trading upon the subject’s image, while the *Simeonov* court viewed the sculpture as potentially containing significant artistic elements.

## “Transformative Depictions” and “Artistic Use” Tests

The focus on whether the work is artistic has been picked up by other courts applying a right of publicity claim in the context of an expressive work. One particular test that has been gaining traction among courts assesses whether the work in question is sufficiently “transformative” to be of independent artistic value, and not merely trading on the value of the subject. If sufficiently transformative, the work is protected from a right of publicity claim. Conversely, if not transformative, the work is not protected from a right of publicity claim. This test was applied by the Supreme Court of California in *Comedy III Productions, Inc. v. Gary Saderup, Inc.*<sup>39</sup> to hold that an artist who made T-shirts and lithographs with images of the Three Stooges violated said Stooges’ right of publicity. There the court considered application of a full-scale fair use analysis, using the same factors as would be applied in a fair use copyright defense,<sup>40</sup> but determined that the only factor applicable to a right of publicity claim was the question of whether the work was “transformative.”<sup>41</sup>

The court reasoned that when “artistic expression takes the form of a literal depiction or imitation of a celebrity for commercial gain, directly trespassing on the right of publicity without adding significant expression beyond that trespass,” such use provides limited added value necessitating protection.<sup>42</sup> “On the other hand, when a work contains significant transformative elements, it is not only especially worthy of First Amendment protection, but it is also less likely to interfere with the economic interest protected by the right of publicity.”<sup>43</sup>

In determining whether a work is “transformative,” the court sought to balance the fame of the person depicted against the skill and creativity of the artist. The court reasoned that if “the value of the work comes principally from some source other than the fame of the celebrity—from the creativity, skill, and reputation of the artist—it may be presumed that sufficient transformative elements are present to warrant First Amendment protection.”<sup>44</sup> Thus, the court concluded that because the works at issue were “literal, conventional

depictions of The Three Stooges" they were not insulated from a right of publicity claim.<sup>45</sup>

A split Sixth Circuit Court of Appeals, in *ETW Corporation v. Jireh Publishing, Inc.*, adopted this approach and held that an artist who marketed "limited edition art prints" showing an image of Tiger Woods at the Masters Tournament in Augusta, Georgia, had not violated Woods' right of publicity.<sup>46</sup> Setting the tone of the opinion, the court noted at the outset that the work had "artistic relevance,"<sup>47</sup> and "added a significant creative component . . . to Woods's identity."<sup>48</sup> The Court further reasoned that because the work contained "significant transformative elements" it did not "capitalize solely on a literal depiction of Woods," and therefore did not violate Woods's right of publicity.<sup>49</sup>

In applying the transformative test, courts have often reduced its essence to the question: Does the value of the defendant's product derive from that which has been taken, namely, a literal depiction of the plaintiff, or is the value in that which has been added, specifically, in how the image has been transformed?<sup>50</sup> The more it is the former, the less protection is afforded; the more it is the latter, the more protection is afforded. This type of judgment is problematic both in the nature of the evaluation as well as the practical ability of the court to make the evaluation.

Asking a court to identify the value in a work is essentially asking the court to make a judgment of either the artistic value or the value of the speech itself. Neither of these are proper judgments for the court to make. The former runs afoul of Justice Holmes' oft-repeated maxim that it is a "dangerous undertaking for persons trained only to the law to constitute themselves final judges of the worth of pictorial illustrations, outside of the narrowest and most obvious limits."<sup>51</sup> The latter runs afoul of traditional First Amendment jurisprudence by requiring the court to use a content-based evaluation of expressive speech.<sup>52</sup> In the context of the Visual Artists Rights Act (VARA), the Second Circuit recently rejected such a content-based evaluation. In *Pollara v. Seymour*, the court held that a political banner was not protected under the terms of VARA, regardless of its core political speech message. The court reasoned that if possible, it should "steer clear of an interpretation of VARA that would require courts to assess either the worth of a purported work of visual art, or the worth of the purpose for which the work was created."<sup>53</sup>

The ability of the court to reliably make such an evaluation is also questionable. In copyright practice, the transformative test often results in courts making aesthetic comparisons of the works.<sup>54</sup> This is possible because the Copyright Act requires that a work be "fixed in any tangible medium of expression" in order to receive copyright protection.<sup>55</sup> Thus, a copyrighted

work is necessarily fixed in a particular aesthetic to which the allegedly infringing work can be compared. In contrast, a person's identity is not fixed.<sup>56</sup> Because an individual's identity is not fixed, there is no fixed point of comparison for the allegedly infringing work. This makes application of the aesthetic comparison difficult, if not impossible, to apply in the right of publicity context. Such an aesthetic evaluation simply does not make sense for right of publicity claims.

At least in part because of this difficulty in applying the transformative test to a right of publicity claim, the analysis has often devolved into the court passing judgment on whether it believes the expressive work in question is sufficiently artistic. For example, in *Hoepker v. Kruger*, a New York court dismissed a right of publicity claim brought by a model against the artist Barbara Kruger over a work by Ms. Kruger, which was a collage of text superimposed over part of the photograph of the model.<sup>57</sup> In denying the right of publicity claim, the court held that the Kruger work was not only "pure First Amendment speech in the form of artistic expression" but also a transformative work, deserving of protection.<sup>58</sup> Because the *Hoepker* court found the work to be both "artistic expression" and "transformative" it did not decide whether under New York law an artwork *must* be transformative to be protected against a right of publicity claim. In essence, the court held that the Kruger work was sufficiently artistic to not violate the model's right of publicity.

The decision in *Nussenzweig v. diCorcia* extended the reasoning in *Hoepker* and held, without significant discussion, that all artistic works, regardless of whether they are transformative, are exempt from claims under New York's right of publicity laws.<sup>59</sup> Though not purporting to change the law, the court greatly expanded protections to works that are found to be "artistic." In doing so, it noted that the "problem of sorting out what may or may not legally be 'art' remains a difficult one."<sup>60</sup> However, the court was persuaded by diCorcia's "general reputation as a photographic artist in the international artistic community," that the photograph was an artistic use.<sup>61</sup> The court ironically noted that the sale of copies of the photograph did not prevent the author's protection from right of publicity claims, because First Amendment "protection of art is not limited to only starving artists."<sup>62</sup> However, if the evaluation of a work's artistic merit is based upon the critical acclaim of the artist at issue, it may be that the "starving artists" are the artists who are not protected at all.

Commercial viability of a work, however, may not ensure its protection. In *Bosley v. WildWetT.com* the court refused to grant First Amendment protection to the work in question, a video of a wet-t-shirt contest.<sup>63</sup> The court held that the montage of women exposing themselves was not an "expressive work" because it did not



contain “creative components” or any “transformative elements.”<sup>64</sup> Inherently, the *Bosley* court was making a judgment as to the value of the expressive content, which it found negligible. While the video may not be “transformative” in the sense that it did not alter the action photographed, to conclude that it is not “expressive” is a questionable determination to make, akin to deciding what is or is not “art.”<sup>65</sup>

Whether courts use the transformative depictions analysis or the “artistic use” exemption, there is a significant danger that courts will improperly use their subjective evaluation of the artistic merit of the work or artist to determine whether the work in question deserves protection from right of publicity claims. The decisions in *Kruger* and *Bosley* illustrate the dangers of courts regulating speech based upon the speech’s content. Artwork, especially in films and photography, that attempts to reflect a literal visual depiction is no less expressive or less worthy of protection than work found to be “transformative.”<sup>66</sup> If a court examines a work of street photography, the transformative test may require the court to ask if the photographer is trading upon the setting, the construction, or the identity of those photographed. From a practical standpoint, not being able to clearly draw the line between that which is protected and that which is not will certainly invite lawsuits, and likely yield conflicting results.

More important, the focus upon the transformative nature of the aesthetic is a misguided attempt to make an end-run around the prohibition against evaluating the artistic merit of the work but which in practice makes the same judgment, simply using different terms. The *diCorcia* court avoided this step entirely and directly evaluated the artistic merit of the work, based upon the “general reputation” of the artist within the “artistic community.”<sup>67</sup> This too, is problematic. The artistic merit of a work is not necessarily recognized as such immediately after its creation, or even during the lifetime of the artist. The oft-repeated example is the work of Vincent van Gogh, but it should also be noted that until the latter half of the twentieth century many major arts institutions did not consider photography to be fine art at all.

Art is not defined by whether it is aesthetically “transformative” or whether the artistic community has come to a favorable consensus on its worth. Whether a work of art has meaning or artistic merit is a highly subjective determination. The artistic statement or artistic value of a work is not easily quantifiable and courts cannot, and should not, be asked to make this evaluation. Accordingly, neither the transformative test, as applied to the aesthetics of the work, nor an ill-defined “artistic” exemption is a proper or workable solution for evaluating whether an expressive work violates an individual’s right of publicity.

## Focus on the Purpose and Harm, Not the Aesthetic Depiction

As the Supreme Court stated in *Zacchini*, in evaluating a right of publicity claim, the focus should be whether the defendant is getting for “free some aspect of the plaintiff that would have market value and for which he would normally pay.”<sup>68</sup> Accordingly, as interpreted by the Supreme Court in *Zacchini*, individuals should be protected against third-party works that unfairly take their income streams. This should be the case regardless of whether the work is a literal depiction of the subject, or whether the depiction is transformative.

When courts are able to make this analysis directly, it should be the primary consideration. For example, some celebrities’ marketing and publicity machines may be so strong, or the works so far afield from the celebrities’ livelihood that certain works simply would not have any significant effect upon that celebrity’s marketing value. That was, in large part, a driving factor behind the court’s decision in *ETW Corporation*, which held that the artistic prints of Tiger Woods at the Masters did not violate his right of publicity. There, the court reasoned that “[i]t is not at all clear that the appearance of Woods’s likeness in artwork prints which display one of his major achievements will reduce the commercial value of his likeness,” and that the artistic nature of the works, makes them “less likely to interfere with the economic interest protected by Woods’ right of publicity.”<sup>69</sup>

If courts need to resort to the transformative analysis to determine whether a work violates an individual’s right of publicity, they should refrain from using the aesthetics as benchmarks. Courts should instead focus on the way the identity, image or performance is being used. In making the distinction, a court should first distinguish between works that are primarily promotional, such as newspaper advertisements, and works that are not designed to sell unrelated products, such as the Eisenstadt photograph of the sailor or the *diCorcia* photograph of Nussenzweig.<sup>70</sup> If a work is designed to promote or advertise another product, it should be given reduced First Amendment protections.<sup>71</sup> Other works that are primarily expressive, such as artistic works, should be given a heightened level of protection under the First Amendment.

For such primarily expressive works, the evaluation should be: regardless of the medium, was the defendant using an aspect of the plaintiff’s name, persona or performance upon which the plaintiff was trading?<sup>72</sup> And if so, was the defendant using that aspect in the same way that plaintiff was using it?<sup>73</sup> Thus, the focus should be on whether there is a transformative *use* of the person’s identity or persona.<sup>74</sup>

In *Zacchini*, the television station broadcast was using the aspect of the plaintiff's identity upon which he was trading—his performance as the human cannonball. Secondly, the broadcast was not transforming his performance in any meaningful way, simply publishing it through a different medium, videotaped, as opposed to live.

In *Brinkley*, the defendant's posters used the aspect of her persona upon which she was trading, namely, her appearance, and traded upon it in the same way as Brinkley traded upon it. In contrast to the *Brinkley* and *Zacchini* examples, in the Eisenstadt case, the sailor was not trading upon his looks or persona in any way similar to the way that Eisenstadt was. Thus, the "use" of his persona was transformative, even if the aesthetics of the photograph were not.

Using such a test might be a workable middle ground between eviscerating the right of publicity as was done in *Tyne* and asking the court to judge the artistic value of the work, as is employed under the transformative test commonly articulated by the courts as well as in the "artistic use" exemption employed by the court in *diCorcia*. As structured this way, the test also has the benefit of not restricting the public's access to expression. Works with expressive content that is dissimilar to what is available in the market are by their nature transformative uses. In contrast, works that merely trade upon an individual's persona in the same way that that individual does would likely not be a transformative use. To some extent this will result in the same sort of circular reasoning that has accompanied the market value test in the copyright infringement actions.<sup>75</sup> However, it is more appropriate for courts to examine what has been done in the past and what is available in the market than to examine the artistic or communicative value of a new expressive work.

This focus on the transformative nature (as opposed to transformative aesthetics) of the use also allows for parodic works to escape liability. Parodic works are necessarily trading upon the individual's identity in a different way than the subject does even if the visual aesthetic is a literal depiction of the individual.<sup>76</sup>

## Girls Gone Litigious

This analysis might also provide some uniformity to the recent spate of cases of women suing over videotapes showing them in various stages of public undress. For example, in *Bosley v. WildWetT.com*, the district court preliminarily enjoined the sale of a video of the plaintiff, an aspiring television anchorwoman participating in a wet-t-shirt contest, as a violation of her right of publicity.<sup>77</sup> The *Bosley* court stated that the video of the

plaintiff "need not promote a separate product to constitute a commercial use of [the plaintiff's] image,"<sup>78</sup> which would violate her right of publicity.

In contrast, in *Lane v. MRA Holdings, LLC*, the court held that commercial sale of a video containing footage of a woman exposing her breasts, and use of clips of that woman to advertise the video, did not violate her right of publicity under Florida law because it did not use "her image or likeness to directly promote a product or service unrelated to the participation in the expressive work [the video]."<sup>79</sup> The court in *Gritzke v. M.R.A. Holding, LLC*,<sup>80</sup> avoided the question of whether the sale of the video itself violated the woman's right of publicity. Instead, the court held that the use of plaintiff's image in the advertisements for, and on the cover of, the video in which she appeared partially undressed was sufficient to constitute "commercial use" of her identity and a violation of her right of publicity.<sup>81</sup>

In evaluating whether these videos violate the respective women's right of publicity, it should be noted that to the extent stated in the cases, the women were performing in exchange for something of value. For example, in *Bosley*, the plaintiff was participating in a contest, presumably to win a prize,<sup>82</sup> and in *Lane*, the plaintiff was performing in exchange for beaded necklaces.<sup>83</sup> Thus, while one may question whether the women sought adequate compensation, it was not disputed that they were trading upon their performance. Further, the videotapes were not making a transformative use of the person's identity or persona. Essentially, the video producers were trading upon the same aspect of the plaintiffs that the plaintiffs themselves were trading upon, simply in a different medium.<sup>84</sup> Thus, without consent to make a commercial use of the video, these women's right of publicity claims should be sustained.

## Conclusion

While the *Tyne* and *diCorcia* courts' commitment to protecting an expansive public domain for expressive works may be admirable, the courts' reasoning and judicial activism are less so. According to Supreme Court precedent, a primarily expressive work may still violate an individual's right of publicity if it unfairly trades upon the person's image or identity. In making the distinction between that which is protected and that which is not, courts should focus upon the way the identity is being used, not the aesthetics or artistic merit of the depiction. Doing so can accommodate the expansive statutes themselves and prevailing Supreme Court precedent, while providing sufficient room for artistic expression to flourish.

## Endnotes

1. *Philip-Lorca diCorcia: Heads*, Philip-Lorca diCorcia and Luc Sante, Steidl Publishing (October 15, 2001).
2. *Nussenzweig v. diCorcia*, Index No. 108446/05 (Sup. Ct. N.Y. County).
3. *Nussenzweig v. diCorcia*, Index No. 108446/05, 2006 NY Slip Op 50171U; 2006 N.Y. Misc. LEXIS 230 (Sup. Ct. N.Y. County, Feb. 8, 2006).
4. *Nussenzweig v. diCorcia*, 2006 N.Y. Misc. LEXIS 230 at \*\*19-\*\*21.
5. *Id.*
6. Index No. 100966/05 (Sup. Ct. N.Y. County, Jan. 10, 2006) (on February 23, 2006, defendants filed a notice of appeal).
7. *Cardtoons, L.C. v. Major League Baseball Players Ass'n*, 95 F.3d 959, 968 (10th Cir. 1996). Some states refer to such protections under the rubric of "right of privacy" while others use the term "right of publicity." For ease of reference, all such claims will be referred to as "right of publicity" claims in this article.
8. J. Thomas McCarthy, *The Rights of Publicity and Privacy* § 6:3 at 770 (2d Ed. 2005).
9. *See, e.g.*, NY CLS Civ. R § 50 (2005) ("A person, firm or corporation that uses for advertising purposes, or for the purposes of trade, the name, portrait or picture of any living person" without authorized consent violates New York's Civil Rights Law); Fla. Stat. § 540.08 (2005) ("No person shall publish, print, display or otherwise publicly use for purposes of trade or for any commercial or advertising purpose the name, portrait, photograph, or other likeness of any natural person without the express written or oral consent to such use given by [an authorized person.]" ).
10. *Brinkley v. Casablancas*, 80 A.D.2d 428, 440, 438 N.Y.S.2d 1004, 1012 (1st Dept. 1981). Not all states require consent to be written. *See, generally*, McCarthy, *The Rights of Publicity and Privacy* § 10:30.
11. Indeed, if there is any express or implied claim of endorsement or association, such as billboards of a celebrity holding a product, there may also be grounds for a claim for false endorsement under the Lanham Act. *See generally*, *University of Notre Dame Du Lac v. J.C. Gourmet Food Imports Co.*, 703 F.2d 1372, 1376-77 (Fed. Cir. 1983) (discussing the distinction between the then nascent right of privacy and the Lanham Act).
12. *Hoepker v. Kruger*, 200 F. Supp. 2d 340, 348 (S.D.N.Y. 2002).
13. *See, e.g.*, *Who's Afraid of Commercial Speech?*, Alex Kozinski and Stuart Banner, 76 Va. L. Rev. 627, 627 (1990) (stating that the Supreme Court "plucked the commercial speech doctrine out of thin air" and questioning the doctrine's soundness); *Moser v. Frohnmayer*, 315 Ore. 372, 376, 845 P.2d 1284, 1286 (1993) (holding a statute to be invalid under the Oregon Constitution's free speech clause because it applied only to commercial speech); *Gerawan Farming, Inc. v. Lyons*, 24 Cal. 4th 468, 493-97, 12 P.3d 720, 736-37 (2000) (treating truthful commercial speech as fully protected speech under the California Constitution's free speech clause); *but see Gerawan Farming, Inc. v. Kawamura*, 33 Cal. 4th 1, 20-22, 90 P.3d 1179, 1191-93 (2004) (holding the California Constitution's free speech clause to be broader than the First Amendment with respect to protection of commercial speech, though not necessarily requiring application of the strictest scrutiny applicable to restrictions of non-commercial speech).
14. *Mendonsa v. Time, Inc.*, 678 F. Supp. 967 (D.R.I. 1988). The *Mendonsa* court's interpretation of the Rhode Island statute was largely adopted, without significant discussion, by the Supreme Court of Rhode Island in *Leddy v. Narragansett Television, L.P.*, 843 A.2d 481 (R.I. 2004).
15. 901 So. 2d 802 (Fla. 2005). The suit also included a claim for common law false light invasion of privacy and public disclosure of private facts. The former was dismissed because the relatives of the deceased had no right of action on the deceased's behalf. The latter was dismissed because a necessary element is that the disclosure be factually accurate, and the family members' disclosure claims were based on the significant amounts of inaccuracies and speculation added to the story. Although not necessary for the court's holding, the vast majority of briefing by the plaintiffs/movants was related to the significant fictionalization in the film.
16. *Tyne v. Time Warner Entertainment Co. L.P.*, 336 F.3d 1286, 1290-91 (11th Cir. 2003) (citing to *Loft v. Fuller*, 408 So. 2d 619, 623 (Fla. Dist. Ct. App. 4th Dist. 1981) which had rejected a claim by a decedent's wife for the unauthorized use of her husband's name in an account of a fatal crash of an airliner in which he had been the pilot).
17. *Id.* at 1291 (citing Fla. Stat. § 540.08(3)(a)).
18. *Id.* (citing Fla. Stat. § 540.08(3)(b)).
19. *Id.*
20. *Tyne*, 901 So. 2d at 808.
21. 901 So. 2d at 810.
22. There was no published opinion in dissent.
23. Whether a publication directly promotes an unrelated product or service may prove to be a fertile ground for dispute, as motion pictures and other media become increasingly integrated with marketing plans for toys, fast food and video games. *See, e.g.*, Kozinski and Banner, *supra* note 13, 76 Va. L. Rev. at 640 n.54 (discussing trend of product placements in entertainment); Sam Lubell, *Advertising's Twilight Zone: That Signpost Up Ahead May Be a Virtual Product*, *New York Times*, January 2, 2006 (discussing digital manipulations of television programs to add in product placements after the taping of the episode is finished).
24. 433 U.S. 562, 576-77 (1977).
25. *Id.* at 576. Notwithstanding the Supreme Court's characterization of the broadcast as of Zacchini's entire performance, it is unlikely that his appearance was limited to the fifteen seconds of his performance that was broadcast. Zacchini's performance at the fair most likely also involved him explaining his skills and reputation, the cannon and dangers involved, an introduction of a lovely assistant, and a warning to kids not to attempt to match his feat. *See Zacchini*, 433 U.S. 580, n.1, Powell, J. dissenting.
26. *Id.* at 575.
27. *Id.* at 576.
28. *Id.* at 574.
29. *See, e.g.*, *Messenger v. Gruner + Jahr Printing & Publ'g*, 727 N.E.2d 549, 552, 94 N.Y.2d 436, 441-42 (2000) (stating that the New York Court of Appeals "has held that 'newsworthiness' is to be broadly construed" with respect to New York's right of publicity statute); *Kane v. Comedy Partners*, 2003 U.S. Dist. LEXIS 18513, at \*24 (S.D.N.Y. Oct. 15, 2003) (reading the "newsworthy" exception to the right of publicity to include "entertainment and amusement, concerning interesting phases of human activity"); *Dora v. Frontline Video, Inc.*, 15 Cal. App. 4th 536 (Cal. App. 2d Dist. 1993) (finding documentary about surfing did not violate right of publicity of surfing legend portrayed in video).
30. *Tyne v. Time Warner Entertainment Co. L.P.*, 204 F. Supp. 2d 1338, 1342 (M.D. Fla. 2002).
31. *See Titan Sports, Inc. v. Comics World Corp.*, 870 F.2d 85, 87-88 (2d Cir. 1989) (remanding for consideration of whether poster-size photographs of wrestlers in a magazine were offered for the public interest news value or for purposes of trade); *Messenger*, 727 N.E.2d at 553, 94 N.Y.2d at 442-43 ("where a plaintiff's picture is used to illustrate an article on a matter of public interest, there can be no liability under sections 50 and 51 unless the pic-



- ture has no real relationship to the article or the article is an advertisement in disguise"); *De Gregorio v. CBS, Inc.*, 123 Misc.2d 491, 473 N.Y.S.2d 922, 924 (Sup. Ct. N.Y. 1984) (holding that television news crew that filmed and broadcast images of a couple holding hands in public as part of a public interest story did not violate the couple's right of publicity, even though one of the individuals photographed told the crew that he was married to someone else, that the other person was engaged to someone else and asked that film be destroyed).
32. The Second Circuit instructed in *Titan Sports, Inc. v. Comics World Corp.* that a court should consider "the extent of its relationship to the traditional content of a magazine, the ease with which it may be detached from the magazine, whether it is suitable for use as a separate product once detached, and how the publisher markets the item." 870 F.2d at 89.
  33. In *Arrington v. New York Times Co.*, 55 N.Y.2d 433, 440, 449 N.Y.S.2d 941, 944 (1982), the New York Court of Appeals found that the nonconsensual publication of a photograph of a well-dressed African-American man accompanying the article "The Black Middle Class: Making It" in the *New York Times Magazine* was sufficiently related to the public interest aspect of the article that it did not violate the subject's right of publicity. However, the court also held that neither the freelance photographer nor the photographic agency were under such a public interest exception, and refused to dismiss the claims against them. This distinction was implicitly rejected by a later New York Court of Appeals decision, at least with respect to a staff photographer. See, e.g., *Howell v. New York Post Co.*, 81 N.Y.2d 115, 612 N.E.2d 699, 596 N.Y.S.2d 350 (1993) (finding photographs of patient in a psychiatric facility taken by *New York Post* photographer and published in *New York Post* exempted from right of publicity claim as matter of public interest).
  34. *Bery v. City of New York*, 97 F.3d 689, 695 (2d Cir. 1996). Some states, such as California, have a limited statutory exception to the right of publicity that exempts a "single and original work of art." Cal. Civ. Code 3344.1(a)(2) (Deering Supp. 2005); see, e.g., Wash. Rev. Code Ann. 63.60.070(2)(a) (West 2005) ("[s]ingle and original works of fine art, including but not limited to photographic, graphic, and sculptural works of art that are not published in more than five copies"). These exemptions may be limited further, such as in California, where it only applies to uses of the persona of deceased persons. See generally, McCarthy, *The Rights of Publicity and Privacy*, § 6:34.
  35. 80 A.D.2d 428, 438 N.Y.2d 1004 (1st Dept. 1981).
  36. *Id.* at 441, 1013. The Second Circuit obliquely endorsed the result of *Brinkley*, stating it was clear that "photographs marketed as poster are used for the purposes of trade." See *Titan Sports, Inc. v. Comics World Corp.*, 870 F.2d 85, 88 (2d Cir. 1989). Similarly, in *Martin Luther King, Jr. Center for Social Change, Inc. v. American Heritage Products, Inc.*, the Georgia Supreme Court held that the unauthorized sale of busts of Martin Luther King violated his right of publicity. 250 Ga. 135, 296 S.E.2d 697 (1982).
  37. 159 Misc. 2d 54, 602 N.Y.Supp.2d 1014 (N.Y. Civ. Ct. 1993).
  38. *Id.* at 60, 1018 (the artist claimed an intention to make 10 castings from the sculptural mold).
  39. 25 Cal. 4th 387, 21 P.3d 797 (2001).
  40. 25 Cal. 4th at 404-405 (The court reasoned that "the nature of the copyrighted work" and "the amount and substantiality of the portion used" were not useful inquiries in the context of right of publicity claim, and "the effect of the use upon the potential market for or value of the copyrighted work" was difficult to ascertain and possibly irrelevant.).
  41. *Id.*
  42. *Id.* at 405.
  43. *Id.*
  44. *Id.* at 407.
  45. *Id.* at 409.
  46. 332 F.3d 915 (6th Cir. 2003).
  47. *Id.* at 937.
  48. *Id.* at 938.
  49. *Id.*
  50. See, e.g., *Comedy III Productions*, 25 Cal. 4th at 407; *ETW Corp.*, 332 F.3d at 938.
  51. *Bleistein v. Donaldson Lithographing Co.*, 188 U.S. 239, 251 (1903). The Supreme Court has recently reiterated its aversion to construing the aesthetic or artistic value of expressive works. See *Campbell v. Acuff-Rose Music*, 510 U.S. 569, 582-83 (1994) (whether parody is in good or bad taste does not and should not matter for fair use).
  52. See generally Geoffrey R. Stone, *Content-Neutral Restrictions*, 54 U. Chic. L. Rev. 46 (1987) ("outside the realm of low-value speech, the Court has invalidated almost every content-based restriction that it has considered in the past thirty years").
  53. 344 F.3d 265, 271 (2d Cir. 2003).
  54. See generally Robert A. Gorman, *Copyright Courts and Aesthetic Judgments: Abuse or Necessity?*, 25 Colum. J.L. & the Arts 1 (2001) (discussing tendency of courts to make aesthetic judgments when making copyright determinations such as fair use and copyrightability).
  55. 17 U.S.C. § 102.
  56. This significant difference between the requirements of right of publicity protections and those of copyright protections was central to the Seventh Circuit's recent decisions *Toney v. L'Oreal U.S.A., Inc.*, in which the court first held that a model's right of publicity claim was preempted by copyright, 384 F.3d 486 (7th Cir. 2004), and then vacated that decision and held that the model's right of publicity claim was not preempted, because the model's identity was not "fixed," 406 F.3d 905 (7th Cir. 2005).
  57. 200 F. Supp. 2d 340 (S.D.N.Y. 2002) (Thomas Hoepker, the photographer, also asserted a claim for copyright infringement.).
  58. *Id.* at 350.
  59. *Nussenzweig v. diCorcia*, 2006 N.Y. Misc. LEXIS 230 at \*\*19-21 (noting, but declining to use, the transformative test as articulated by the court in *Comedy III Productions*).
  60. *Id.* at \*\*19.
  61. *Id.* at \*\*21.
  62. *Id.* at \*\*20.
  63. 310 F. Supp. 2d 914, 922 (N.D. Ohio 2004) (finding a substantial likelihood of success on plaintiff's claim for a violation of both Ohio's and Florida's right of publicity laws, refusing to find the work satisfied the "the news, entertainment and creative works exception," and granting a preliminary injunction), *stayed pending determination of the merits*, 70 U.S.P.Q.2d (BNA) 1537 (6th Cir. April 21, 2004) (unpublished) (holding the preliminary injunction to be a prior restraint on speech).
  64. *Id.*
  65. Cf. *Hoepker v. Kruger*, 200 F. Supp. 2d at 352 (holding that the items sold in the museum store bearing the images in question were also protected, reasoning that "[c]ourts should not be asked to draw arbitrary lines between what may be art and what may be prosaic as the touchstone of First Amendment protection."). Indeed, as nude dancing has been held to qualify as expressive for First Amendment purposes, see, e.g., *Barnes v. Glen Theatre, Inc.*, 501 U.S. 560, 565-66, (1991) (holding that "bar-room" nude dancing is within the ambit of First Amendment protected expression, though "only marginally so"); *Schad v. Mt. Ephraim*, 452 U.S. 61, 66 (1981) (stating that "nude dancing is not

- without its First Amendment protections”), the *Bosley* decision which holds that a film of such activity is not expressive, is particularly problematic.
66. Street photography, which generally refers to unstaged photographs taken in public places, is an important genre of fine art photography and includes such acclaimed photographers as Henri Cartier-Bresson, Robert Frank and Gary Winograd. Arguably, the entire genre of street photography could be severely hampered by a requirement that either the photograph be aesthetically transformative or the photographer gather permissions from all people in the image.
  67. *Nussenzweig v. diCorcia*, 2006 N.Y. Misc. LEXIS 230 at \*\*21.
  68. *Zacchini*, 433 U.S. at 576.
  69. *ETW Corp.*, 332 F.3d at 938.
  70. Of course, this analysis is itself evaluating the purpose of speech, which is on dangerous First Amendment ground. However, this analysis helps obviate the need for the court to place a value on the content of the speech, which is a much more questionable undertaking. It also is useful to separate the less defensible situation where a corporation takes a person’s photograph and without their consent places it prominently in product advertisements or on product packaging. See *Roberson v. Rochester Folding Box Co.*, 171 N.Y. 538, 64 N.E. 442 (1902) (use of an individual’s picture in advertisements for bags of flour).
  71. For now, First Amendment jurisprudence generally accommodates a lower level of protection for pure commercial speech, namely, speech which is designed to sell products. See generally, Kozinski and Banner, *supra* note 13, discussing origin of commercial speech doctrine and questioning the propriety of lowered First Amendment protections for commercial speech. This distinction, though often questioned, is normally included in right of publicity statutes.
  72. Courts may also seek to protect not only the markets that the plaintiff has previously entered, but also those so reasonably related that they would be probable areas of expansion for the plaintiff to occupy. Such an analysis might resemble the conceptually similar “natural zone of expansion” test used in trademark analysis to protect trademark holders from others encroaching too closely to their protected marks. See, e.g., *Westchester Media v. PRL USA Holdings, Inc.*, 214 F.3d 658, 665-67 (5th Cir. 2000); *Brookfield Communications, Inc. v. West Coast Entertainment Corp.*, 174 F.3d 1036, 1047 (9th Cir. 1999).
  73. A similar “function” based test is advanced by Nimmer for use in copyright fair use determinations. See Melville B. Nimmer and David Nimmer, 4 Nimmer on Copyright § 13.05[B].
  74. This is also consistent with the original construction of the “transformative” test as described by Judge Leval in his article, *Toward A Fair Use Standard*, 103 Harv. L. Rev. 1105, 1111 (1990), in which he states that a transformative use is one that is “productive and must employ the quoted matter in a different manner or for a different purpose from the original.”
  75. See, e.g., 4 Nimmer § 13.05[A][4] (stating that with regard to the copyright fair use factor evaluating the effect upon the plaintiff’s potential market, there is a “danger of circularity,” because “it is a given in every fair use case that plaintiff suffers a loss of a potential market if that potential is defined as the theoretical market for licensing the very use at bar.”)
  76. As stated by the Supreme Court, it is the “joinder of reference and ridicule that marks off the author’s choice of parody from the other types of comment and criticism that traditionally have had a claim to fair use protection as transformative works.” *Campbell*, 510 U.S. at 583. Parody, one of the traditional “fair use” exceptions has been used to successfully defeat a right of publicity claim. The Tenth Circuit in *Cardtoons, L.C. v. Major League Baseball Players Association*, 95 F.3d 959 (10th Cir. 1996), held that trading cards featuring caricatures of Major League Baseball players did infringe on the players’ publicity right but were nonetheless protected as parody. There, the court analogized to fair use principles to find that the societal importance of the “free expression” of the author outweighed the economic and non-economic effect on the individuals whose names and images were being used. *Id.* at 972-76. The problem with this type of balancing is that it inherently requires a court to make a judgment as to the societal value of certain types of expression, a determination that courts should generally not be asked to make.
  77. See *supra* note 63 and accompanying text.
  78. *Id.* at 922.
  79. 242 F. Supp. 2d 1205, 1215 (M.D. Fla. 2002).
  80. 2003 U.S. Dist. LEXIS 9307, at \*1 (N.D. Fla. Mar. 16, 2003).
  81. The court in *Gritzke* relied, in part, on the fact that the plaintiff’s identity was used to promote the video, not merely as a part of it. 2003 U.S. Dist. LEXIS at \*3. However, in *Lane* the plaintiff’s photograph was also used to promote the video on television, and in *Tyne*, the identities of the characters were used to promote the film. Generally, it is a disingenuous distinction to focus upon promotional use of accurate clips of the product. If the original product is an allowable use of a person’s image, then incidental use of the same images to advertise or promote the product should also be permitted. See *Kane v. Comedy Partners*, 2003 U.S. Dist. LEXIS 18513 (S.D.N.Y. Oct. 15, 2003) (use of a very short clip of a woman dancing in a bikini to advertise Comedy Central’s “The Daily Show” is an allowed use); *Groden v. Random House*, 61 F.3d 1045, 1049 (2d Cir. 1995) (allowing incidental use); *Velez v. VV Pub. Corp.*, 135 A.D.2d 47, 50, 524 N.Y.S.2d 186, 187 (1st Dep’t), *appeal denied*, 72 N.Y.2d 808, 533 N.Y.S.2d 57, 529 N.E.2d 425 (1988) (“[T]he incidental use in an advertisement by a news disseminator of a person’s name or identity does not violate the statutory proscription, if it had previously published the item exhibited as a matter of public interest.”). The court in *Lane*, 242 F. Supp. 2d at 1213, also held that use of the woman’s image in advertisements for the video did not give rise to liability.
  82. 310 F. Supp. 2d at 917.
  83. *Lane*, 242 F. Supp. 2d at 1209.
  84. Though somewhat opaquely, the *Bosley* decision appears to make this point. The court states that “the images of Catherine Bosley are mere copies of Catherine Bosley’s performance,” and that the defendants were “selling Plaintiff’s image for a profit without including a message of their own.” *Bosley*, 310 F. Supp. 2d at 928.

**Jason D. Sanders is an attorney at Cowan, Liebowitz & Latman, P.C. in New York and represents clients from emerging artists to established organizations in protection of their intellectual property and other rights. He is a graduate of Duke University and the University of Michigan Law School.**

# The Legalities and Realities of Control Within Artist-Driven Nonprofit Organizations

By Sharon Connelly

*We have all walked the high wire of circumstance at times. We recognize the gravity pull . . . as [the acrobat] does. The smile is there because he is practicing living at that instant of danger. He does not choose to fall.*

**Martha Graham (1894–1991)<sup>1</sup>**

In a ruling feared to have set a dangerous precedent by many in the dance community, the nonprofit Martha Graham Center of Contemporary Dance (“Center”) was held to own the copyrights to the bulk of Martha Graham’s choreographic work.<sup>2</sup> This decision was an affront to the accepted tenets of the dance world, where there has “always been the assumption . . . that the choreographer owns his or her own work and can leave that work to whomever he or she would like to.”<sup>3</sup> Even more unsettling to many in the field was the determination by the court that the Center was the statutory “author”—for purposes of copyright—of works created while Graham, one of the leading choreographers of the twentieth century, was Artistic Director of the Center.<sup>4</sup>

Ronald Protas,<sup>5</sup> Graham’s legatee and her successor as Artistic Director, claimed the rights to her work as residuary legatee under her will<sup>6</sup> and instigated the suit against the nonprofit Center which had supported and maintained Graham’s choreography since 1948. At issue in the case were the copyrights to seventy choreographic works created by Martha Graham between the early 1920s and her death in 1991.<sup>7</sup> The main issue on appeal was whether the work-for-hire doctrine applied to works choreographed by an artistic genius employed by a nonprofit corporation formed to serve her creative endeavors.<sup>8</sup> The Second Circuit upheld the application of the work-for-hire doctrine to works created after 1966 while Graham was a full-time employee of the Center, during which time her contractual duties as Artistic Director included choreography.<sup>9</sup>

While the primary question considered in the case was whether Graham actually owned the rights to her work at the time of her death, the overriding issue seemed to be whether her beneficiary should be allowed to remove those works from the nonprofit dance company she had founded. Consequently, the court’s decision may have been influenced by the fundamental equitable consideration of who *deserves* to own these works. A finding in favor of the Center, which had served as incubator and home to the work for more than fifty years, would likely guarantee continued life for the works through performance and

preservation. In contrast, a finding in favor of Protas, who had refused to allow the Martha Graham Dance Company to perform any of Graham’s works after his removal as Artistic Director of the Center, would possibly leave no single living repository for the work and might place the dances in danger of disappearing forever from the public eye.<sup>10</sup> Although these concerns were not cited as reasons for the court’s holding, their underlying presence was inescapable.

According to custom within the dance community, a choreographer is presumed by her peers to “own” her choreography, in the absence of an agreement to the contrary.<sup>11</sup> Choreographers creating under the auspices of nonprofit organizations have previously willed their works to other parties without question, and their beneficiaries, motivated by a respect for the work and a desire to see it preserved and performed, have licensed or sold the works to the companies for which the dances had been created.<sup>12</sup> In the present case, a rift between Protas and the Center led to the legal challenge and a ruling that questions the tradition and custom of a field subject to little prior legal interference.

The work-for-hire portion of the *Graham* ruling may be used as a catalyst for exploring the legalities and realities of control within “artist-driven”<sup>13</sup> nonprofit organizations. Interpreting the *Graham* decision through a prism of nonprofit, moral rights, and equitable considerations suggests that: (1) the economic rights of nonprofit organizations ultimately benefit their founding artists; (2) a constraint on an artist’s right to transfer copyright ownership at the time of her death might be viewed as a fair exchange for the benefits provided to the artist by a nonprofit organization; (3) artistic control, which is not a feature of U.S. copyright law but is often of primary concern to artists, may be analogous to the “moral rights” recognized in other countries and, to a limited extent, within the United States; and (4) founding artists generally have the freedom and power to negotiate to retain rights to their works via contract. Thus, the precedent set by the *Graham* ruling, that copyright vests in a nonprofit employer in the absence of an agreement to the contrary, does not necessarily undercut the rights that are of primary concern to artists. Not only may this presumed employer ownership be overruled by memorializing the parties’ specific intentions in a written agreement, but it is also possible that an artist’s primary interests may be better protected by a nonprofit organization created by the artist specifically to nurture, advance, and preserve her work.



## Setting the Stage

### Martha Graham, the Center, and the School

Martha Graham began dancing in the early 1920s, and by 1926 had given her first public performance of her own works, eventually forming a troupe that became known as the Martha Graham Dance Company (“Company”).<sup>14</sup> The Company was run as a sole proprietorship, and Graham’s choreography was initially financed by commissions from wealthy benefactors.<sup>15</sup> Graham performed with the Company from its inception until the late 1960s (at which time she was in her seventies) and choreographed more than 180 works.<sup>16</sup> Around 1930, she opened the Martha Graham School of Dance, a sole proprietorship through which she taught her own system of dance movements and exercises known as the Martha Graham Technique.<sup>17</sup>

Graham established the Martha Graham Foundation for Contemporary Dance (“Foundation”) as a non-profit corporation in 1948.<sup>18</sup> “The Foundation was created to support modern dance by promoting and disseminating the Martha Graham technique, as well as raising funds for performances of the Martha Graham Dance Company.”<sup>19</sup> In 1956, Graham incorporated the Martha Graham School of Contemporary Dance (“School”) and subsequently sold her sole proprietorship dance school, including its name, assets, and goodwill, to the newly incorporated School.<sup>20</sup> Graham was not employed by either organization in any capacity prior to 1956,<sup>21</sup> although eventually Graham’s works were exclusively created through these organizations.<sup>22</sup>

In 1968, the Foundation’s name was changed to the Martha Graham Center of Contemporary Dance.<sup>23</sup> The Center served as an umbrella organization for the incorporated School and the unincorporated Company.<sup>24</sup> Although separately incorporated, the Center and the School largely operated as a single entity.<sup>25</sup> Graham served as Artistic Director and a board member of both the Center and the School from 1966 until her death in 1991.<sup>26</sup> Graham’s responsibilities as Artistic Director were “to create new dances, to maintain the repertory of dances, to rehearse the company, and to supervise the School.”<sup>27</sup>

### Overview of the Martha Graham Copyright Case<sup>28</sup>

In January 2001, Protas filed suit against the Center and School under section 2201(a) of title 28 of the U.S. Code, seeking a declaratory judgment that: (1) none of the seventy dances in question were in the public domain, (2) he owned all rights in these works, and (3) unauthorized performance of these dances would constitute willful copyright infringement.<sup>29</sup> The Center counterclaimed for a declaration of ownership of the works in question, arguing that it owned the dances via Graham’s assignment and the work-for-hire doctrine,

and thus, Protas had not inherited any rights to these works.<sup>30</sup> New York State Attorney General Eliot Spitzer intervened on behalf of the Center to protect the interests of the citizens of New York in the assets of this New York state nonprofit corporation.<sup>31</sup>

A bench trial was held in April 2002 before Judge Miriam Goldman Cedarbaum of the District Court for the Southern District of New York—“an effort to recapture a history that partially predated the knowledge and memory of the living witnesses.”<sup>32</sup> The specific circumstances of each work further complicated the district court’s analysis. Some works were governed by the Copyright Act of 1909 (“1909 Act”), others by the Copyright Act of 1976 (“1976 Act”); some were created before the Center was established, others after; some had been published, others had not.<sup>33</sup> Additionally, the critical events of this litigation spanned sixty-five years and inadequate record keeping hindered access to many pertinent facts.<sup>34</sup> Also informing the district court’s decision was Judge Cedarbaum’s finding that Protas was not a credible witness due to “his evasive and inconsistent testimony and . . . his demeanor.”<sup>35</sup>

The district court overwhelmingly found in favor of the Center, holding that it owned the rights to forty-five of Graham’s dances.<sup>36</sup> Thirty-four dances created by Graham while she was employed by the School or the Center between 1956 and 1991 were found to have been works for hire.<sup>37</sup> The district court found that the Center held the copyrights to only twenty-seven of these thirty-four dances, since seven dances had been published without sufficient evidence as to whether there was copyright notice.<sup>38</sup> The district court also found that Graham had assigned a total of twenty-one of her earlier unpublished works to the Center.<sup>39</sup> Although there was no evidence of a written assignment by Graham, the district court held that “a preponderance of the credible evidence” established the transfer of the common law copyright in these unpublished works.<sup>40</sup> This evidence included letters, documents, contracts with third parties, minutes of the Center’s board of directors’ meetings, financial records, and witness testimony showing that the Center consistently acted as the owner of these dances and that Graham did not object.<sup>41</sup> Eighteen of the twenty-one assigned works were held to presently belong to the Center.<sup>42</sup> Protas established that, as executor of Graham’s estate, he was entitled to the renewal term in one dance originally assigned to the Center and subsequently published with notice of copyright in 1969.<sup>43</sup> The district court held that neither party had established ownership of twenty-four dances, ten of which had entered the public domain for lack of timely renewal, five of which were commissioned works, and nine of which were published, but for which neither side had established adequate notice of copyright or lack thereof.<sup>44</sup>

The appeal was argued before the Second Circuit on January 29, 2004.<sup>45</sup> The Second Circuit largely upheld the district court's work-for-hire ruling, disagreeing primarily in the application of the work-for-hire doctrine to ten works choreographed by Graham between 1956 and 1965 while she was a part-time employee of the School.<sup>46</sup> The case was remanded to the district court for a determination of ownership of seven of the ten dances created between 1956 and 1965.<sup>47</sup> Judge Cedarbaum held an evidentiary hearing in May 2005, after which she determined that the seven dances found by the Second Circuit not to be works for hire had been assigned to the Center by Graham.<sup>48</sup> This holding was based on much of the same evidence that had established Graham's assignment to the Center of her pre-1956 works.<sup>49</sup>

A petition for a writ of certiorari was filed by Protas on March 21, 2005, challenging the Second Circuit's work-for-hire holdings and questioning "[w]hether the work-for-hire doctrine can divest an artist from the ownership of her body of work in situations where that artist has established a not-for-profit entity to facilitate the creation and presentation of those same works."<sup>50</sup> The Supreme Court denied the petition without comment.<sup>51</sup>

### **Protection for Choreographer's Rights and the Essence of "Owning" a Dance**

"Custom . . . draws its strength from the consent of those who agree to be bound by it."<sup>52</sup> As members of an interdependent community, American choreographers have long yielded to their self-imposed rules which continue to offer a means of recognizing and protecting their rights.<sup>53</sup> "Many choreographers maintain that the threat of ostracism from the dance community is sufficient to deter most potential breaches."<sup>54</sup> Even with the availability of copyright protection for choreographic works, custom continues to act as a formidable regulatory force within the field.

There is little case law in the field of choreography dealing with either infringement or breach of licensing agreements.<sup>55</sup> The few early cases dealt not with ownership or infringement, but with whether the works at issue were even eligible for copyright protection—questioning whether such protection was appropriate for "a mere spectacle [that] must be seen to be appreciated"<sup>56</sup> or for a work that was found to be "solely the devising of a series of graceful movements . . . telling no story, portraying no character, depicting no emotion."<sup>57</sup> Past courts have also interpreted the Constitutional mandate limiting copyright protection to works that promote the "useful arts"<sup>58</sup> as an invitation to judge the moral worth of the works and a mandate to uphold public virtue.<sup>59</sup> The 1985 case of *Horgan v. MacMillan, Inc.*,<sup>60</sup> which considered whether George Balanchine's<sup>61</sup> choreography could be infringed by photographs of his work, was the

first case in which a choreographic copyright was alleged to have been infringed under the 1976 Act,<sup>62</sup> which for the first time recognized choreography as a distinct category of protectable work.<sup>63</sup>

For the vast majority of the field, there is little economic incentive driving considerations of intellectual property, and infringements rarely warrant litigation.<sup>64</sup> Most choreographers make little from the performance or licensing of their works, so a suit based on actual damages or an infringer's profits generally would be of little value.<sup>65</sup> "[W]hatever the legality of the situation, most of the time the bottom line is the cost of litigation. 'The copyright law merely gives you the right to sue. . . . But lawsuits are enormously expensive.'"<sup>66</sup>

The general elusiveness of dance also continues to raise challenges in fitting works of choreography into the system of copyright protection. Determining the economic value of a dance copyright is a difficult task. The value rests in the potential to exploit the rights secured by copyright by performing the work publicly, licensing performance rights to other dancers or dance companies, allowing the creation of derivative works of choreography, or authorizing derivative works in other media such as film, videotape, or television.<sup>67</sup> It is often difficult to speculate what the future value will be, especially at the moment of creation when—for the vast majority of choreographers—the economic value may be minimal or non-existent.<sup>68</sup> Determining the future value of a dance remains challenging even once a company or choreographer begins to license and receive income from the work.<sup>69</sup>

In order to exploit the rights granted to a work of choreography by copyright, resources beyond the copyright itself are required. Access to the original work, one such resource, may be provided through tangible media such as film, videotape, and/or a notated score,<sup>70</sup> or through the memory of the choreographer, original performers, or other parties familiar with the work.<sup>71</sup> Beyond access, utilization of the work requires the participation of someone with the technical expertise to translate the work from the film, videotape, score, or personal memory onto the bodies of dancers.<sup>72</sup> Financial resources also are required to fund the reconstruction, resetting, and production of the work.<sup>73</sup>

There must be some connection between the copyright itself and the other resources necessary to utilize the work, or the copyright has no functional value. Nonprofit dance companies make excellent repositories for such resources, and there is enormous cultural value, beyond the economic value of the copyright itself, to keeping the work alive in the repertoire of a dance company.<sup>74</sup> Carla Maxwell, Artistic Director of the nonprofit dance company of José Limón, a contemporary of Martha Graham, observed, "The overwhelming thing that hit us all when Jos[é] died was that if we

disbanded, an entire lifetime of work was going to disappear.”<sup>75</sup>

Due to the specific dance knowledge required to utilize works of choreography and to the lack of case law in the area of choreographic copyright protection, the customary views of ownership within the field carry great weight with choreographers. Often, the fact that a choreographer owns and has the right to control his choreography is taken for granted within the contemporary American dance community.<sup>76</sup> José Limón (d. 1972), George Balanchine (d. 1983), Alvin Ailey (d. 1989), and Jerome Robbins (d. 1998)—each of whom had created dances under the auspices of nonprofit organizations—left their works to private parties who then licensed or sold the choreographers’ works back to the companies for which they had been created.<sup>77</sup> These bequests were not challenged.<sup>78</sup> Since the parties involved did not seek a legal determination of copyright ownership, the legal standard was not called into question.

Graham’s right to leave her dances to Protas would likely have remained unquestioned had Protas not attempted to deny the Center access to the works. Respecting the custom of the field, the Center would likely have continued to pay Protas a licensing fee for use of Graham’s works while allowing him to reap the profits of licensing the works to other companies.

### The Right to Control and the Work-for-Hire Doctrine

Congress has not fully defined the term “author” as used in the Copyright Act, although both the 1909 and 1976 Acts state that an employer is considered the author in the case of works made for hire.<sup>79</sup> “[W]ith respect to works for hire, the employer is legally regarded as the ‘author,’ as distinguished from the creator of the work, whom Learned Hand referred to as ‘the “author” in the colloquial sense.’”<sup>80</sup> The Supreme Court has defined “author” in this sense to be “[h]e to whom anything owes its origin; originator, maker.”<sup>81</sup>

Under both the 1909 and 1976 Acts, the work-for-hire doctrine embraces the tenet that in a typical employer-employee relationship, the employer has some right of control over the creation of a work by an employee.<sup>82</sup> Although “no one sells or mortgages all the products of his brain to his employer by the mere fact of employment,”<sup>83</sup> the Center’s right to control Graham’s work, as her employer, was a factor in determining that the work-for-hire doctrine applied.<sup>84</sup> As the Second Circuit highlighted in its opinion, so long as the employer has the *right to supervise* the manner in which a work is created, the fact that the employer did not *exercise control* does not preclude application of the work-for-hire doctrine.<sup>85</sup>

### Works for Hire under the 1909 Act: The “Instance and Expense” Test

An employer-employee relationship signifying work-for-hire status for works created under the 1909 Act is determined through application of the “instance and expense” test, first utilized by the Second Circuit in *Brattleboro Publishing Co. v. Winnill Publishing Co.*,<sup>86</sup> which held that when an employee’s work was created at the employer’s instance and expense and the intent of the parties could not be determined, the presumption of copyright ownership ran in favor of the employer.<sup>87</sup> These principles were found to apply to both the traditional employer-employee relationship as well as in the relationship of employer and independent contractor.<sup>88</sup> The Second Circuit has since defined the “instance and expense” test as being met when the employer both induced the creation of the work and had the right to direct and supervise how the work was executed.<sup>89</sup> Significantly, “[t]he *right* to direct and supervise the manner in which work is created need never be exercised.”<sup>90</sup>

In holding that nineteen dances choreographed by Graham from 1956 through 1977 were works for hire, the district court found the “expense” test to be satisfied because Graham choreographed on dancers employed by the Center; thus, the tools used to create Graham’s choreographic works were provided by the Center.<sup>91</sup> Graham herself had recognized that she could never have accomplished all that she did if she had not had access to a place such as the Center.<sup>92</sup> While acknowledging that it was “undisputed that Martha Graham was ultimately responsible for making all final artistic decisions relating to the dances,”<sup>93</sup> the court found the “instance” test to be satisfied as well, holding that the fact that “the Center’s board of directors did not interfere with Graham’s artistic decisions does not show that it did not have the legal authority, as her employer, to ensure that dances were created at the ‘instance’ of the defendants.”<sup>94</sup>

On appeal, Protas contended that Graham was not an employee within the scope of the 1909 Act since “she choreographed at no one’s instance but her own.”<sup>95</sup> The Second Circuit found, however, that whether Graham would have choreographed without her salary and the support of the Center was irrelevant and that the instance and expense test does not require the employer to be the precipitating force behind each work created by an employee.<sup>96</sup> “Many talented people . . . are expected by their employers to produce the sort of work for which they were hired, without any need for the employer to suggest any particular product.”<sup>97</sup> The fact that Graham was paid by the Center specifically to create the intellectual property at issue in this litigation was significant in finding that a work-for-hire relationship existed.<sup>98</sup>



Despite the Second Circuit's agreement with the district court's application of the instance and expense test, it concluded that the district court erred in finding ten works choreographed by Graham from 1956 through 1965 to be works for hire.<sup>99</sup> Per Graham's employment contract, she was employed by the School during that period only to teach and supervise the School's education program as part-time Program Director, despite the fact that part of the School's purpose was the creation of dances.<sup>100</sup> There was no evidence that her duties included choreography, while there was evidence that during this period Graham received income from other sources for her choreography.<sup>101</sup> Although the resources provided by the Center, including rehearsal space and dancers, may have aided Graham in her choreography—arguably satisfying the “expense” test—“no dances were proved to have been created before 1966 at the ‘instance’ of the Center.”<sup>102</sup>

The Second Circuit upheld the district court's work-for-hire finding with respect to the nine works created from 1966 through 1977, finding that Graham had signed a new ten-year contract with the Center in 1966 that changed her status to full-time Artistic Director of the Center.<sup>103</sup> After this contract was signed, Graham's “primary duty was to choreograph new dances.”<sup>104</sup> This contract was renewed indefinitely in 1976 and remained in effect until Graham's death in 1991.<sup>105</sup>

#### **Works for Hire under the 1976 Act: “Employee” Status under the Common Law of Agency**

Under the 1976 Act, there is a presumption of ownership by the employer, unless contracted otherwise in writing.<sup>106</sup> To ascertain whether a work created on or after January 1, 1978 is a work for hire, the determinative question is whether it was “prepared by an employee within the scope of his or her employment.”<sup>107</sup> Definitions for “employee” and “scope of employment” are lacking under the 1976 Act,<sup>108</sup> but the Supreme Court has held that “the term ‘employee’ should be understood in light of the general common law of agency.”<sup>109</sup> Work is within an employee's “scope of employment” if (1) it is of the kind the employee was hired to perform, (2) its creation occurs substantially within the authorized time and space limits of the job, and (3) it was at least partially motivated by a desire to serve the employer.<sup>110</sup>

In *Community for Creative Non-Violence v. Reid*,<sup>111</sup> the Supreme Court listed twelve factors to consider in determining whether a party is an employee under the common law of agency, no one of which is determinative: (1) the right to control the manner and means of production, (2) the necessary skill, (3) the source of the instrumentalities and tools, (4) the location of the work, (5) the duration of the relationship, (6) the right to

assign additional projects, (7) control over when and how long to work, (8) the method of payment, (9) the choice and compensation of assistants, (10) the regular business of the hiring party, (11) employee benefits provided, and (12) tax treatment.<sup>112</sup> The *Reid* Court “held that ‘employee’ should not be interpreted exclusively in terms of whether the hiring party retains the right to control the product, nor in terms of whether the hiring party has actually wielded control over the creation of the work.”<sup>113</sup>

In *Aymes v. Bonelli*,<sup>114</sup> the Second Circuit subsequently narrowed the list to five factors that “will be significant in virtually every situation . . . and should be given more weight in the analysis”: (1) requisite skill, (2) the right of the hiring party to control the manner and means of production, (3) whether the hired party may be assigned additional projects, (4) tax treatment of the hired party, and (5) provision of employee benefits.<sup>115</sup>

The status of fifteen of Graham's works, choreographed from 1978 through 1991, was assessed under the 1976 Act.<sup>116</sup> A balancing of the *Aymes* factors by the district court showed that Graham was an employee of the Center.<sup>117</sup> Although Graham's level of skill was uncontested, the court found that the board exercised its control “in all the ways it saw fit while giving deference to Graham's talent as a choreographer.”<sup>118</sup> The board also “encouraged her to produce new work, and occasionally suggested themes for new dances.”<sup>119</sup> Graham received a salary from the Center as Artistic Director, from which taxes were withheld, and the Center paid personal, travel, and medical expenses and other employee benefits on her behalf.<sup>120</sup>

The court also applied additional factors from *Reid* that further supported its determination of Graham's employee status.<sup>121</sup> The Center was the “source of [Graham's] instrumentalities and tools,” as it paid for the dancers, pianists, sets, and costumes and provided the rehearsal space.<sup>122</sup> The “location of the work” was the defendants' premises.<sup>123</sup> The “duration of the relationship” was more than three decades of employment.<sup>124</sup> The “method of payment” was a fixed annual salary, set by the board of directors, “with no separate compensation for the creation of dances.”<sup>125</sup> Furthermore, the creation of dances by Martha Graham was part of the “regular business” of the Center.<sup>126</sup> These factors pointed “overwhelmingly to the conclusion that Graham was an employee of the defendants.”<sup>127</sup>

The Second Circuit agreed with the district court's conclusion that Graham's dances created from 1978 through 1991 were works for hire.<sup>128</sup> Conceding that the Center did not exercise much control over Graham, the Second Circuit focused on the fact that “the absence of a

hiring party's *exercise* of control does not mean that an artist is not an employee where other factors weigh in favor of finding an employment relationship."<sup>129</sup> Thus, while recognition of Graham's artistic genius would explain the Center's disinclination to exercise control over her choreography, such uncontested artistic skill does not preclude a finding of an employment relationship for purposes of the work-for-hire doctrine.<sup>130</sup>

## Artistic Control and Nonprofit Organizations

### Artist-Driven Organizations within the Nonprofit Rubric

"Artists are . . . inextricably tied to not-for-profit organizations," which provide a structure, a home, and financing for artistic works.<sup>131</sup> Most dance companies, including the Center, are incorporated under state not-for-profit law<sup>132</sup> and receive tax-exempt status under the Internal Revenue Code (the "Code").<sup>133</sup> Federal tax exemption is granted to such organizations due to their charitable purposes, since they serve the public good rather than a private interest.<sup>134</sup> Arts and cultural organizations have been recognized as having an educational purpose, one of the enumerated exempt purposes in the Code.<sup>135</sup> From an economic perspective, the nonprofit structure may be an artist's only financial option, especially "where significant resources must be marshaled for an artist's vision to be realized."<sup>136</sup> Changes in the available funding streams for the arts in the mid-twentieth century increasingly channeled the formation of arts organizations into the nonprofit structure.<sup>137</sup> The majority of foundation and corporate grant-making programs authorize donations only to nonprofit, tax-exempt organizations, and the tax deduction available to individuals provides a strong incentive to restrict their philanthropy to nonprofit organizations.<sup>138</sup> The defining characteristic of a nonprofit organization is the "nondistribution constraint" (also known as the "private inurement doctrine"), which means that such organizations may not distribute income or assets to shareholders, owners, directors, or officers.<sup>139</sup>

Just as the goal of a for-profit corporation is to make money for its investors, the goal of a not-for-profit is to make money that can be spent on furthering its [exempt purpose] objectives. . . . What distinguishes a not-for-profit is not whether it receives money, but what it does with the money.<sup>140</sup>

Many choreographers are employed by nonprofit organizations which they have founded. The programs and activities of these artist-driven organizations are focused on the work of their founding artists.<sup>141</sup> The primary purposes of such organizations are generally to support, utilize, and preserve the work of the founding artist.<sup>142</sup>

## The Significance of Control within Nonprofit Organizations

An additional prism through which to interpret the *Graham* case is the nonprofit structure of the Center. A nonprofit organization is legally controlled by its board members, who bear ultimate fiduciary responsibility for the management of the organization.<sup>143</sup> In many artist-driven organizations, however, the board will defer to the wishes of the founding artist.<sup>144</sup> Deference to the artist may be justified as an application of the board's business judgment<sup>145</sup> in serving the mission of the organization, which often revolves around the founding artist's work.<sup>146</sup> Graham was not only an employee of the Center, she was also its founder and artistic director, a member of its board of directors, and, in practice if not legally, the person with primary control over the organization.<sup>147</sup> Graham exercised unfettered artistic control over the Center.<sup>148</sup> Although the Center's board of directors bore ultimate fiduciary responsibility for the organization, the board did not interfere with Graham's artistic decisions and understood its role and the role of the Center to be one of support for Graham.<sup>149</sup> Graham's leadership role was significant, because her control over the Center could have potentially raised fiduciary duty and private inurement issues in connection with the ownership and use of her works during her lifetime. The board's deferral of control to Graham was a significant consideration both in the court's application of the work-for-hire doctrine and in the field's reaction to the ruling. Although not raised in the *Graham* case, considerations of fiduciary duty and private inurement could strengthen the equitable rationale for allowing ownership to vest in the Center.

New York Not-for-Profit Corporation Law requires that nonprofit directors and officers "discharge [their] duties . . . in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions."<sup>150</sup> The district court found that by virtue of his role as a board member and as principal managerial employee of the Center, "Protas had a fiduciary duty of undivided loyalty to the Center and the School."<sup>151</sup> The Second Circuit affirmed that he violated this duty and profited improperly at the Center's expense when he failed to investigate what he owned under Graham's will (as he had been advised to do by his attorney) and represented to the other board members that he owned Graham's dances.<sup>152</sup> In doing so, he "failed to exercise the 'degree of diligence, care and skill' required of directors and officers of not-for-profit corporations."<sup>153</sup>

The board of the Center had a comparable fiduciary duty to uphold the mission of the organization by protecting and preserving Graham's work.<sup>154</sup> This duty provided a strong motivation for the Center's position in the *Graham* case; the board could not allow Protas to

endanger the existence of the Center by removing Graham's works from the Company's repertoire.

Martha Graham—as founder, artistic director, and member of the board—was bound by a similar duty to the Center. This duty required her to place the interests of the Center above her own.<sup>155</sup> Since the Center was founded to promote and disseminate Graham's work,<sup>156</sup> Graham and the Center shared a common purpose. By furthering her own artistic interests, Graham was also furthering the interests of the Center.<sup>157</sup> Had she made an attempt to personally profit from works created with Center resources at the expense of the Center, however, a duty of loyalty question might have been raised.<sup>158</sup> Simply owning the copyright in her works should not have called this duty into question, but private economic exploitation of the rights secured by copyright, to the detriment of the Center, might have raised a question of whether the assets of the Center had been “distributed” to Graham in violation of the nondistribution constraint.<sup>159</sup> During Graham's lifetime, her ability to exploit her rights in her choreography may have been limited by her leadership role within the Center.

On the federal level, to qualify for tax exemption under section 501(c)(3) of the Internal Revenue Code, “no part of the net earnings [may] inure to the benefit of any private shareholder or individual.”<sup>160</sup> To allow “private inurement” would indicate that the organization was operated for a private, rather than public, purpose.<sup>161</sup> The Treasury Department regulations define prohibited private interests as those of “the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.”<sup>162</sup> As the founder of the Center, Graham would have qualified under this definition as a “private shareholder or individual.”<sup>163</sup>

The Internal Revenue Service has denied or revoked tax exemption from nonprofit organizations found to serve the private interests of artists who were founders or directors of the organizations, including “an organization whose primary purpose [was] to promote the circulation of books [written by] one of its incorporators”;<sup>164</sup> “a cooperative art gallery formed and operated by a group of artists for the purposes of exhibiting and selling their work”;<sup>165</sup> and a foundation, the resources of which were used for the benefit of a board member who was a well-known textile artist and wife of the foundation's president.<sup>166</sup> “The heart of § 501(c)(3) tax exempt status is the phrase ‘inures to the benefit.’ . . . Unaccounted for diversions of a charitable organization's resources by one who has complete and unfettered control can constitute inurement.”<sup>167</sup> Since intellectual property rights in choreography are a resource for a dance company, as a party with a prohibited private interest, Graham's retention of copyright could have raised a question of private inurement.

## Artistic Control and Moral Rights

Another issue not arising in the *Graham* case but essential to interpreting the significance of the ruling concerns “rights” of artistic control, which may be viewed as analogous to moral rights—personal rights of the author recognized as independent from the economic rights of copyright.<sup>168</sup> Although the U.S. Copyright Act does not acknowledge such moral rights in either works of choreography or works for hire, nor does the Act recognize the existence of any moral rights after an artist's death, the relationship of moral rights to artistic control as recognized within the dance field is noteworthy.

### Moral Rights Defined

Moral rights are rights of a “spiritual, non-economic, and personal nature,”<sup>169</sup> which are based on the theory that an original creation reflects the personality of its creator.<sup>170</sup> These rights “result in a climate of artistic worth and honor that encourages the author in the arduous act of creation.”<sup>171</sup> In countries that recognize such rights, even a full transfer of copyright for economic purposes does not serve to divest an author of his moral rights.<sup>172</sup> European courts, however, have allowed these “inalienable” rights to be waived or modified by contract.<sup>173</sup>

Moral rights are commonly believed to have originated in France and developed in civil law jurisdictions.<sup>174</sup> Specific moral rights are defined by the national laws protecting their existence, but such rights are generally of two types: Rights of paternity (also known as rights of attribution) and rights of integrity,<sup>175</sup> which are mandated by Article 6bis of the Berne Convention, which states:

(1) Independently of the author's economic rights, and even after the transfer of the said rights, the author shall have the right to claim authorship of the work and to object to any distortion, mutilation or other modification of, or other derogatory action in relation to, the said work, which would be prejudicial to his honor or reputation.<sup>176</sup>

Basic paternity rights under French law include the artist's rights to be publicly recognized as the creator of his work or to publish anonymously or pseudonymously, to prevent another from claiming authorship of his work, and to prevent his name from being used in connection with the work of another or in connection with an altered or distorted version of his own work.<sup>177</sup> The paternity right has been said to encompass an artist's right “to have his work attributed to him in the form in which he created it.”<sup>178</sup> Enduring choreographic credit each time a dance is performed is an example of a



paternity right.<sup>179</sup> Integrity rights allow an author to prohibit or control alterations of his works.<sup>180</sup> With choreography, an integrity right is acknowledged in that those performing the work are not allowed to make unauthorized changes, but the choreographer retains the right to revise the work “whenever aesthetic or practical reasons dictate.”<sup>181</sup> In some jurisdictions, the integrity right also allows an author to protect his work from destruction.<sup>182</sup>

In addition, some European countries recognize a withdrawal right which allows an artist to withdraw the work from the public or to make modifications.<sup>183</sup> This right may be exercised even if exploitation rights have been transferred, “so long as the artist indemnifies the transferee before exercising the right.”<sup>184</sup>

### Limited U.S. Recognition of Moral Rights

U.S. copyright law seeks primarily to vindicate the economic rights of artists.<sup>185</sup> The only moral rights currently acknowledged by the 1976 Act are limited rights of attribution and integrity, which are provided only to authors of works of visual art.<sup>186</sup> The Second Circuit has recognized, however, that “the economic incentive for artistic and intellectual creation that serves as the foundation for American copyright law cannot be reconciled with the inability of artists to obtain relief for mutilation or misrepresentation of their work to the public on which the artists are financially dependent.”<sup>187</sup>

Even though Congress has yet to acknowledge full moral rights for all genres of work, some federal and state courts have recognized these rights as “necessary and proper adjuncts to the creative process.”<sup>188</sup> Courts have provided sporadic relief for infringements of paternity and integrity rights by “cloaking the concept in the guise of other legal theories,”<sup>189</sup> such as invasion of privacy,<sup>190</sup> unfair competition,<sup>191</sup> false designation of origin under the Lanham Act,<sup>192</sup> breach of contract,<sup>193</sup> and defamation.<sup>194</sup> These decisions “vindicate the author’s personal right to prevent the presentation of his work to the public in a distorted form,” even though the holdings have been based on proprietary rights in one’s creation rather than an acknowledgment of the legal existence of moral rights.<sup>195</sup> “Where, however, the parties have entered into a contract . . . [any] so-called ‘moral right’ is controlled by the law of contract.”<sup>196</sup>

To the extent that an employment relationship exists and copyright ownership vests in the employer rather than the artist, the right to attribution is relinquished unless expressly reserved.<sup>197</sup> In a work-for-hire situation, listing authorship credit under the corporate name “accurately reflects the legal state of affairs.”<sup>198</sup> “[A]ll U.S. creators working in an employment relationship will, on account of that employment status, be

most challenged to vindicate, under copyright law, any of the quasi-moral rights” recognized by U.S. courts.<sup>199</sup>

### The Control Conundrum

The *Graham* ruling is significant to both artists and legal practitioners because it establishes that artists employed by nonprofit organizations, even those organizations that they themselves have created, are not exempt from the work-for-hire doctrine. While *Graham* is also one of the few cases to deal with a dance copyright issue, it arguably sets a precedent not only for choreographers, but also for artists creating in other genres while employed by nonprofit organizations. This precedent, however, is not as “dangerous” as it may seem to many artists. Artists do not necessarily give up all rights to their creations by forming nonprofit organizations to finance and facilitate their works, even following the Second Circuit’s ruling that an artist creating under the aegis of a nonprofit organization had ceded authorship status to the nonprofit employer.

### Nonprofit Organizations Promote Artists’ Economic and Artistic Interests

*Graham* made a conscious choice in the nonprofit structure of the Center because of the many benefits it provided.<sup>200</sup> In 1957 *Graham* wrote:

The [Center] has made a legal arrangement with me by means of which they “buy” the school and my name. . . . I am in a position to solicit funds from large foundations because [the Center] is tax exempt. Also the [Center] takes over matters of management. . . . There is not much more money available [sic] but there is so much less worry and fear because it is well taken care of and the future is better arranged for than ever before.<sup>201</sup>

She chose to establish and rely on a nonprofit organization so that she would not have to deal with financial and legal matters, freeing her to focus on creative endeavors,<sup>202</sup> and she recognized that, “[f]or the future there must always be the security of a place to work for people like us.”<sup>203</sup>

“[T]he policy reason for granting copyright protection to choreographic works is to encourage production of choreographic works that will inure to the public benefit.”<sup>204</sup> The purposes of copyright protection can be well served by allowing copyright to vest in a nonprofit organization, especially an artist-driven organization established for the purpose of supporting the development of work by a particular artist and maintaining, protecting, and preserving that work. The physical author’s interests may be furthered by this arrangement

as well, especially when the artist and the nonprofit organization have a shared interest and a symbiotic relationship. Thus, the motivating factors in the choice of the nonprofit structure are often the same as the reasons why the nonprofit may be better equipped to protect and secure the work.

Nonprofits must reinvest any profits into their programs.<sup>205</sup> In the case of an artist-centered organization, the nonprofit's programs are integrally tied to the founding artist's work.<sup>206</sup> Reinvestment generally translates into the financing of further creative works by the founding artist;<sup>207</sup> thus, the artist reaps the benefit of the economic right, and the copyright serves its purpose as an impetus for creativity. In the case of the Center, income from the performance and the licensing of Graham's dances helped to finance rehearsal space, dancer salaries, and other resources utilized by Graham for the creation of subsequent works.<sup>208</sup> The nonprofit structure also provides the artist with other financial resources—such as the ability to solicit contributions and generate tax-free revenue—which provide additional support for the creation of new works.<sup>209</sup>

Nonprofit organizations have perpetual life.<sup>210</sup> They are empowered to outlive their founders and thus can give creative work a life beyond the natural life of a founding artist.<sup>211</sup> Although there is some debate as to whether all artists want their works to live on after their deaths,<sup>212</sup> and though it has been posited that Graham “may have subconsciously wished to take her work with her to the grave,”<sup>213</sup> Graham expressed a clear desire for the Center to continue after her death. “So deeply concerned am I for the future of my work and that the Martha Graham Center goes on,” Graham wrote, “that I have ensured through my attorney that the technique and the ballets will continue to be available and used by the Martha Graham Company and School.”<sup>214</sup> In her will, Graham also named the Center as the sole contingent beneficiary<sup>215</sup> and “requested that, in lieu of a funeral or memorial service, ‘contributions be made to the Martha Graham Center of Contemporary Dance, Inc. to support that which has played such a rich and meaningful part in my life.’”<sup>216</sup>

Not only are artists' interests upheld by this arrangement, but the artist may still retain ultimate artistic control, even if divested of personal economic ownership. Representatives of the dance community have argued that “depriving [the] artist of all rights in the work, including the rights to create derivative works, to perform, publicly display, license and otherwise control the work does great damage to the organization's mission, and to the author personally.”<sup>217</sup> If the artist controls the board of directors, however—either through actual, acknowledged control or through a more subtle sense of deference to the artist's wishes—the artist would likely remain in control of the work,

even if the nonprofit organization were to hold the copyright. Since it was established that Graham controlled the activities of the Center, it stands to reason that she retained ultimate control over its property, which, according to the court, included her dances.<sup>218</sup> Even pure employee status would allow the artist to act as an agent of the organization and make decisions regarding the use of her works; in hiring her as Artistic Director, the board would have vested in Graham the authority to make artistic decisions.<sup>219</sup>

## Artists' Rights as Distinct from Successors' Rights

It is worth noting that the *Graham* case was not a dispute between a nonprofit organization and the artist that had created the works in question, but rather a dispute with that artist's legatee. In a copyright dispute similar to that between Protas and the Center, but between a living artist and a nonprofit organization, many other issues would likely come into play. If board members were denying a founding artist any control over her works, this action might cause concern among funding organizations or could potentially be construed as a breach of the board's duty to uphold the mission of the organization, because a board could not claim to be furthering the development of an artist's work while divesting the artist of any control over that same work. Although the work-for-hire doctrine may require that the nonprofit be acknowledged as the statutory author for copyright purposes, a living artist would likely have other avenues for redress. Where underlying equitable considerations—such as who *deserved* to own the works—weighed against Protas in his dispute with the Center, these same considerations would likely weigh in favor of a living artist in a dispute with a nonprofit organization over either control or ownership of the artist's works.

The Second Circuit's use of the work-for-hire doctrine could potentially be interpreted as nothing more than a constraint on the artist's right to transfer copyright ownership at the time of her death. Admittedly a limitation on ownership, this restriction might be viewed as a fair exchange for the benefits provided by the nonprofit organization. “Ms. Graham obtained crucial public support for her creative enterprise by forming corporations that could take advantage of tax exempt, tax-deductible treatment. . . . It is important that the public also receive the benefit of this bargain, so that her great achievements can be perpetuated by the charities she founded.”<sup>220</sup>

## Artistic Control and the “Moral” Aspects of Economic Rights

Apart from the control that artists may wield via their leadership roles within nonprofit organizations,

they retain intrinsic moral rights as well.<sup>221</sup> To artists, there is definite value in rights of artistic control.<sup>222</sup> Artistic control, as recognized among artists, is essentially the enforcement of the moral facets of the economic rights of copyright. Although traditional moral rights, as such, are not widely recognized in the United States, the essence of these moral rights can be found within U.S. economic rights. Each of the economic rights of copyright may be said to have a moral component that is distinct from the strictly economic element.

Traditional moral rights infuse the basic economic rights. All of the rights secured by copyright carry with them the right of attribution, such that the party in control of these rights may require that appropriate credit be given in any licensed use of a right.<sup>223</sup> The right to prepare derivative works also encompasses the right to control the creation of derivative works by other parties, which equates with a right of integrity.<sup>224</sup> Additionally, it is inherent that the economic rights secured by copyright may also be asserted in the negative, thus guaranteeing that an author has the right to *not* reproduce, *not* prepare derivative works, *not* distribute copies, *not* perform, and *not* display.<sup>225</sup> These negative rights ensure continued artistic control over the work. The right to *not* perform or display, for example, is in essence the right to withhold or withdraw the work from the public, like the European withdrawal right.<sup>226</sup> Due to the founding artist's influence within a nonprofit organization, the deference accorded the artist's wishes, and the artist's unique ability to utilize these rights, the artist herself remains in control of the moral elements of economic rights.<sup>227</sup>

The custom of the American dance community provides choreographers with an effective mechanism for the acknowledgment and enforcement of their moral rights.<sup>228</sup> The right of paternity is upheld through enduring choreographic credit.<sup>229</sup> "The choreographer's name attaches to his work at the first and all subsequent performances of the work, whether or not the choreographer, his company, or another company has legal ownership of the piece."<sup>230</sup> Dance community custom recognizes the artist's rights to preserve the integrity of his work, even after he has relinquished control of the economic rights to that work, as evidenced in a choreographer's ability to withdraw a licensed work due to artistic concerns.<sup>231</sup>

"[T]he primary interest of choreographers in maintaining the artistic integrity of their works conflicts with the Copyright Act's favoring of economic benefits at the expense of artistic concerns."<sup>232</sup> Since copyright law does not acknowledge these rights of control that are of the utmost importance to artists, the repercussions of a determination of copyright ownership are limited and, as a matter of practice or custom, control of such rights does not necessarily vest in the statutory author.

## Contracting for Control

A nonprofit organization is not required to assert its work-for-hire rights against a founding artist; yet, in light of the issues unearthed by the *Graham* case, artists creating work while employed by nonprofit organizations would be well advised to validate their ownership assumptions in writing. "[T]he initial ownership of rights in a work made for hire are only presumed to be in the employer . . . , which presumption may be rebutted by an express agreement in writing between the parties."<sup>233</sup> Since founding artists generally exert control over nonprofit dance companies and other artist-driven organizations, these artists are in a strong bargaining position and should be able to contract for an arrangement that reflects their wishes. In response to the concerns raised by the *Graham* ruling, Dance/NYC, a service organization for the dance community, has drafted several model intellectual property agreements<sup>234</sup> which may suffice for most dance artists' needs. With an eye toward fairness in light of potential private inurement issues, and being mindful not to reap a personal profit at the expense of the nonprofit organization, the artist should be able to own and/or control the rights to her work within the confines of both copyright and nonprofit law.

In contracting for the rights to their works, choreographers should give careful consideration to their ultimate goals. Although an artist may choose to contract for full ownership of all economic and moral rights, she should keep in mind the potential artistic repercussions if her heir or legatee should be uncooperative or if she should die intestate and without an heir.<sup>235</sup> It is conceivable that choreographic rights would be better protected in the hands of a nonprofit organization with a board dedicated to nurturing and preserving the artist's work, than in the hands of the artist's chosen beneficiary, statutory heir, or a disinterested party chosen to dispose of intestate assets.<sup>236</sup> As an alternative to retaining full copyright ownership, an artist might choose to allow the copyright to vest in the nonprofit organization, while contracting for a consultation right or, better yet, some level of control over exploitation of one or more of the exclusive rights of the copyright holder. This would in essence be a contract for the artist to retain moral rights. Retention of these rights should not raise a private inurement issue, since these rights do not hold a legally acknowledged economic value.

## Conclusion

The Second Circuit's ruling is not cause for alarm among artists. Where an artist is the primary creative force behind a nonprofit organization, she will generally retain artistic control, regardless of who holds the copyright, the economic rights of the nonprofit organization will ultimately benefit the artist, and informal



recognition of “moral rights” within the field likely will not change as a result of *Graham*.<sup>237</sup> The *Graham* case should, however, alert artists to the importance of carefully considering their intentions for the future of their works as well as the need to memorialize these intentions in writing.

In the end, most choreographers will never be faced with such a controversy over the rights to their legacy. According to choreographer Eliot Feld, “I wish people were stealing my work left and right, and it became an enormous issue for me. . . . The idea that any of us would share the problem that Martha’s work has engendered is presumptuous beyond belief.”<sup>238</sup> No one can predict the future, however, and the financial climate for dance is constantly evolving.<sup>239</sup> It is important for choreographers to consider the future and make arrangements for the rights to their works as if they might someday be the subjects of such a dispute. As an emerging choreographer in the early twentieth century, even Martha Graham could not have predicted the chaos that would ensue after her death.

*At times I fear walking that tightrope. I fear the venture into the unknown. But that is part of the act of creating and the act of performing. That is what a dancer does.*<sup>240</sup>

## Endnotes

1. Martha Graham, *Blood Memory* 5 (1991). Graham’s dance technique, by contrast, contains a series of falls, because “[w]hen one physically rises from the ground, it empowers the possibility of beginning again.” Jennifer Dunning, *Still Paying Heed to Graham’s Cry*, N.Y. Times, Sept. 16, 2001, § 2 at 18 (quoting Pearl Lang, choreographer and former lead performer in the Martha Graham Dance Company).
2. *Martha Graham Sch. & Dance Found., Inc. v. Martha Graham Ctr. of Contemporary Dance, Inc.*, 380 F.3d 624, 647 (2d Cir. 2004), cert. denied, 125 S. Ct. 2518 (2005) [hereinafter *Graham IV*]; see also *Martha Graham Sch. & Dance Found., Inc. v. Martha Graham Ctr. of Contemporary Dance, Inc.*, 224 F. Supp. 2d 567, 612–13 (S.D.N.Y. 2002), *aff’d in part*, 380 F.3d 624 (2d Cir. 2004) [hereinafter *Graham III*]; Brief of Amici Curiae American Dance Festival, Inc. et al. at 2, 11, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)) (This brief was filed on behalf of the American Dance Festival; Gerald Arpino, co-founder and Artistic Director of the Joffrey Ballet of Chicago, and Gordon Davidson, Artistic Director of the Center Theatre Group/Mark Taper Forum of the Los Angeles County Music Center). The Amici Curiae warned that the district court’s decision would have “far-reaching implications in the art world” and “turn[ed] the rationale of the work-for-hire doctrine on its head.” *Id.* at 2.
3. Jennifer Dunning, *Dance and Profit: Who Gets It?*, N.Y. Times, Sept. 20, 2003, at B9 [hereinafter Dunning, *Dance and Profit*] (quoting Charles Reinhart, Director of the American Dance Festival). “The whole structure of the Martha Graham Dance Company and its legal entities was to support Martha, not the other way around.” *Id.*; see also Jennifer Dunning, *Hearings Start in Suit over Graham Legacy*, N.Y. Times, Mar. 22, 2001, at E8 [hereinafter Dunning, *Hearings Start*] (“[L]eading and innovative choreographers like Graham, George Balanchine, Merce Cunningham and Paul Taylor have long been assumed to own their work rather than to be employees hired by the institutions they worked with and created.”).

4. See *Graham IV*, 380 F.3d at 634, 641–42 (holding that the Center, as Graham’s employer, was the legal “author,” whereas Graham, as the creator of the work, was the “author” in the colloquial sense); see also Dunning, *Dance & Profit*, *supra* note 3 (“It has been hard for some in dance to reconcile the image of Graham as a pioneering artist in American modern dance, an art known for its unruly independence, with the idea of a choreographer as a negotiating employee . . .”); *infra* notes 79–81 and accompanying text. See also *Martha Graham Sch. & Dance Found., Inc. v. Martha Graham Ctr. of Contemporary Dance, Inc.*, 153 F. Supp. 2d 512, 515 (S.D.N.Y. 2001), *aff’d*, 43 Fed. Appx. 408 (2d Cir. 2002) [hereinafter *Graham I*].
5. Ronald Protas met Martha Graham in 1967, when he was twenty-six and she was seventy-three, and they developed a close friendship. See *Graham IV*, 380 F.3d at 629; *Graham I*, 153 F. Supp. 2d at 516.
6. Graham’s last will, executed on January 19, 1989, did not specify what Graham owned at the time of her death but named Protas as executor and residuary legatee. See *Graham IV*, 380 F.3d at 629; *Graham III*, 224 F. Supp. 2d at 576. Graham’s will included the following provisions:

The residue . . . of all my property, real and personal, of every kind and description and wherever situated, including all property over which I may have power of appointment at the time of my death . . . and including all property not otherwise effectively disposed of hereunder . . . I give, devise and bequeath to my said friend, Ron Protas, if he shall survive me, or, if he shall not survive me, to the Martha Graham Center of Contemporary Dance, Inc.

In connection with any rights or interests in any dance works, musical scores, scenery sets, my personal papers and the use of my name, which may pass to my said friend Ron Protas . . . I request, but do not enjoin, that he consult with my friends, Linda Hodes, Diane Gray, Halston, Ted Michaelson, Alex Racolin and Lee Traub, regarding the use of such rights or interests.

*Id.* (emphasis added).

7. *Graham III*, 224 F. Supp. 2d at 570. Although Graham choreographed 180 works during her lifetime, only 70 are “fixed in a tangible medium of expression from which they can be reproduced.” See *id.*
8. See *Graham IV*, 380 F.3d at 628 (quoting Brief for Plaintiff-Counter-Claimant-Appellant Martha Graham School and Dance Foundation at 20, *Graham IV*, 380 F.3d 624 (No. 02-9451(L))).
9. See *id.* at 628, 639–41.
10. See Paul Ben-Itzak, *If Protas Wins, Martha Will Die a Second Death*, *Dance Insider* (May 7, 2002), [http://www.danceinsider.com/f2002/f0507\\_1.html](http://www.danceinsider.com/f2002/f0507_1.html) (“[P]ractically speaking, if the Graham work is assigned to Protas—a non-artist who has never taken a dance class in his life, and who would have difficulty finding a real Graham dancer to stage the work—it could indeed be relegated to the dustbin of history.”).
11. See *supra* note 3 and accompanying text.
12. Alvin Ailey, José Limón, George Balanchine, and Jerome Robbins, for example, did not leave their works to the nonprofit dance companies with which they were affiliated, the Alvin Ailey American Dance Theater, José Limón Dance Company, and New York City Ballet (Balanchine and Robbins), respectively. See *infra* note 77 and accompanying text.
13. An “artist-driven” organization’s programs and activities primarily revolve around the work of a founding artist or artists. See, e.g., Gregory Kandel, *The Art in the Process of Planning*, Nat’l Endowment for the Arts, <http://www.nea.gov/resources/>

- Lessons/kandel1.html (last visited Jan. 13, 2006) (listing a modern dance company that has a single choreographer as an example of an artist-driven organization). The rights of non-founding artists hired by nonprofit organizations are beyond the scope of this article. These artists more clearly resemble traditional employees; they do not wield the same level of control over the organization as do founding artists, and their rights are generally subject to specific contract terms.
14. See *Graham I*, 153 F. Supp. 2d 512, 515 (S.D.N.Y. 2001), *aff'd*, 43 Fed. Appx. 408 (2d Cir. 2002).
  15. See *Graham IV*, 380 F.3d 624, 629 (2d Cir. 2004), *cert. denied*, 1255 S. Ct. 2518 (2005). Early patrons of Graham included Lila Acheson Wallace, Joan Davidson, Katharine Cornell, Baroness Bethsabée de Rothschild, Doris Duke, and Halston. See *Graham*, *supra* note 6, 134, 145–47, 181, 267–69; Anna Kisselgoff, *Rebuilding the Martha Graham Legacy*, N.Y. Times, Jan. 31, 1999, § 2, at 1.
  16. See About Martha Graham, Martha Graham Dance Co. at City Cent., Playbill, Vol. 120, No. 5 (May 2004). Graham's last complete dance, *Maple Leaf Rag*, was premiered in the year before Graham's death. See Program Notes, Martha Graham Dance Co. at City Cent., Playbill, Vol. 120, No. 5 (May 2004).
  17. See *Graham I*, 153 F. Supp. 2d at 515; Martha Graham Center of Contemporary Dance, *Biography of Martha Graham*, at [http://www.marthagrahamdance.org/resources/about\\_martha\\_graham.php](http://www.marthagrahamdance.org/resources/about_martha_graham.php) (last visited Jan. 13, 2006). "I did not teach the technique classes that I learned at the Denishawn school [of Ruth St. Denis and Ted Shawn] for the simple reason that I could not afford the five-hundred-dollar fee they demanded from anyone who taught their method." *Graham*, *supra* note 120. Graham's students included many who would become major modern dance choreographers in their own right—Merce Cunningham, Paul Taylor, and Twyla Tharp, to name a few—as well as luminaries such as Bette Davis, Gregory Peck, Liza Minelli, Woody Allen, Joanne Woodward, Tony Randall, Madonna, Betty Ford, Mikhail Baryshnikov, and Rudolf Nureyev. See *id.*; *Biography of Martha Graham*, *supra*; Martha Graham Center of Contemporary Dance, *Martha Graham Center*, at <http://www.marthagrahamdance.org/center> (last visited Jan. 13, 2006).
  18. See *Graham I*, 153 F. Supp. 2d at 515. The Foundation was incorporated under New York state law. See *id.*
  19. *Id.* at 525. "The Center was established for . . . the dual purposes of enabling the creation and performance of choreography by Graham and perpetuating and preserving Graham's work after her death." Brief for Defendants-Counter-Claimants-Appellees at 10, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)) (emphasis added) (citations omitted).
  20. *Graham I*, 153 F. Supp. 2d at 526.  

The purposes of the School, as stated in its certificate of incorporation were to, *inter alia*, "teach the science and art of the dance," and "in conjunction with the conduct of such school . . . to compose, perform and demonstrate, and to commission the composition, performance and demonstration of dances, ballets, dramas and music."

*Graham III*, 224 F. Supp. 2d 567, 572 (S.D.N.Y. 2002), *aff'd in part*, 380 F.3d 624 (2d Cir. 2004) (quoting the School's Certificate of Incorporation). Graham's accountant had advised her "to form this new not-for-profit entity because . . . contributions to the School would be tax-deductible." *Graham I*, 153 F. Supp. 2d at 526.
  21. See *Graham IV*, 380 F.3d at 637.
  22. See *id.* at 629.
  23. *Id.*
  24. See *id.* at 629 n.2; *Graham III*, 224 F. Supp. 2d at 572. Today, the Center provides the Martha Graham Dance Company, the Martha Graham School of Contemporary Dance, and Martha Graham Resources. See *Martha Graham Center*, *supra* note 17.
  25. See *Graham IV*, 380 F.3d at 629 n.2. By 1980, the two corporations filed combined statements and had identical boards of trustees. See *id.*; *Graham III*, 224 F. Supp. 2d at 572.
  26. See *Graham I*, 153 F. Supp. 2d 512, 516 (S.D.N.Y. 2001), *aff'd*, 43 Fed. Appx. 408 (2d Cir. 2002).
  27. *Graham III*, 224 F. Supp. 2d at 573 (emphasis added). Judge Cedarbaum concluded that Center board members "Francis Mason, Judith Schlosser, and Lee Traub . . . testified credibly that Graham's responsibilities during her employment included the creation of dances." *Id.*
  28. The Martha Graham copyright case was the second phase of Protas's suit. See generally *Graham III*, 224 F. Supp. 2d 567. The first phase of the suit dealt with trademark claims: Protas attempted to enjoin the Center and School from using the names under which they had been incorporated and from claiming to teach the "Martha Graham technique." See *Graham I*, 153 F. Supp. at 514. Protas was unsuccessful on all counts. See *Martha Graham Sch. & Dance Found., Inc. v. Martha Graham Ctr. of Contemporary Dance, Inc.*, 43 Fed. Appx. 408, 410 (2d Cir. 2002) [hereinafter *Graham II*]; *Graham I*, 153 F. Supp. 2d at 526–27.
  29. See *Graham IV*, 380 F.3d at 630–31.
  30. See *id.* at 631. The Center also counterclaimed for breach of fiduciary duty, fraud, and negligent misrepresentation by Protas and for replevin of items possessed and money improperly borrowed by Protas. See *Graham III*, 224 F. Supp. 2d at 570. The Center sought "a constructive trust to recover the proceeds of [Protas's] licensing of the ballets, sets, and costumes to third parties and of his sale of defendants' property to the Library of Congress [and] disgorgement of ten years of Protas' salary and of payments made to Protas by defendants under [the] 1999 license agreement." *Id.*
  31. See *Graham IV*, 380 F.3d at 631 (stating that the Center's position was supported by Attorney General Spitzer); Paul Ben-Itzak, *Who Owns Martha Graham? Protas Gets His Close Up, and Dancers Get Their Day in Court*, Dance Insider (Mar. 24, 2001) ("[T]he citizens of New York have an interest and investment in the outcome of the case."), at <http://www.danceinsider.com/f2001/f324.html>. Attorney General Spitzer's office had previously tried to mediate the dispute. See Doreen Carvajal, *A State Grant Could Help Save Graham Studio*, N.Y. Times, Oct. 30, 2000, at E1.
  32. *Graham III*, 224 F. Supp. 2d at 570–71.
  33. "The copyright claims in this case have to be assessed through the prism of the changes in the copyright law that took effect in 1978, 1989, and 1992. The chronology of creation, publication, and copyright registration and renewal of the choreography of each dance is critical to a determination of copyright ownership." *Graham III*, 224 F. Supp. 2d at 582–83 (citations omitted). For a complete overview of the issues presented by this case, see David Goldberg & Robert J. Bernstein, *Shall We Dance?: Choreographic Works and 'Martha Graham,'* 228 N.Y.L.J. 3 (2002).
  34. See *Graham IV*, 380 F.3d at 629.
  35. *Graham III*, 224 F. Supp. 2d at 572. Although the trial was not officially about who deserved to own the works, the plaintiff's "erratic, ingratiating, spiteful, dissembling, un-mindful, vindictive, simpering and quite possibly demented personality [was] also on trial." Paul Ben-Itzak, *If Protas is Defeated, Would Dancers Win the Battle but Lose the War?*, Dance Insider (Apr. 26, 2002), at [http://www.danceinsider.com/f2002/f0426\\_1.html](http://www.danceinsider.com/f2002/f0426_1.html).
  36. See *Graham III*, 224 F. Supp. 2d at 612. The district court's ruling as to each dance is detailed in the Appendix to the Second Circuit's decision. *Graham IV*, 380 F.3d at 647–48.
  37. See *Graham III*, 224 F. Supp. 2d at 592.
  38. See *id.* at 594.

39. See *id.* at 597.
40. *Id.* at 596–97. “[T]he transfer of the ‘common law copyright’ in unpublished works did not have to be in writing but could be oral or inferred from conduct.” *Id.* at 596 (quoting *Jerry Vogel Music Co. v. Warner Bros., Inc.*, 535 F. Supp. 172, 174 (S.D.N.Y. 1982)).
41. See *id.* at 598–600.
42. See *Graham IV*, 380 F.3d at 624, 631 (2d Cir. 2004), *cert. denied*, 125 S. Ct. 2518 (2005); *Graham III*, 224 F. Supp. 2d at 612. Present ownership of two of the twenty-one assigned works was not determined because they were subsequently published and neither party was able to establish whether or not they had been published with adequate notice of copyright. See *Graham III*, 224 F. Supp. 2d at 613.
43. See *Graham III*, 224 F. Supp. 2d at 602, 613.
44. See *Graham III*, *id.* at 612–13. Both parties requested that the Second Circuit clarify whether the fourteen works for which ownership remained unproven (the five commissioned works and the nine lacking evidence of adequate statutory notice) were in the public domain or whether there remained a possibility of proving ownership. See Brief for Plaintiff-Counter-Claimant-Appellant Martha Graham School & Dance Found. at 64–66, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)); Brief for Defendants-Counter-Claimants-Appellees at 67, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)). The Second Circuit, however, simply affirmed the district court’s ruling that neither party had established ownership of these dances. See *Graham IV*, 380 F.3d at 637 n.25, 647–48.
45. *Graham IV*, 380 F.3d at 624 (argued before Circuit Judges Newman, Kears, and Pooler and decided on August 18, 2004).
46. See *id.* at 628, 637–39, 647. The Second Circuit also disagreed with the district court’s determination that two works were unpublished. See *id.* at 637, 642, 640.
47. See *id.* at 647. The ownership of the two dances that were incorrectly held to be unpublished was also to be reconsidered on remand. See *id.* The district court was also instructed to recalculate the amount of Protas’ proceeds from the licensing of the works determined to belong to the Center that the Center was entitled to recover, in light of the district court’s findings on remand in determining ownership of the nine dances at issue. See *id.* at 646–47; see also *supra* note 30.
48. See *Martha Graham Sch. & Dance Found., Inc. v. Martha Graham Ctr. of Contemporary Dance, Inc.*, 374 F. Supp. 2d 355, 356–58 (S.D.N.Y. 2005) [hereinafter *Graham V*]. The district court also held that one of the previously determined unpublished works had been published without the adequate copyright notice and is in the public domain. See *id.* at 356–57. The other work in question was found to be an excerpt of a larger work rather than a distinct dance, and the Center’s copyright in the excerpt was preserved by a notice appearing on a televised broadcast. See *id.* at 357. Concerning the licensing fees awarded to the Center, since no fees had been awarded to the Center for the licensing of any of the nine works being considered on remand, no recalculation of the constructive trust was necessary and Protas was ordered to pay the Center \$282,462.44. See *id.* at 356.
49. See *id.* at 358; see also *supra* notes 39–41 and accompanying text.
50. Petition of Writ of Certiorari, 2005 WL 682101, at \*1, *Martha Graham Sch. & Dance Found., Inc. v. Spitzer*, 125 S. Ct. 2518 (2004) (No. 04-1277). The second question presented for review was: “[w]hether the conflict between the . . . Second and Ninth Circuits with respect to scope of the work-for-hire doctrine as applied to copyrights of creative works should be resolved in favor of Ninth Circuit’s interpretation.” *Id.*
51. *Martha Graham Sch. & Dance Found., Inc. v. Spitzer*, 125 S. Ct. 2518 (2005).
52. Barbara A. Singer, *In Search of Adequate Protection for Choreographic Works: Legislative and Judicial Alternatives vs. the Custom of the Dance Community*, 38 U. Miami L. Rev. 287, 319 (1984).
53. See *id.* at 291, 319.
54. *Id.* at 296 n.36.
55. See Anne K. Weinhardt, *Copyright Infringement of Choreography: The Legal Aspects of Fixation*, 13 J. Corp. L. 839, 842 (1988). As of 1984, “not one case involving a statutory copyright of choreography [had] yet reached an American court of law” and “apparently no recorded cases of actions for breach of a choreographic licensing agreement.” Singer, *supra* note 52, at 290 n.12, 295 n.34. This remains true even though many choreographic works have been filmed, or notated and registered with the Copyright Office in the past decades. See Weinhardt, *supra*, at 843.
56. *Martinetti v. Maguire*, 16 F. Cas. 920, 921 (C.C. Cal. 1867). Although not specifically a choreography case, *Martinetti* considered and ultimately denied copyright protection for a play which “cannot not be read” and “has no value except as it is appreciated by the theatre-going public.” *Id.*
57. *Fuller v. Bemis*, 50 F. 926, 929 (C.C.S.D.N.Y. 1892) (denying copyright protection to a choreographic work by modern dance pioneer Loie Fuller).
58. U.S. Const. art I, § 8, cl. 8 (“The Congress shall have Power . . . [t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors . . . the exclusive Right to their respective Writings. . .”).
59. See Singer, *supra* note 52, at 299 & n.52 (citing *Martinetti*, 16 F. Cas. at 922 (finding that an “‘exhibition of women ‘lying about loose’ or otherwise’ was indecent, corrupt, and in no way promoted the useful arts”)); *Fuller*, 50 F. at 92 (“The Fuller court was likewise wary of the seductive effect created by modern dance pioneer Loie Fuller as she swirled her skirts in her ‘Serpentine Dance.’”)) “As late as 1963 a court rejected protection of a choreographic work on [morality] grounds.” *Id.* at 299 n.52 (quoting *Dane v. M & H Co.*, 136 U.S.P.Q. 426, 429 (N.Y. Sup. Ct. 1963) (finding that a striptease dance number did not “tend to promote the progress of science of the useful arts” where the performance contained “nothing of a literary, dramatic or musical character which [was] calculated to elevate, cultivate, inform, or improve the moral or intellectual natures of the audience”). But see *Bleistein v. Donaldson Lithographing Co.*, 188 U.S. 239 (1903) (not endorsing this puritanical view).

It would be a dangerous undertaking for persons trained only to the law to constitute themselves final judges of the worth of [artistic creations], outside of the narrowest and most obvious limits . . . [S]ome works of genius would be sure to miss appreciation . . . It may be more than doubted, for instance, whether the etchings of Goya or the paintings of Manet would have been sure of protection when seen for the first time.

*Id.* at 251–52.

60. 621 F. Supp. 1169 (S.D.N.Y. 1985), *rev'd*, 789 F.2d 157 (2d Cir. 1986).
61. In 1933, George Balanchine, along with Lincoln Kirstein, co-founded the school that would serve as the incubator of the New York City Ballet. *About NYCB*, <http://www.nycballet.com/about/aboutnycb.html> (last visited Jan. 13, 2006). Balanchine served as ballet master and chief choreographer of the company from its inception in 1948 until his death in 1983. See *Horgan*, 789 F.2d at 158.
62. Pub. L. No. 94-553, 90 Stat. 2451 (codified as amended in scattered sections of 17 U.S.C.); see also Leslie Erin Wallis, *The Different Art: Choreography and Copyright*, 33 U.C.L.A. L. Rev. 1442, 1445 n.23 (1986).



63. See Copyright Act of 1976, 17 U.S.C. § 102 (2000). Section 102(a) provides that:
- Copyright protection subsists, in accordance with this title, in original works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. Works of authorship include . . . (4) pantomimes and choreographic works. . . .
- Id.* (emphasis added).
64. See Singer, *supra* note 52, at 296. “[T]he ‘economic remuneration of choreographers’ ha[s] not kept pace ‘with their creative achievements.’” *Horgan*, 789 F.2d at 161 (citing Melanie Cook, Comment, *Moving to a New Beat: Copyright Protection for Choreographic Works*, 24 U.C.L.A. L. Rev. 1287, 1287 (1977)).
65. See Singer, *supra* note 52, at 305. Under § 504 of the 1976 Act, a copyright owner is entitled to recover either (i) actual damages and the infringer’s profits or (ii) statutory damages that generally range from \$750 to \$30,000. See 17 U.S.C. §§ 504(b), 504(c)(1) (2000). Statutory damages may be as high as \$150,000 if the infringement is determined to have been willful. See *id.* § 504(c)(2).
66. Leslie Bennetts, *Pirating of “The Pirates of Penzance,”* N.Y. Times, Aug. 18, 1982, at C15 (quoting Wilford Leach, director of the New York Shakespeare Festival production of “The Pirates of Penzance”).
67. Section 106 of the Copyright Act includes, among the exclusive rights protected by copyright, the rights to reproduce the work in copies and phonorecords, to prepare derivative works, to distribute copies to the public, and to perform and display the work publicly. 17 U.S.C. § 106 (2000).
68. Cf. Diane M. Zorich, *Managing Digital Assets: Options for Cultural and Educational Organizations* 88–89 (1999) (assessing the economic value of creative works requires consideration of the intended context and users of the work, the associative value, the rights conveyed to others, current events and timely associations, transformative use, and increased visibility).
69. Cf. *id.* The José Limón Dance Foundation, for example, does not place a financial value on its ownership of José Limón’s works, even though the company generates considerable revenue through licensing fees and the restaging of these works. Interview with Ann Vachon, Institute Director, Limón Institute, in New York, NY [hereinafter Vachon Interview] (Apr. 1, 2004) (on file with author). “The idea of owning a dance as property is relatively new.” Jennifer Dunning, *Warning: Ephemeral but Private Property; Notions of Ownership Tie Up Dance Legacies*, N.Y. Times, July 26, 2000, at E1.
70. Notated dance scores function for dance the same way music scores function for music; dance notation captures in writing the direction, level and timing of movement, as well as the part of the body producing the movement. See Dance Notation Bureau, *Notation Basics*, at <http://www.scottssutherland.com/DNB> (last visited Jan. 13, 2006); Dance Notation Bureau, *About DNB*, at <http://www.scottssutherland.com/DNB> (last visited Jan. 13, 2006) [hereinafter Dance Notation Bureau, *About DNB*].
71. See Joseph Carman, *Who Owns a Dance? It Depends on the Maker*, N.Y. Times, Dec. 23, 2001, at § 2, p. 28 (noting that “[a] distinct difference between the preservation of dance and other artistic media is that choreography often depends on an oral tradition to uphold its integrity through style, motivation and content.”).
72. See Julie Charlotte Van Camp, *Philosophical Problems of Dance Criticism* 169 (Dec. 1981) (unpublished Ph.D. dissertation, Temple University), <http://www.csulb.edu/~jvancamp/diss.html> (last visited Jan. 13, 2006) (“[M]any companies are finding themselves unable to perform certain works, because a rehearsal master who knows the ballet is unavailable to teach it to the company.”).
73. Common costs for reconstruction and resetting include studio space, dancer fees, and licensing fees; performance and/or documentation may incur additional costs, such as theater rental and videographer fees. See generally Dance Notation Bureau, *Staging from the Score*, at <http://www.scottssutherland.com/DNB> (last visited Jan. 13, 2006).
74. “[T]he longer ballets are out of circulation, the more difficult it is to recreate them.” Carman, *supra* note 71.
- Granted, these resources may also exist outside of an artist-driven nonprofit institution. Organizations such as the nonprofit Dance Notation Bureau provide access to dance works of the past and serve as clearinghouses for the rights and documentation necessary to utilize choreographic works. See Dance Notation Bureau, *About DNB*, *supra* note 70. The Dance Notation Bureau produces and houses notated dance scores by more than 160 artists, including George Balanchine, Paul Taylor, Antony Tudor, Bill T. Jones, Doris Humphrey, William Forsythe, José Limón, and Laura Dean. *Id.* “Each year DNB assists in staging some 40 works from scores.” *Id.*
- The Balanchine Trust, a repository for the works of George Balanchine which was created by his legatees, retains ballet masters to set Balanchine works on more than 150 companies around the world. See Carman, *supra* note 71.
- Charles Woodford, son and heir of Doris Humphrey, who was not affiliated with a dance company at the time of her death, has secured the future of her dances without having a nonprofit organization at his disposal by utilizing the services of the Dance Notation Bureau and actively pursuing notation, licensing, and the reconstruction of Humphrey’s works on other dance companies. Telephone Interview with Charles Woodford (Apr. 15, 2004) (on file with author); see also Dunning, *supra* note 69. To preserve works under such circumstances requires extreme dedication and commitment on the part of the heir.
75. Deborah Jowitt, *Dance—Honoring the Founding Vision, and Moving On; When a Company’s Creator is Gone*, N.Y. Times, Nov. 22, 1998, § 2, at 1. “Artists of [Limón’s] generation didn’t concern themselves with business . . . ‘He really, really believed . . . that if he was good enough, somebody was going to come up and give him money.’ . . . He named no successor to lead [the company]. His will didn’t even mention his dances.” *Id.* (quoting Carla Maxwell, Artistic Director of Limón’s company since 1978).
76. See *supra* note 3 and accompanying text. “As George Balanchine explained, ‘I can do with my ballets whatever I like. They are mine . . . I made them . . .’” Singer, *supra* note 52, at 310 n.106 (citations omitted). “[A]n artist in the process of creation injects his spirit into the work and . . . the artist’s personality . . . should therefore be . . . preserved.” *Carter v. Helmsley-Spear, Inc.*, 71 F.3d 77, 81 (2d Cir. 1995) (citations omitted).
77. See *Horgan v. Macmillan, Inc.*, 789 F.2d 157, 158 (2d Cir. 1986); Jowitt, *supra* note 75; Alvin Ailey American Dance Theater, *History*, 1989, at <http://alvinailey.org/history.asp?dateid=29> (last visited Jan. 13, 2006).
- “Balanchine’s . . . will . . . left selected ballets to treasured dancers associated with them. He also willed a bit of chaos to his legatees.” Jowitt, *supra* note 75. He divided his body of work among several people, even splitting the American, foreign, and media rights of single ballets among different people. See *id.* “Fortunately all of us cared for Mr. Balanchine, and all of us care for each other.” *Id.* (quoting Barbara Horgan, Balanchine’s executor). The legatees created the George Balanchine Trust, which has streamlined the process of licensing Balanchine’s works. See Carman, *supra* note 71. After Jerome Robbins’ death, “he left his ballets in the hands of a trust that specified that a committee composed of trustees, ballet masters, and his close

friends should oversee the licensing of his ballets.” *Id.* “Generally meeting once a month, the Trust reviews requests for staging Robbins’ works.” *Id.* The board of the Alvin Ailey American Dance Theater “bought the rights to Ailey’s dances from his mother, to whom [Ailey] had left” his work. *See* Dunning, *supra* note 69. “The board felt the dances had to be owned by a non-profit institution and not a single person who could sell [Ailey’s masterwork] *Revelations* to the Rockettes.” *Id.* (quoting Sharon Luckman, executive director of the Ailey company). José Limón’s heirs sold the rights to Limón’s work to the José Limón Dance Foundation, the parent organization of the Limón Dance Company. Vachon Interview, *supra* note 69; *see also* Dunning, *supra* note 69.

Of course, the specific facts of the relationship between the choreographer and the dance company in each of the above situations may distinguish these choreographers’ rights from those of Graham. In the case of Balanchine, for example, the New York City Ballet paid Balanchine a royalty each time the company performed his works. *See Horgan*, 789 F.2d at 158. In *Graham*, the district court found that no credible evidence was offered to prove that Graham received royalties from the Center for use of her dances. *See Graham IV*, 380 F.3d 624, 641 (2d Cir. 2004), *cert. denied*, 125 S. Ct. 2518 (2005).

78. *See* Joseph Carman, *Graham Center Victory*, *Dance Mag.*, Nov. 1, 2002, at 20.
79. *See* Copyright Act of 1976, 17 U.S.C. § 201(b) (2000) (“In the case of a work made for hire, the employer or other person for whom the work was prepared is considered the author for purposes of this title . . . .); Copyright Act of 1909, 17 U.S.C. § 26 (1909) (“[In] the interpretation and construction of this title . . . the word ‘author’ shall include an employer in the case of works made for hire.”).
80. *Graham IV*, 380 F.3d at 634 (quoting *Shapiro, Bernstein & Co. v. Bryan*, 123 F.2d 697, 699 (2d Cir. 1941)).
81. *Burrow-Giles Lithographic Co. v. Sarony*, 111 U.S. 53, 58 (1884); *see also Goldstein v. California*, 412 U.S. 546, 561 (1973) (holding that the term “author” is not to be construed in its “narrow literal sense, but, rather, with the reach necessary to reflect the broad scope of constitutional principles”). As the Center financially enabled the creation of Graham’s works, the works at least partially “owed their origin” to the Center. *Compare Burrow-Giles*, 111 U.S. at 58, with *Nottage v. Jackson*, 11 Q.B. 627 (1883) (quoted by the U.S. Supreme Court in *Burrow-Giles*, 111 U.S. at 60–61) (stating that an author “is the person who effectively is as near as he can be, the cause of the picture which is produced . . . the person who has superintended the arrangement, who has actually formed the picture by putting persons in position and arranging the place where the people are to be.”).
82. *See Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 751–52 (1989) (establishing that, for works created under the 1976 Act, the extent of the employer’s control is a factor to be considered in determining whether a party is an employee under the common law of agency); *Playboy Enters., Inc. v. Dumas*, 53 F.3d 549, 554 (2d Cir. 1995) (quoting *Picture Music, Inc. v. Bourne, Inc.*, 457 F.2d 1213, 1216 (2d Cir. 1972)) (holding that in applying the “instance and expense” test to works created under the 1909 Act, “an essential element of the employer-employee relationship, [is] the right of the employer to direct and supervise the manner in which the writer performs his work”).
83. *Pub. Affairs Assocs. v. Rickover*, 177 F. Supp. 601, 604 (D.D.C. 1959), *rev’d on other grounds*, 284 F.2d 262 (D.C. Cir. 1960), *vacated for insufficient record*, 369 U.S. 111 (1962).
84. *See Graham IV*, 380 F.3d at 633–42.
85. *See id.* at 635 (citing *Scherr v. Universal Match Corp.*, 417 F.2d 497, 500–01 (2d Cir. 1969)), 642 (citing *Carter v. Helmsley-Spear, Inc.*, 71 F.3d 77, 85–88 (2d Cir. 1995)).
86. 369 F.2d 565 (2d Cir. 1966).

87. *See id.* at 567–68 (2d Cir. 1966); *see also Graham III*, 224 F. Supp. 2d 567, 588 (S.D.N.Y. 2002), *aff’d in part*, 380 F.3d 624 (2d Cir. 2004) (citing *Brattleboro*, 369 F.2d at 568). The Second Circuit traced the use of the phrase “instance and expense” in copyright jurisprudence back to the 1887 case of *Hanson v. Jaccard Jewelry Co.*, 32 F. 202, 202 (C.C.E.D. Mo. 1887). *See Graham IV*, 380 F.3d at 635 n.17. “[T]he phrase was first used in an operative sense in a provision of a [1905] draft bill prepared by . . . Thorvald Solberg, then the Register of Copyrights,” that would have offered protection for a “composite or collective work . . . produced at the instance and expense of a publisher.” *Id.* (citation omitted). The next use of the phrase was found in the 1964 edition of *Nimmer on Copyright*. *See id.* The phrase first appeared in a reported opinion in 1965: *Lin-Brook Builders Hardware v. Gertler*, 352 F.2d 298, 300 (9th Cir. 1965). *See id.*
88. *See Graham IV*, 380 F.3d at 635 (citing *Brattleboro*, 369 F.2d at 568).
89. *See Playboy Enters., Inc. v. Dumas*, 53 F.3d 549, 554 (2d Cir. 1995) (citing *Siegel v. Nat’l Periodical Publ’ns, Inc.*, 508 F.2d 909, 914 (2d Cir. 1974); *Picture Music, Inc. v. Bourne, Inc.*, 457 F.2d 1213, 1216 (2d Cir. 1972)).
90. *Graham IV*, 380 F.3d at 635 (citing *Scherr*, 417 F.2d at 500–01).
91. *See Graham III*, 224 F. Supp. 2d at 589–90 (“The creation of the dances was a collaborative process in which the Center’s employees played an indispensable role.”).
92. *See id.* at 589.
93. *Id.* at 590.
94. *Id.*
95. *Id.*
96. *See id.* at 640. *But see Self-Realization Fellowship Church v. Ananda Church of Self-Realization*, 206 F.3d 1322, 1326 (9th Cir. 2000) (finding that writings by a monk who founded his own religious order were “motivated by [his] own desire for self-expression or religious instruction of the public” and therefore did not qualify as works for hire under the 1909 Act). The Second Circuit distinguished the employee in *Self-Realization Fellowship Church* from Graham in that Swami Paramahansa Yogananda had much less of a connection to his putative employer church than would an employee in a traditional employment relationship. *Graham IV*, 380 F.3d 624, 640 (2d Cir. 2004), *cert. denied*, 125 S. Ct. 2518 (2005). Additionally, while Graham’s choreography was clearly part of the regular business of the Center, *see infra* note 126 and accompanying text, the Swami’s writings were not necessarily part of the regular business of the Self-Realization Fellowship Church. *Cf. Aims & Ideals of Self-Realization Fellowship* (listing the aims and ideals of the Church as set forth by founder Paramahansa Yogananda), at [http://www.yogananda.com/aboutsrf/aims\\_ideals.html](http://www.yogananda.com/aboutsrf/aims_ideals.html) (last updated Sept. 12, 2000). Although the Ninth Circuit’s opinion did not define the regular business of the Church, whether the “employee created the work as part of the regular course of business of the employer” was mentioned as a consideration in establishing a work-for-hire relationship. *See Self-Realization Fellowship Church*, 206 F.3d at 1326–27 (citation omitted).
97. *Graham IV*, 380 F.3d at 640–41.
98. *See id.* at 640.
99. *See id.* at 637. The Second Circuit vacated the district court’s ruling with respect to seven unpublished works created during this timeframe. *Id.* The question of the ownership of these dances was remanded to the district court to determine if Graham had assigned any of these dances to the Center or whether the works had passed to Protas as part of Graham’s estate. *Id.* at 638–39; *see also* discussion *supra* notes 47–49. As to the remaining three works created from 1956 through 1965, which the Second Circuit determined not to be works for hire, the Second Circuit affirmed the district court’s holding that two of these works belonged to neither the Center nor Protas because it had not

been sufficiently proven that the works had been published with the required statutory notice of copyright. *See Graham IV*, 380 F.3d at 638. The Second Circuit reversed the district court's holding with respect to the third work, determined to have been published with copyright notice, because even if Graham has assigned the renewal term for that work to the Center, her death prior to the beginning of the renewal term would have voided such assignment; therefore, this work had passed to Protas as Graham's beneficiary. *See id.* at 645.

100. *See id.* at 637–38.

101. *See id.*

102. *Id.* at 638.

103. *See id.* at 639.

104. *See id.* at 640.

105. *See id.* at 639.

106. *See* Copyright Act of 1976, 17 U.S.C. § 201(b) (2000). This section provides:

In the case of a work made for hire, the employer or other person for whom the work was prepared is considered the author for purposes of this title, and unless the parties have expressly agreed otherwise in a written instrument signed by them, owns all of the rights comprised in the copyright.

*Id.* (emphasis added).

107. *Id.* § 101; Copyright Act of 1976, Pub. L. 94-553, § 102, 90 Stat. 2541, 2598 (1976).

108. *See Carter v. Helmsley-Spear, Inc.*, 71 F.3d 77, 85 (2d Cir. 1995).

109. *Cnty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 739 (1989).

110. *See Avotec Sys., Inc. v. Peiffer*, 21 F.3d 568, 571 (4th Cir. 1994) (citing Restatement (Second) of Agency § 228 (1958)).

111. 490 U.S. 730 (1989).

112. *See id.* at 751–52 (citing Restatement (Second) of Agency § 220(2) (1958)).

113. *Graham III*, 224 F. Supp. 2d 567, 591 (S.D.N.Y. 2002), *aff'd in part*, 380 F.3d 624 (2d Cir. 2004) (citing *Reid*, 490 U.S. at 742–43).

114. 980 F.2d 857 (2d Cir. 1992).

115. *Id.* at 861.

116. *See Graham III*, 224 F. Supp. 2d at 587, 590–92.

117. *See id.* at 591.

118. *Id.* at 592 (“Graham reported regularly to the board on her new works, and the board set the financial bounds within which she could work.”). The Second Circuit has held that a sculpture created by artists who “had complete artistic freedom with respect to every aspect of the sculpture’s creation,” was a work made for hire. *See Carter v. Helmsley-Spear, Inc.*, 71 F.3d 77, 86–87 (2d Cir. 1995).

119. *Graham III*, 224 F. Supp. 2d at 592.

120. *See id.* at 573. Graham’s salary was described as “‘several hundred a week’ when there was money.” Dunning, *Hearings Start*, *supra* note 3 (quoting Cynthia Parker Kaback, general manager of the Center from the mid-1970s to the early 1980s).

121. *See Graham III*, 224 F. Supp. 2d at 592; *see also supra* text accompanying note 112.

122. *Id.* (citing *Cnty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 751 (1989)).

123. *See id.*

124. *See id.*

125. *Id.*

126. *Id.*

127. *Id.* Interestingly enough, in considering when a work that was “specially ordered or commissioned” (as opposed to created by an employee within the scope of his employment) is entitled to work-for-hire status under 17 U.S.C. § 101(2), the Register of Copyrights has stated that visual artists and photographers were “among the most vulnerable and poorly protected of all the beneficiaries of the copyright law, and it seems clear that, like serious composers and choreographers, [these artists] were not intended to be treated as ‘employees’ under the carefully negotiated definition in section 101.” *Reid*, 490 U.S. at 747 n.13 (emphasis added) (quoting U.S. Copyright Office, Second Supplementary Rep. of the Reg. of Copyrights on the Gen. Revision of U.S. Copyright Law ch. XI, at 12–13 (1975)).

128. *See Graham IV*, 380 F.3d 624, 641 (2d Cir. 2004), *cert. denied*, 125 S. Ct. 2518 (2005).

129. *Id.* at 642 (citing *Carter v. Helmsley Spear, Inc.*, 71 F.3d 77, 85–88 (2d Cir. 1995)) (emphasis added).

130. *See id.* “The Restatement offers the example of a ‘full-time cook’ over whose culinary activity ‘it is understood that the employer will exercise no control.’” *Id.* (citing Restatement (Second) of Agency § 220(1) cmt. d (1958)).

131. Brief of Amici Curiae American Dance Festival, Inc. et al. at 3, *Graham IV*, 380 F.3d 624 (2d Cir. 2004) (No. 02-9451(L)).

132. The Center was incorporated under New York Membership Corporation Law, “the statutory predecessor of the current Not-For-Profit Corporation Law.” *Graham I*, 153 F. Supp. 2d 512, 515 (S.D.N.Y. 2001), *aff’d*, 43 Fed. Appx. 408 (2d Cir. 2002); *see also* N.Y. Not-for-Profit Corp. Law § 201(b) (McKinney 1997 & Supp. 2005) (“A not-for-profit corporation . . . may be formed for any one or more of the following non-business purposes: charitable, educational, religious, scientific, literary, *cultural*. . . .”) (emphasis added).

133. *See* 26 U.S.C. § 501(c)(3) (2000) (requiring that an organization be “organized and operated exclusively for [exempt purposes] . . .” to qualify for the tax exemption provided for in the same section); *see also* Treas. Reg. § 1.501(c)(3)-1(d) (1990). In addition to tax exemption, arts organizations generally qualify to receive tax-deductible donations under section 170 of the Code. *See* 26 U.S.C. § 170(c)(2)(B) (2000). The tax deduction for charitable contributions was adopted in 1917 in response to the fear that higher tax rates would cause philanthropy to decline. *See* James J. Fishman & Stephen Schwartz, *Nonprofit Organizations: Cases and Materials* 308 (1st ed. 1995).

134. *See* Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (stating that an exempt organization must serve “a public, rather than a private, interest”); *see also generally Summers v. Cherokee Children & Family Servs., Inc.*, 112 S.W.3d 486 (Tenn. Ct. App. 2002) (holding that two nonprofit public benefit corporations formed to perform child care services of their executive director had abandoned any public or charitable purposes).

135. *See* Rev. Rul. 64-175, 1964-1 C.B. 185. A nonprofit corporation organized “to stimulate, promote, and develop the interest of the American public in the dramatic arts and which operates a permanent repertory theatre” was found to be educational, much in “the same manner as a symphony orchestra is considered educational.” *Id.* Symphony orchestras are one of the examples of educational organization listed in the regulations. *See* Treas. Reg. § 1.501(c)(3)-1(d)(3)(ii); *see also* Rev. Rul. 73-45, 1973-1 C.B. 220 (holding that “a nonprofit organization created to foster the development . . . of an appreciation for drama and musical arts by sponsoring professional presentations qualifies for exemption under section 501(c)(3) of the Code”); Rev. Rul. 64-174, 1964-1 C.B. 183 (holding that a foundation established to create interest in American theatre was an exempt organization under section 501(c)(3)).

136. Brief of Amici Curiae American Dance Festival, Inc., et al. at 3, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)).



137. See John Kreidler, *Leverage Lost: The Nonprofit Arts in the Post-Ford Era*, In Motion Mag., Feb. 16, 1996, at pt. 2, <http://www.inmotionmagazine.com/lost.html>. These changes included the establishment of arts grants by the Ford Foundation, Carnegie Foundation, The Rockefeller Foundation, and The Andrew W. Mellon Foundation, as well as the formation of the National Endowment for the Arts ("NEA") in 1965 (which led to the formation of state arts agencies in all states by 1980, followed by the formation of more than 3,000 local arts agencies). See *id.* Most NEA grants to arts organizations also required matching support and served to stimulate a broad base of funding from individual and institutional sources. See *id.*
138. N.Y. Found. for the Arts, *Frequently Asked Questions*, at <http://www.nyfa.org/level3.asp?id=64&fid=1&sid=44> (last visited Jan. 13, 2006) ("Individual artists and new organizations face genuine obstacles when seeking the funding necessary to continue and complete their work.").
139. See Victoria B. Bjorklund et al., *New York Nonprofit Law and Practice: With Tax Analysis* § 1-2 & n.16 (1997 & Supp. 2005); see also 26 U.S.C. § 501(c)(3) (2000) (stating that no part of the net earnings of an exempt organization may inure "to the benefit of any private shareholder or individual"); N.Y. Not-for-Profit Corp. Law §§ 102(a)(5), 204, 508, 515(a) (McKinney 1997 & Supp. 2005).
140. Bjorklund et al., *supra* note 139, § 1-2 n.17 (quoting *Am. Baptist Churches of Metro. N.Y. v. Galloway*, 710 N.Y.S.2d 12, 15 (App. Div. 2000)).
141. See *supra* note 13.
142. The Center and the School, for example, are nonprofit "educational institutions which contribute to the advancement of the art of dance and Martha Graham's legacy." *Graham I*, 153 F. Supp. 2d 512, 522 (S.D.N.Y. 2001), *aff'd*, 43 Fed. Appx. 408 (2d Cir. 2002).
143. See N.Y. Not-for-Profit Corp. Law §§ 701, 717 (McKinney 1997 & Supp. 2005).
144. See, e.g., Jennifer Dunning, *Suit Over Graham's Dances Moves into a New Phase*, N.Y. Times, Apr. 23, 2002, at E4. The Second Circuit conceded that "as the revered doyenne, Graham held remarkable sway over the Center's Board of Directors." *Graham IV*, 380 F.3d 624, 640 (2d Cir. 2004), *cert. denied*, 125 S. Ct. 2518 (2005).
145. A board's decisions will not be second-guessed by the court so long as the directors discharge the duties of their positions "in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions." N.Y. Not-for-Profit Corp. Law § 717(a). Board members are entitled to rely on the opinions of employees of the organization who are believed to be "reliable and competent in the matters presented." *Id.* § 717(b). As a result, board members would be justified in relying on the opinions of an artistic director (such as Graham) in making artistic decisions. *Cf. id.*
146. See, e.g., *Nationalist Movement v. Comm'r*, 102 T.C. 558, 574 (1994), *aff'd*, 37 F.3d 216 (5th Cir. 1994) ("Substantial domination of an organization by its founder does not necessarily disqualify the organization from [tax-exempt status]."); see also Rev. Rul. 66-259, 1966-2 C.B. 214 (noting that the mere fact that the creator of an organization has control will not, in itself, prevent the organization from qualifying for exemption).
147. See *supra* notes 144-145; *Graham I*, 153 F. Supp. 2d at 516.
148. See *supra* note 93 and accompanying text.
149. See *Graham III*, 224 F. Supp. 2d 567, 590 (S.D.N.Y. 2002), *aff'd in part*, 380 F.3d 624 (2d Cir. 2004); see also Dunning, *supra* note 144 ("Francis Mason, the chairman of the center's board, described that organization as an informal family that existed to enable Graham to create and maintain dances.").
150. N.Y. Not-for-Profit Corp. Law § 717(a) (McKinney 1997 & Supp. 2005).
151. *Graham I*, 153 F. Supp. 2d at 521-22 (citing *Aramony v. United Way of Am.*, No. 96 Civ. 3962, 1998 WL 205331, at \*7 (S.D.N.Y. Apr. 27, 1998) ("As chief executive officer of UWA, Aramony owed the organization and its members a fiduciary duty of undivided loyalty.")). Protas's position as Artistic Director of the Center "carried with it an implied promise to act in the Center's best interest." *Graham IV*, 380 F.3d 624, 646 (2d Cir. 2004), *cert. denied*, 105 S. Ct. 2518 (2005).
152. See *Graham IV*, 380 F.3d at 630; *Graham III*, 224 F. Supp. 2d at 609; *Graham I*, 153 F. Supp. 2d at 516.
153. *Graham III*, 224 F. Supp. 2d at 609. "These assertions were, at best, irresponsibly made, and, at worst, intentionally misleading." *Graham IV*, 380 F.3d at 646.
154. See Bjorklund et al., *supra* note 139, § 11-4(a) ("One of a director's basic responsibilities is to ensure that the mission of the organization . . . is carried out."). "It is firmly established that the directors of a corporation have the fiduciary obligation to act on behalf of the corporation in good faith and with reasonable care so as to protect and advance its interests." *Graham III*, 224 F. Supp. 2d at 608 (citing *Pebble Cove Homeowners' Ass'n v. Shoratlantic Dev. Co.*, 595 N.Y.S.2d 92, 93 (App. Div. 1992)).
155. See *Aramony*, 1998 WL 205331, at \*7; see also *S.H. & Helen R. Scheuer Family Found., Inc. v. 61 Assocs.*, 582 N.Y.S.2d 662, 665 (App. Div. 1992) (citation omitted) ("[I]t is well established that, as fiduciaries, board members bear a duty of loyalty to the corporation and 'may not profit improperly at the expense of the corporation.'").
156. See *Graham I*, 153 F. Supp. 2d at 525.
157. *Cf. id.* at 526.
158. A contract or transaction between a nonprofit organization and one of its directors or officers is allowed if the director's or officer's interest in the transaction is disclosed or known to the board, and the other board members authorize the transaction with such knowledge. See N.Y. Not-for-Profit Corp. Law § 715(a) (McKinney 1997 & Supp. 2005). Without disclosure of the director's interest, such a transaction may still be considered valid so long as it was fair and reasonable to the nonprofit organization at the time of the transaction. See *id.* § 715(b). Practically speaking, the board of the Center would have been well aware of Graham's interest in any transaction involving her work, and this knowledge would have validated such a transaction. So long as the board had authorized such an arrangement, the "fair and reasonable" question would never have been raised. Thus, a duty of loyalty question would have been relevant only if Graham had personally utilized her works without the board's knowledge and consent.
159. See *id.* § 508 (providing that all "profits shall be applied to the maintenance, expansion or operation of the lawful activities of the corporation, and in no case shall be divided or distributed in any manner whatsoever among the members, directors, or officers of the corporation"); see also *supra* notes 139-140 and accompanying text.
160. 26 U.S.C. § 501(c)(3) (2000).
161. See *id.*
162. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (2004) (emphasis added).
163. See Treas. Reg. § 1.501(a)-1(c) ("The words private shareholder or individual in section 501 refer to persons having a personal and private interest in the activities of the organization.").
164. See Rev. Rul. 55-231, 1955-1 C.B. 72 (holding that an organization was not organized and operated exclusively for educational purposes where its primary activity was the purchase and distribution of an incorporator's books).

165. See Rev. Rul. 71-395, 1971-2 C.B. 228 (holding that a gallery served only the private purposes of its members, and therefore was not exempt under § 501(c)(3), where it was a vehicle for advancing the careers of its members and promoting the sale of their work).
166. See Tech. Adv. Mem. 94-08-006 (Dec. 4, 1992) (holding that the foundation's earnings inured to the textile artist/board member where the foundation promoted the board member's artwork and career).
167. *Church of Scientology v. Comm'r*, 823 F.2d 1310, 1316 (9th Cir. 1987) (affirming a tax court decision which upheld the Commissioner's revocation of tax exemption from the Church of Scientology of California, the "Mother Church" of the many Scientology churches, because significant sums of money had inured to the benefit of the church's founder, L. Ron Hubbard, and his family). But cf. *Self-Realization Fellowship Church v. Ananda Church of Self-Realization*, 206 F.3d 1322 (9th Cir. 2000) (holding that common law copyrights to works of a Swami monk who was founder, president, and a director of Self-Realization Fellowship Church did not vest in the church as a matter of law). Following authorization of the IRS intermediate sanctions in 1996, a transaction providing an "excess benefit" to a person in a position to exercise substantial influence over the nonprofit organization may result in taxes on such person and on the nonprofit director or officer allowing the transaction, rather than resulting in an immediate revocation of tax exempt status. See 26 U.S.C. § 4958 (2000).
168. See 3 Melville B. Nimmer & David Nimmer, Nimmer on Copyright § 8D.01[A] (2003) (citing World Intellectual Property Organization, Guide to the Berne Convention for the Protection of Literary and Artistic Works (Paris Act, 1971) 41 (1978); H.R. Rep. No. 101-514, reprinted in 1990 U.S.C.C.A.N. 6915, 6928 (1990)).
169. *Carter v. Helmsley-Spear, Inc.*, 71 F.3d 77, 81 (2d Cir. 1995).
170. See World Intell. Prop. Org., Guide to the Berne Convention of the International Union for the Protection of Literary and Artistic Works (Paris Act, 1971) 41 (1978).
171. *Carter*, 71 F.3d at 83 (citation omitted).
172. See Berne Convention for the Protection of Literary and Artistic Works, art. 6bis, Sept. 9, 1886, revised July 24, 1971, 828 U.N.T.S. 221 [hereinafter Berne Convention], <http://www.wipo.int/clea/docs/en/wo/wo001en.htm>. Under French law, moral rights attach to the author rather than to the work itself, "and, therefore remain vested in the artist even after the work is transferred." 2 Ralph E. Lerner & Judith Bresler, Art Law 947 (2d ed. 1998) (citing Registrar of Copyrights Final Report, Waiver of Moral Rights in Visual Artworks 39 (1996)).
173. See Singer, *supra* note 52, at 317 n.141 (citing William Strauss, *The Moral Right of the Author*, 4 Am. J. Comp. L. 506, 516-17 (1955)). The Berne Convention "disregards the principle of assignability and does not prohibit waivability." Lerner & Bresler, *supra* note 52, at 948 (citing Registrar of Copyrights Final Report, Waiver of Moral Rights in Visual Artworks 52 (1996)).
174. See Lerner & Bresler, *supra* note 172, at 944. The term "moral rights" is literally a translation of the French *le droit moral*. See *Carter*, 71 F.3d at 81.
175. See *Carter*, 71 F.3d at 81. Rights of paternity and integrity are protected by most of the legal systems which currently acknowledge moral rights. See Lerner & Bresler, *supra* note 172, at 946.
176. Berne Convention, *supra* note 172, art. 6bis; see also Lerner & Bresler, *supra* note 172, at 947.
177. See *Carter*, 71 F.3d at 81; Lerner & Bresler, *supra* note 172, at 946.
178. *Gilliam v. ABC*, 538 F.2d 14, 24 (2d Cir. 1976).
179. See Singer, *supra* note 52, at 292-93.
180. See *Carter*, 71 F.3d at 81; Lerner & Bresler, *supra* note 172, at 947.
181. Singer, *supra* note 52, at 310.
182. See *Carter*, 71 F.3d at 81-82. Protection against destruction is not expressly mentioned in the Berne Convention, but such a right is recognized in the United States. See Lerner & Bresler, *supra* note 172, at 947 (citing Edward J. Damich, *The Visual Artists Rights Act of 1990: Toward a Federal System of Moral Rights Protection for Visual Art*, 39 Cath. U. L. Rev. 945, 963 (1990)).
183. See Lerner & Bresler, *supra* note 172, at 945.
184. *Id.* This right is rarely invoked. See *id.* at 946 ("[F]ew French cases have even addressed the right.").
185. See *Gilliam v. ABC*, 538 F.2d 14, 24 (2d Cir. 1976). According to the Supreme Court, "the economic philosophy behind the clause" is "the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors . . ." *Mazer v. Stein*, 347 U.S. 201, 219 (1954).
186. See Visual Artist Rights Act of 1990 ("VARA"), 17 U.S.C. § 106A(a) (2000). These rights are limited to the life of the author, and they may not be transferred to another party, although they may be waived via a signed writing. See *id.* § 106A(d)-(e). Works of visual art include paintings, drawings, prints, sculptures, and photographs. See *id.* § 101. Works for hire are excluded from the definition of a "work of visual art." See generally *id.* Thus, neither works for hire nor works of choreography are eligible for any moral rights protection under the 1976 Act.
187. *Gilliam*, 538 F.2d at 24 (internal citations omitted).
188. Singer, *supra* note 52, at 311.
189. *Carter v. Helmsley-Spear, Inc.*, 71 F.3d 77, 82 (2d Cir. 1995). Per § 301(b)(3) of the 1976 Act, state court remedies that are not equivalent to those secured by the Act are not preempted. See 17 U.S.C. § 301(b) (2000); Singer, *supra* note 52, at 311 n.111. "[F]ederal pre-emption is generally inapplicable to state laws of unfair competition of the passing off variety, defamation, invasion of privacy, and contracts." Nimmer & Nimmer, *supra* note 168, § 8D.02(B). While the specific provisions of VARA preempt some state laws with respect to moral rights in works of visual art, it is likely that state laws are not preempted with respect to moral rights in other categories of work. *Id.*
190. See Singer, *supra* note 52, at 313 (citing *Kerby v. Hal Roach Studios*, 127 P.2d 577, 579-81 (Cal. Ct. App. 1942) (finding that an improper attribution adversely affected an artist's good reputation and, therefore, constituted an invasion of privacy)).
191. See *id.* (citing *Granz v. Harris*, 198 F.2d 585, 588-99 (2d Cir. 1952)). The *Granz* case held that "although the purchaser of the plaintiff's master record discs could lawfully use, produce, and sell abbreviated versions of the records, to publicly attribute them to the plaintiff without express contractual authorization would constitute unfair competition." *Id.*
192. See *id.* at 315 n.133 (citing *Gilliam*, 538 F.2d at 23-24) (holding that disputed mutilations to Monty Python's work might deter viewers from becoming Monty Python fans and thus constituted false representation under the Lanham Act; additionally, "the Lanham Act was violated by a representation that, while technically correct, creates a false impression of a product's origin"); *Geisel v. Poynter Prod., Inc.*, 283 F. Supp. 261, 268 (S.D.N.Y. 1968) (holding that use of the pseudonym "Dr. Seuss" on the advertising and sale of dolls, without authorization, constituted false designations of origin under the Lanham Act).
193. See *Gilliam*, 538 F.2d at 24-26 (citing *Granz*, 198 F.2d 585, 588-99) (holding that, as a matter of contract, an obligation to mention the name of the author carries with it the implied duty not to make such changes in the work as would render the credit line a false attribution of authorship)).
194. See Lerner & Bresler, *supra* note 172, at 957 (citing *Clevenger v. Baker Voorhis & Co.*, 8 N.Y.2d 187, 189, 192 (1960) (holding that a publisher had impaired the reputation of an author by publishing an error-ridden edition of his book without indicating that

- the author had not performed the revision, as “the purchase of the copyright did not carry with it a license to defame”).
195. See *Gilliam*, 538 F.2d at 24 (citing *Gardella v. Log Cabin Prods. Co.*, 89 F.2d 891, 895–96 (2d Cir. 1937)). “[T]he Lanham Act does not deal with artistic integrity. It only goes to misdescription of origin and the like.” *Id.* at 27 (Gurfein, J., concurring).
  196. *Edison v. Viva Int’l, Ltd.*, 421 N.Y.S.2d 203, 206 (App. Div. 1979) (holding that plaintiff’s moral right to protection had been subsumed in his contractual right to seek redress for the alleged mutilation of his article); see also *Gilliam*, 538 F.2d at 27 (Gurfein, J., concurring) (noting that if the “licensee may, by contract, distort the recorded work, the Lanham Act does not come into play”); *McGuire v. United Artists Television Prods., Inc.*, 254 F. Supp. 270, 271–72 (S.D. Cal. 1966) (holding that where there was a contract, the artist’s right of artistic control was lost absent express reservation by the artist within the contract, regardless of the custom of the film industry).
  197. *Cleary v. News Corp.*, 30 F.3d 1255, 1260 (9th Cir. 1994) (citing *Vargas v. Esquire, Inc.*, 164 F.2d 522, 524–27 (7th Cir. 1947) (holding that an artist could not claim a right of attribution against a magazine where the artist was found to have granted the magazine all rights to his drawings in exchange for monthly compensation)); *Nelson v. Radio Corp.*, 148 F. Supp. 1, 3 (S.D. Fla. 1957) (denying a singer a right to attribution in the absence of an agreement to provide label credit, where the singer was found to be an employee of the recording company).
  198. Nimmer & Nimmer, *supra* note 168, § 8D.03(A)(3) (citing *Dun & Bradstreet Corp. v. Harpercollins Publ’rs, Inc.*, 872 F. Supp. 103 (S.D.N.Y. 1995)); see also *Graham IV*, 380 F.3d 624, 638 n.30 (2d Cir. 2004), *cert. denied*, 125 S. Ct. 2518 (2005) (holding that a copyright notice in the Center’s name was sufficient to preserve Graham’s copyright even though the work was not determined to be a work for hire) (citing *Goodis v. United Artists Television, Inc.*, 425 F.2d 397, 402–03 (2d Cir. 1970)).
  199. Nimmer & Nimmer, *supra* note 168, § 8D.02(D)(1).
  200. See *Graham IV*, 380 F.3d at 640 (“Graham went to great lengths to become an employee of the Center so that she could insulate herself from the legal and financial aspects of her work.”).
  201. Brief for Defendants-Counter-Claimants-Appellees at 2, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)) (citations omitted) (quoting a letter from Graham to her mother). In the letter, Graham also explained, “I shall have a salary over the years regardless of the intake of the school.” Dunning, *Dance and Profit*, *supra* note 3.
  202. See *Graham IV*, 380 F.3d at 629 (finding that Graham began relying on nonprofit corporations, which she led, to support her work “for tax reasons and because she wanted to extricate herself from funding and legal matters”); Brief for Defendants-Counter-Claimants-Appellees at 2, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)) (noting that Graham was “clear-sighted enough to take steps” to ensure her legacy and free her time for creative endeavors, “leaving the financial and practical worries to others.”).
  203. Brief for Defendants-Counter-Claimants-Appellees at 3, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)) (quoting Joint Appendix A2977).
  204. Thomas J. Overton, Comment, *Unraveling the Choreographer’s Copyright Dilemma*, 49 Tenn. L. Rev. 594, 597 (1982). “The copyright laws are clearly intended to provide economic incentives to produce artistic works, and the legislative objective behind the copyright laws is to bring as many new works into the public domain as possible.” *Id.* at 611 (citation omitted).
  205. See N.Y. Not-for-Profit Corp. Law § 204 (McKinney 1997 & Supp. 2005); Bjorklund et al., *supra* note 139, § 1-2; *supra* notes 139–140 and accompanying text.
  206. See *supra* notes 19, 141–142 and accompanying text.
  207. See *supra* notes 19, 139–142 and accompanying text.
  208. See *supra* notes 91–92, 102, 122–123 and accompanying text.
  209. See *supra* notes 131–138 and accompanying text.
  210. N.Y. Not-for-Profit Corp. Law § 202(a)(1).
  211. One of the reasons for the establishment of the Center was to “perpetuat[e] and preserv[e] Graham’s work after her death.” Brief for Defendants-Counter-Claimants-Appellees at 10, *Graham IV*, 380 F.3d 624 (2d Cir. 2004) (No. 02-9451(L)); see also *Graham I*, 153 F. Supp. 2d 512, 525 (S.D.N.Y. 2001), *aff’d*, 43 Fed. Appx. 408 (2d Cir. 2002).
  212. See Singer, *supra* note 52, at 301 n.61.  
The late George Balanchine viewed his ballets as “butterflies” destined to live for a season. In answer to a question concerning the preservation of his ballets, Balanchine once remarked, “They don’t have to be preserved. Why should they be? I think ballet is NOW. It’s about people who are NOW. Not about what will be. Because as soon as you don’t have these bodies to work with, it’s already finished.”  
*Id.* (quoting George Balanchine, *Work In Progress*, in *Dance as a Theatre Art: Source Readings in Dance History from 1581 to the Present* 187, 192 (Selma Jean Cohen ed., 1975)). And yet, more than two decades after his death, Balanchine’s works continue to be performed by major ballet companies around the world. See *George Balanchine*, <http://www.balanchine.org/01/index.html> (last visited Jan. 13, 2006). Eighty-four works are currently in active repertory. See *Ballets in Active Repertory*, <http://www.balanchine.org/01/activerep.html> (last visited Jan. 13, 2006).
  213. Carman, 71. “Choreographers . . . rarely wish to deal with the consequences of their deaths.” Jowitt, *supra* 75.
  214. *Graham I*, 153 F. Supp. 2d at 521 (quoting a September 14, 1990 letter written by Ron Protas on behalf of Martha Graham to Jim McGarry “concerning a potentially negative article that was to be written by Laura Shapiro of *Newsweek*”).
  215. Brief for Defendants-Counter-Claimants-Appellees at 11, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)); see also *supra* note 6.
  216. Brief for Defendants-Counter-Claimants-Appellees at 12, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)). In a letter to Jerome Robbins shortly before her death in 1991, Graham also wrote that “the company must continue now and in the future.” Carman, *supra* note 71.
  217. Brief of Amici Curiae American Dance Festival, Inc., et al. at 11, *Graham IV*, 380 F.3d 624 (No. 02-9451(L)).
  218. See *Graham III*, 224 F. Supp. 2d 567, 592 (S.D.N.Y. 2002), *aff’d in part*, 380 F.3d 624 (2d Cir. 2004).
  219. See, e.g., Restatement (Second) of Agency § 43 (2004) (“Acquiescence by the principal in conduct of an agent whose previously conferred authorization reasonably might include it, indicates that the conduct was authorized; if clearly not included in the authorization, acquiescence in it indicates affirmance.”).
  220. Press Release, Office of New York State Attorney General Eliot Spitzer, Spitzer Says Court Ruling Will Preserve Martha Graham Dance Legacy (July 5, 2002) (quoting Attorney General Eliot Spitzer as he hailed the Second Circuit’s earlier decision in the Graham case, *Graham II*, 43 Fed. Appx. 408, 410 (2d Cir. 2002), as “a unanimous federal appeals court ruling upholding the rights of two charities, the Martha Graham School of Contemporary Dance and the Martha Graham Center of Contemporary Dance, to continue to operate according to the wishes of the legendary dancer”), [http://www.oag.state.ny.us/press/2002/jul/jul05a\\_02.html](http://www.oag.state.ny.us/press/2002/jul/jul05a_02.html) (last visited Jan. 13, 2006).
  221. “A statement from the Max Planck Institute avers that ‘each moral right has what is called a “positive nucleus,” which is regarded as being so vital to the expression of the respective personality that any waiver would be null and void.’” Nimmer



- & Nimmer, *supra* note 168, § 8D.01(A) n.30 (quoting Register of Copyrights, Technological Alterations to Motion Pictures 78 n.134 (1989)).
222. See Singer, *supra* note 52, at 307. "It all comes down to this: if you put your name on something, you should be there." Graham, *supra* note 1, at 14.
223. See *supra* notes 177–179 and accompanying text.
224. See *supra* notes 180–182 and accompanying text.
225. Cf. 17 U.S.C. § 106 (2000).
226. See *supra* note 183–184 and accompanying text.
227. Such control would necessarily be limited to the extent it might infringe on the "public benefit" provided by the nonprofit organization. Where a choreographer's decision to withdraw a single work from a dance company's repertoire would likely be deferred to as an aesthetic choice, a choreographer's attempt to withdraw her entire body of work from public presentation might be interpreted as threatening the existence of the nonprofit organization.
228. See Singer, *supra* note 52, at 318.
229. See *id.* at 292.
230. *Id.* at 292–93. Marius Petipa's name, for example, is still linked to the classic ballet *Sleeping Beauty*, which was first performed in 1890, even though the choreography has undergone many changes since its first performance and the work has long since been in the public domain. See *id.* at 293 n.22.
231. See *id.* at 310, 318. George Balanchine was known to withdraw works from licensee companies' repertoires when the artistic director to whom he had licensed the works left the dance company. See *id.* at 310 n.107 (citations omitted).
- When the Pennsylvania Ballet forced its artistic director, Barbara Weisberger, to resign in February 1982, Balanchine promptly notified the company that he intended to withdraw his ballets from the company's repertoire. Balanchine explained that he had originally given the works to Weisberger (a Balanchine protégé), and since she was no longer in charge of "her" company, he did not wish to have his ballets performed by them. . . . Balanchine also withdrew works from the Pacific Northwest Ballet when former NYCB principal Melissa Hayden left that company.
- Id.*
232. Singer, *supra* note 52, at 304.
233. Nimmer & Nimmer, *supra* note 168, § 5.03(D). "If such a presumption were not rebuttable, a serious issue of constitutional validity would be raised." *Id.* As the Constitution "authorizes only the enactment of legislation securing 'authors' the exclusive right of their writings, [i]t would thus be quite doubtful that Congress could grant employers the exclusive right to the writings of employees regardless of the circumstances." *Scherr v. Universal Match Corp.*, 417 F.2d 497, 502 (2d Cir. 1969).
234. See *Contract Templates*, at <http://www.dancenyc.org/dancers.asp?file=contract> (last visited Jan. 13, 2006). See in particular the "Letter of Agreement covering work created in the past or to be created in the future by the artistic director/choreographer of a single choreographer company." *Id.*
235. Choreographer Erick Hawkins, for example, died without leaving a will. See Jennifer Dunning, *Forum Asks, Who Owns A Dance?*, N.Y. Times, Oct. 10, 2002, at E1. Upon his death in 1994, his wife and collaborator, Lucia Dlugoszewski, inherited his work and took over the supervision of the Erick Hawkins Dance Company. *Id.* When Dlugoszewski died in 2000, also without a will, the company seemed to die with her, and the disposition of Hawkins' dances was left up to the public administrator. *Id.*
236. Choreographer Paul Taylor has decided that his works will go to his company, the Paul Taylor Dance Company, after his death. See Jennifer Dunning, *Graham Company Leaps Back to Life; But After a Favorable Court Ruling, Questions Linger About Choreographers' Legacies*, N.Y. Times, Sept. 2, 2002, at E1. "'The thing about [Graham's] works going to the company seems right to me, . . . [n]ot just because she was an employee of the company and the company therefore owns the dances. That seems logical. But I'm real glad the dances will be seen.'" *Id.* (quoting Paul Taylor).
237. But see generally Holly Rich & Sarah Kutner, *Dirty Dancing: The Moral Right of Attribution, the Work-for-Hire Doctrine and the Usurping of the Ultimate Grand Dame and Founder of Modern Dance, Martha Graham*, N.Y. St. B. Ass'n Ent. Arts & Sports L. J., Summer 2004, at 11 (analyzing similar issues but reaching a contrary conclusion).
238. Carman, *supra* note 71. "Martha was and is a transformer of dance of the first order." *Id.* (quoting Eliot Feld).
239. See generally Dunning, *Dance and Profit*, *supra* note 3.
- This is definitely a success problem. . . . These problems would never have existed 50 years ago, because the concept of a penny being made by a choreographer or from a dance was unheard of. So now that the commercial aspect of making money has prevailed in this nonprofit world of dance, and the valuable asset is the dance itself—hey, that's a success story.
- Id.* (quoting Charles Reinhart, director of the American Dance Festival).
240. Martha Graham, *I am a Dancer*, [http://www.marthagrahamdance.org/resources/about\\_martha\\_graham.php](http://www.marthagrahamdance.org/resources/about_martha_graham.php) (last visited Jan. 13, 2006).

**Sharon Connelly is a J.D. Candidate, Fordham University School of Law, 2006. She received her B.A. in English and Performing Arts from Mary Washington College in 1990. Ms. Connelly was Notes & Articles Editor, Vol. XV of the *Fordham Intellectual Property, Media & Entertainment Law Journal*. The author would like to thank Professors Hugh Hansen, Stanley Rothenberg, and Linda Sugin; Barbara Quint, Assistant Attorney General, Charities Bureau, New York State Department of Law; Nicole Serratore; Craig Flanagin; Sarah Adams; and Elizabeth Hoag for their insightful comments and assistance. This article is dedicated to Stephanie Reinhart (1944–2002), Dr. Gerald E. Myers, and Laurie Hudson Connelly (1953–2005).**

An earlier version of this article was published as Note, *Authorship, Ownership, and Control: Balancing the Economic & Artistic Issues Raised by the Martha Graham Copyright Case* at 15 *Fordham Intell. Prop. Media & Ent. L.J.* 837 (2005). Reprinted with permission of the publisher.

# International Commercial Arbitration in the Entertainment Industry

By Adam Kagan

The global marketplace is changing the way in which the entertainment industry functions. "The barrier of distance that once tended to confine a business concern to a modest territory, no longer does so. The expansion of American business and industry will hardly be encouraged if we insist on a parochial concept that all disputes must be resolved under our laws and in our courts."<sup>1</sup>

Section 1 of this article surveys the current domestic dispute resolution processes used by the entertainment industry, and discusses how those practices should be retained in the international entertainment marketplace. To do so, three assumptions are required: First, the producer of entertainment content will want to level the playing field with a quick resolution of disputes, because that party is traditionally the economically weaker one.<sup>2</sup> Second, the distributor of content is typically a company with significant international resources and may benefit from a war of attrition. Third, disputes arise and are disposed of differently in the labor, distribution or financing contexts.

Section 2 of this article surveys dispute resolution in three countries active in the entertainment industry and Section 3 concludes by highlighting areas for inclusion in agreements.

The commoditization of entertainment content requires multi-national companies like News Corp., Disney and Sony to report to shareholders who expect maximization of value by increasing profits and cutting costs.<sup>3</sup> Companies must continuously develop new outlets for exploitation of their film, television, music, theater and publishing (collectively known herein as "Content"), and to find ways to produce less expensive Content.

The international marketplace satisfies both of those needs. By repurposing existing Content in different media and countries, the companies are able to make greater profits from each project.<sup>4</sup> In addition, technology permits cleaving off each individual component of the Content production process and outsourcing it to the most cost-efficient supplier, regardless of location.<sup>5</sup> Today, the dynamics of the global marketplace, rather than the traditional movie moguls, determine where Content will be produced most efficiently.

## Section 1

### Choosing Arbitration

Although technology now permits studios to source globally, international Content creators, like domestic creators, continue to be plagued with the same disputes that need timely resolution. There are many forms of dispute resolution, but arbitration is more prevalent in the entertainment industry than mediation (sometimes conflated with conciliation<sup>6</sup>), mini-trial, summary jury trial or litigation.<sup>7</sup> Mediation is an often-disfavored option because it is non-binding.<sup>8</sup> Furthermore, under the rules of at least one arbitral institution, a mediator cannot serve as an arbitrator of the same dispute he mediated, requiring the additional expense and delay of engaging another neutral if the parties fail voluntarily to reach an accord.<sup>9</sup> Mini-trials and summary jury trials are time consuming and may involve officers of a party's company that are not available. Litigation of an issue could also take years, severely diminishing the value of the Content. Due to the extended time for creation (a feature film may take more than two years from development through distribution) and the short life span of the entertainment product, both Content producers and Content distributors need the finality of an arbitral award.<sup>10</sup>

Yet some attorneys counsel against arbitration, because a client may be forced to present his case without the tools of formal discovery and the rules of evidence. In addition, if the client were in court, he could always appeal an adverse judgment. Finally, many litigators are not accustomed to the informal flexibility of an arbitral proceeding and lack of procedural safeguards.<sup>11</sup>

However, as explored further below, the speed of resolution, decreased costs, preservation of privacy, flexible customized solutions, and avoidance of jurisdictional disputes all weigh heavily in favor of arbitration. Additionally, agreeing to arbitration in an international dispute will provide the powerful enforcement mechanism of the New York Convention.

### Speed of Resolution

Entertainment product has a finite shelf life and the speed of arbitration often allows Content to be released on schedule. A film (or television show, CD or book)

locked in litigation may miss its window in a valuable market and may not regain its ability to attract distributors or exhibitors.<sup>12</sup> With the streamlined process for the appointment of arbitrators, there is no lengthy wait for judicial calendaring. Moreover, the informal nature of arbitration permits simple disputes to be heard in a single day. In simple cases involving geographically distant parties, an arbitrator can even agree to hear a case based only on documents and telephone conference calls.<sup>13</sup>

As technology changes the Content creation industry, arbitration is evolving as well. One arbitral body now permits arbitration via videoconference.<sup>14</sup> Another provides for arbitration in an online environment, enabling all participants to communicate through a secure website.<sup>15</sup> These new tools not only save clients and counsel the time and expense of travel, but also keep the stream of international commerce flowing smoothly.

Speed also works to balance the financial inequities between Content producers and distributors by avoiding a war of attrition. Generally, this works in favor of producers who do not have the resources to outlast a Content distributor.<sup>16</sup> Furthermore, resolution is reached quickly and the process is usually more cost efficient than other dispute resolution options.

### **Decreased Costs of Resolution**

Domestic arbitration in the U.S. saves money in two ways. First, by quickly resolving the dispute, the Content is able to be released to the market in time for maximum exposure, thereby increasing the likelihood of a return on the investment. Second, by resolving the dispute quickly and informally, legal fees should be less than if the parties litigated the same issue. However, in contrast to litigation, in arbitration, the parties pay the arbitrator. Under most arbitration rules the arbitrator sets his own fees and has discretion to split the fee or unequally apportion fees to either party.<sup>17</sup>

In the international context, arbitration is even more cost efficient. If the arbitration is in a foreign jurisdiction and the attorney understands the contract and is competent to practice under local laws governing the issue, there is no requirement (as there would be with litigation) to add the expense of local counsel. If a client brings a domestic arbitration against a foreign entity, there is no need to litigate the same issue in other countries to reach a locally enforceable judgment.

Conversely, if a client prevails in litigation in the United States and receives a judgment against a foreign company or individual without assets in the court's jurisdiction, the client may still have to re-litigate in the adversary's home jurisdiction. No treaty guarantees the enforcement of domestic court judgments in all countries.<sup>18</sup> Additionally, forcing litigation in the courts of

one country when the dispute is between transnational parties may result in a heightened level of uncertainty and unpredictability for at least one of the parties.<sup>19</sup>

One of the primary advantages of arbitration is that unlike judicial decisions, arbitral awards are presumptively valid and enforceable in any of the 137 nations that are parties or signatories to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, commonly referred to as the New York Convention.<sup>20</sup> This presumption of validity places the burden of proving invalidity on the party opposing enforcement and requires that the enforcement mechanisms for international awards be no more onerous than the mechanisms used for domestic award enforcement in the country.<sup>21</sup> The United States acceded to the New York Convention on December 29, 1970, when it authorized 9 U.S.C. § 201 (2005).

### **Preservation of Privacy/Confidentiality**

Another advantage of arbitration is the ability to maintain confidentiality.<sup>22</sup> Most companies involved in the creation or distribution of Content also will not want an adverse precedent if they lose in court. However reluctant an adversary may be to agree to an arbitration clause, most recognize the precedential value of an adverse judgment in a public court proceeding has a far more damaging effect than an adverse but confidential arbitral award. Furthermore, in arbitration, Content creators and distributors may be able to limit the scope of discovery and can continue their business practices in private. However, in an industry as insular as entertainment, it may prove difficult to determine damages if one side leaks the terms of the award. Due to the private nature of an award and the wide latitude given to arbitrators on evidentiary matters, an arbitral award is not binding precedent in other litigation and not generally available to the public.

### **Flexibly Customized Solutions**

In addition to privacy, speed and cost, part of the value of arbitration is that the arbitrator draws on considerable experience in the field to craft a uniquely suitable remedy. An arbitrator is only constrained by his creativity and experience in fashioning a workable solution.<sup>23</sup> Since the entertainment industry is highly specialized, complete with its own jargon and methods of accounting, an arbitrator with a similar background to the parties is especially valuable.<sup>24</sup> Someone "in the business" is more likely to be familiar with the conventions and practices of the trade when working with international parties where language and distance may be compounding a contractual problem. This familiarity is especially important when a contract dispute turns on the interpretation of an agreement that is dependent on trade custom. In such cases, arbitration avoids the task of educating a judge or jury as to industry norms.<sup>25</sup>



When contracting with an international party, extra care may be needed for an assurance that an arbitration will be neutral. In situations where there is unfamiliarity or distrust between the parties, the prestige of an institutional arbitration may assuage the fears of both parties. Arbitral institutions like the American Arbitration Association (“AAA”) and International Chamber of Commerce (“ICC”), explored further below, lend credibility to an award because both parties know that the award is likely to be enforced by local courts.<sup>26</sup>

Neutrality is even more important in an international dispute where parties are wary of possible bias in favor of a certain nationality. Arbitration may soothe fears of foreign adversaries wary of the American system of extensive discovery during litigation. In addition, the American jury system’s propensity to sympathize with individual artists over faceless corporations can be of particular concern to foreign corporate parties.<sup>27</sup> Perhaps most importantly however, the flexible process of arriving at an award is more likely to preserve business relationships.<sup>28</sup>

### Choosing an Arbitral Forum for Your Dispute

After agreeing to include an arbitration clause, there are two types of arbitrations to consider, institutional and *ad-hoc*. In the United States, many of the contracts that govern the individual relationships between entertainment industry parties mandate institutional arbitration. Those agreements are supervised by “associational”<sup>29</sup> arbitrators, like the industry-specific Independent Film and Television Alliance (“IFTA”), or the more general “administrative”<sup>30</sup> arbitration institutions, such as the AAA and Judicial Arbitration and Mediation Services (“JAMS”). Those agreements that specify arbitration but do not specify an administering institution result in what is known as *ad-hoc* tribunals.

The *ad-hoc* arbitration is found in many of the collective bargaining relationships in the entertainment industry. It is often found where a union and signatory companies agree on a list of arbitrators<sup>31</sup> and procedures in advance, including the scope of the arbitrator’s powers, discovery of evidence, jurisdictional maximum,<sup>32</sup> time period for filing,<sup>33</sup> interim orders and the design of the award.<sup>34</sup> These *ad-hoc* procedural rules are usually spelled out in lengthy contracts, known as “Basic Agreements.” Although their awards are no less binding or enforceable than institutional arbitration awards, the major disadvantage to *ad-hoc* arbitration is that there is no independent administrative body to schedule meetings or move the process along.<sup>35</sup>

In an institutional arbitration, the parties have agreed to arbitrate under the auspices of an independent arbitral body as part of their existing contract (or a later agreement to arbitrate). The advantages of institutional arbitrations are the pre-qualified lists of neutral

arbitrators, an independent expediter, and the provision of uniform procedural rules. In addition, institutions lend credibility in the international context because some, like the ICC Court, review the final award to verify enforceability in other countries.<sup>36</sup>

There are three institutional dispute resolution bodies that handle most domestic entertainment industry disputes.<sup>37</sup> To reflect the globalization of the entertainment industry these bodies have all changed their names to reflect a less “American” lineage. The American Film Marketing Association (“AFMA”) became IFTA, the AAA founded the International Center for Dispute Resolution (“ICDR”) and JAMS joined with the leading alternative dispute resolution (“ADR”) providers in four other countries to form the International Mediation Services Alliance (“MEDALS”).<sup>38</sup>

A fourth body, the ICC, is the pre-eminent body of international commercial arbitration that has heard over 13,000 cases since 1923,<sup>39</sup> but that is not yet a force in the entertainment industry. A fifth forum, the World Intellectual Property Organization (“WIPO”), also has an arbitral body with rules designed for intellectual property disputes. At this time, WIPO has had insufficient opportunity to establish a track record with administration of arbitral proceedings.<sup>40</sup>

### AFMA/IFTA

IFTA is a trade association for the entertainment industry with a current membership of more than 150 companies in sixteen different countries.<sup>41</sup> Many contracts governing the non-labor relationships in the creation of audiovisual Content specify IFTA. As IFTA hears only entertainment-based arbitrations, it arguably has the deepest body of native entertainment industry knowledge. IFTA reports opening ninety-three matters in 2005, an increase from eighty-seven in 2004.<sup>42</sup> Although based in Los Angeles, IFTA can hold arbitrations in a variety of venues around the world.<sup>43</sup>

IFTA has promulgated its own single set of rules that apply with equal force for both domestic and international arbitrations. Unlike ICC arbitrations, IFTA has no “court” to review the international enforceability of awards. However, because of the closed nature of the film distribution industry, IFTA’s sanction of not allowing a losing party to attend the American Film Market is a powerful motivation to honor an award.<sup>44</sup> This is especially useful for repeat offenders who ignore an award and, for example, who change the names of their companies. IFTA can “pierce the veil” by requiring personal binders of company executives to avoid the use of “shell companies.”<sup>45</sup>

### AAA/ICDR

Although the AAA is not specifically an entertainment industry forum, it is still a popular choice for the

entertainment industry with more than seventy-five arbitrators around the world specializing in national and international entertainment. To qualify as a specialist, more than fifty percent of an arbitrator's practice or business experience must be in the entertainment industry.<sup>46</sup> Since 1996, the AAA has referred international cases to the ICDR, a division of the AAA.<sup>47</sup>

The AAA furnishes pre-qualified, independent arbitrators and administrative services, such as standardized rules, notice to parties, pre-hearing conferences, scheduling and neutral locations, all intended to insure that the process runs smoothly and that the chances of a successful challenge to the award are minimized.<sup>48</sup> The AAA boasts the largest caseload in the United States, with 14,440 disputes in 2004, a decrease from 14,759 in 2003, with the average dispute being resolved in eleven months. Of that number, the AAA heard sixty-eight entertainment industry-related cases in 2004, a decrease from eighty in 2003. The AAA does not record the number of how many arbitrations involved international parties.<sup>49</sup>

## JAMS

Another popular institutional arbitrator is JAMS, which uses retired judges and professional arbitrators.<sup>50</sup> While the parties are free to choose their arbitrators based on resumes and experience, the JAMS arbitrators solely practice ADR and are exclusive to the institution.<sup>51</sup> Therefore, they may not have the same currency in the entertainment industry as an IFTA or AAA arbitrator, who arbitrates in addition to working in the entertainment industry. JAMS arbitrations are better suited to matters such as financing agreements that may require specific knowledge, but not knowledge specific to entertainment. JAMS hears approximately 10,000 cases per year, but does not keep total numbers regarding cases in specific industries.<sup>52</sup>

In addition to arbitration JAMS provides mediation, mini-trial, summary jury trial, non-binding arbitration, and expert fact-finding. Unlike IFTA, JAMS has a separate set of international arbitration rules, apart from its comprehensive rules.<sup>53</sup>

## ICC

The ICC is located in Paris, France, and provides for international arbitration under its International Court of Arbitration. Although the ICC Court is the leader in international business dispute resolution,<sup>54</sup> it is rarely chosen as an administrative body in Content disputes. The general perception is that resolution may take up to two years, its costs are greater than those of the other bodies, and the location in Paris is undesirable, because it requires a fourteen-hour flight from Los Angeles. However, the ICC appears to be interested in changing that perception. It recently held an interna-

tional ADR seminar in California called "Flexible Solutions For An Evolving World"<sup>55</sup> and also holds a seminar yearly at the Cannes International Film Festival. The 2006 topic is the role of international audio-visual law in film distribution.<sup>56</sup>

Unlike the AAA, IFTA or JAMS, the ICC Court reviews a final award to verify enforceability in other countries.<sup>57</sup> Although the ICC's lengthy average resolution time and increased costs restrict use by the entertainment community, that will most likely change with the development of technology, such as its Net Case product, which allows arbitration to occur in an online environment.<sup>58</sup> This results in a quicker resolution, yet still maintains the imprimatur of the ICC.

## Section 2

### Role of ADR Outside of the United States

After an arbitrator has issued an award, the New York Convention requires a foreign signatory nation to enforce the award with no less authority than it would if the award were issued in that nation. However, there are occasions where an award may be reviewed in a host nation. When an award is contrary to public policy in the nation where enforcement is sought, or the issue is not arbitrable in the host country, the New York Convention permits the host nation to decline to enforce that award.<sup>59</sup> Below are surveys of arbitration in three countries as they relate to Content.

### China

Although China has a reputation for failing to protect intellectual property rights, the market for Content in China is too large for producers to ignore. Chinese courts and arbitration panels do resolve many business conflicts that arise from China's economy, however many of its most powerful businesses are still state-owned enterprises ("SOEs"), subject to strict government oversight.<sup>60</sup> The Chinese Radio, Film and Television Administration controls production, import, export, distribution and projection of films (which shall be oriented to the needs of the people and socialism)<sup>61</sup> and still requires a permit to engage in production, import, distribution or projection of films.<sup>62</sup>

When a United States-based business contracts with foreign businesses that are SOEs, (e.g. China's CCTV) the Foreign Sovereign Immunities Act ("FSIA") applies. In disputes with foreign sovereigns, the FSIA<sup>63</sup> provides immunity from the jurisdiction of United States Courts for the acts of foreign sovereigns within their own territories.<sup>64</sup> However, if the parties agree to an arbitration clause, the FSIA expressly provides an exemption from immunity for an SOE to allow an arbitrator to fashion an award that is enforceable under the New York Convention.<sup>65</sup>

China appears to be embracing arbitration with the China International Economic and Trade Arbitration Committee ("CIETAC"), which introduced new arbitration rules as of May 1, 2005.<sup>66</sup> CIETAC was formed as the Foreign Trade Arbitration Commission in 1956.<sup>67</sup> In addition, labor law in China does permit the recognition of trade unions for employees and permits arbitration for violations of a collective contract.<sup>68</sup> However, if the trade union is not satisfied with the ruling, it may still bring the case before a People's Court.<sup>69</sup>

## Canada

In the early 1990s American production of Content began to migrate to Canada because of favorable exchange rates, inexpensively similar locations and facilities, and Canadian tax incentives. The North American Free Trade Agreement ("NAFTA") governs the United States entertainment industry's relationship with Canadian Content producers and distributors. NAFTA is designed to eliminate tariffs and stimulate cross-border trade among Canada, the United States and Mexico, without sacrificing national economic independence. NAFTA requires each member government to "encourage and facilitate the use of arbitration . . . for the settlement of international commercial disputes between private parties in the free trade area."<sup>70</sup>

As NAFTA prohibits tariffs among members, American Content producers have a financial incentive to produce Content in Canada at a discount without being subject to countervailing duties when the Content is repatriated to the United States. Canada's federal and provincial tax credit programs were designed to lure investment in physical infrastructure so that more productions could be accommodated. As a by-product, the influx of work stimulated Canada's indigenous Content production industry, thereby resulting in the growth of an experienced labor pool.<sup>71</sup>

## Great Britain and the European Union

In contrast to the Canadian system of tax credits for Content producers, the United Kingdom's domestic Content creation industry receives funding directly from the National Lottery of the United Kingdom through the national U.K. Film Council. The International Department of the U.K. Film Council even maintains a permanent office in Hollywood, to encourage investment in the U.K. from international production companies.<sup>72</sup> The Film Council oversees three development and production funds disbursing a total of £17 million per year.<sup>73</sup>

Although funding may come from the government, arbitration in the entertainment industry is more limited than in the United States. For example, the Basic Agreement of the Writers Guild of Great Britain ("WGGB") refers disputes to a standing joint committee

of representatives of the producers and writers. However, the WGGB basic agreement goes on to say, "nothing in this clause shall in any way affect or restrict the rights of the producer or a writer to apply to the courts for equitable relief."<sup>74</sup>

In addition, European Union Directives can impact arbitration as well. For example, contracts for labor cannot mandate arbitration in the European Union, because as a matter of public policy, pre-dispute arbitration clauses are presumptively unfair to employees.<sup>75</sup> However, arbitration can be agreed upon after a dispute arises.

## Role of ADR in the United States

Within the United States the grounds for overturning arbitral awards are narrow, requiring "manifest disregard for the law,"<sup>76</sup> proof that the award was procured by corruption or fraud, or the arbitrator lacked jurisdiction. The jurisdictional challenge is especially difficult to overcome because most arbitration clauses today include specific language conferring jurisdiction over both the dispute and arbitrability on the arbitrator.<sup>77</sup> The United States Supreme Court reasoned that in return for a quick, inexpensive and conclusive resolution of a dispute, the parties agree to take the risk without the opportunity for review, that the arbitrator may make mistakes and commit errors of fact and law.<sup>78</sup>

Due to the interconnected nature of the Content creation industry, most disputes in America will touch more than one state or nation, automatically invoking the Federal Arbitration Act ("FAA") in addition to the relevant state laws.<sup>79</sup> The FAA only permits vacatur of an award in limited circumstances: corruption, bias, arbitrator misconduct, arbitrator exceeds powers, or manifest disregard for the law. With those narrowly defined circumstances in mind, practitioners should address the following in an arbitration agreement with international parties.

## Section 3

### Define Scope of Arbitrability

If granting an arbitrator the ability to decide the validity of the arbitration clause, recognize that the person who is analyzing the contract may not be an attorney, and that his compensation corresponds to the volume of arbitration performed. If an arbitrator determines that a contract is void, there is nothing to arbitrate. The laws of New York, California and the AAA also permit an arbitrator to hear and determine the controversy on available evidence, even if a party fails to appear.<sup>80</sup> As you would not ignore a summons in litigation, do not ignore a demand for arbitration.



## Specify Recovery of Fees

In litigation under the American rule, attorney's fees cannot be recovered unless part of the agreement. Arbitration functions the same way. The arbitrator may award attorney's fees to either side only if provided in the underlying contract or the rules of the arbitration. The arbitrator may also apportion his fees as he so chooses.<sup>81</sup>

## Determine Situs, Choice of Law, Language

When contracting with international parties, specify the situs, the choice of law and the language of the arbitration. Although the situs should be mutually convenient, care should be taken to specify the applicable choice of law.<sup>82</sup> If no choice of law is specified, international custom is to apply the procedural law of the situs.<sup>83</sup> Therefore, even though the FAA will apply if an agreement is arbitrated in the U.S. between an American company and a company of a foreign country, state law may nonetheless prevail if affirmatively selected.<sup>84</sup> It is also important to specify the language of the arbitration and to use care in selecting interpreters and translators, because words in certain languages may have more than one meaning or connotation.

## Settlement as Award

No treaty protects settlements. Therefore, it is critical to take the extra step and have the settlement agreement incorporated in an arbitral award.<sup>85</sup> In the United States, an arbitral award can be confirmed in court. Outside of the United States, an arbitral award will find recognition in the courts of any nation signatory to the New York Convention.

## Conclusion

As cross-border transactions increase in the entertainment industry, so do the opportunities for disputes. As the entertainment industry becomes more economically interdependent on foreign nations and new technology changes the way Content is consumed around the world, Content producers and distributors will need more accessible methods of dispute resolution. The need to control costs, speed, enforceability, privacy and flexibility will drive more of those disputes to arbitration. By using the lessons of decades of domestic arbitration practices, U.S. Content producers will remain competitive in the global entertainment marketplace.

## Endnotes

1. *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972).
2. See generally Mark Litwak, *Distribution and the Indie Filmmaker*, available at [http://www.marklitwak.com/articles/film/indie\\_filmmaker.html](http://www.marklitwak.com/articles/film/indie_filmmaker.html) (last visited Oct. 29, 2005).

3. See generally Laura Holson, *Can Hollywood Evade the Death Eaters?* N.Y. Times, Nov. 6, 2005.
4. Joe Schlosser, *The Court May Set Precedent*, Broadcasting And Cable Magazine, Nov. 5, 2001, available at <http://www.broadcastingcable.com> (last visited Dec. 3, 2005).
5. Department of Commerce, *Report on the Impact of Migration of U.S. Film and Television Production*, Jan. 18, 2001 at P4, available at <http://www.ita.doc.gov/media> (last visited Dec. 3, 2005).
6. "Conciliation is more formal than mediation; the conciliator hears evidence, perhaps conducts an investigation, makes findings of fact and law, and gives a proposed solution. Unlike arbitration, the conciliator's decision is not binding." See Daniel C.K. Chow, Thomas J. Schoenbaum, *Int'l. Bus. Transactions*, at 662 (2005).
7. Thomas D. Selz, *et al.*, *Entertainment Law: Legal Concepts And Business Practices*, § 21:17 at 21-51 (2d ed. 2005).
8. See Bridget Goldshmidt, *ADR Procedures on the Rise; Using Less Invasive Methods to Resolve Industry Tiffs*, Ent. Law & Fin., April 1998.
9. Indep. Film & Television Ass'n ("IFTA") *Rules for International Arbitration*, Rule 16.4, available at [http://www.ifta-online.org/Arbitration/intl\\_arbit\\_rules.asp](http://www.ifta-online.org/Arbitration/intl_arbit_rules.asp) (last visited Dec. 3, 2005).
10. Shawn K. Judge, *Giving Credit Where Credit is Due: The Unusual Use of Arbitration in Determining Screen Writing Credits*, 13 Ohio St. J. on Disp. Resol. at 231-232 (1997).
11. Selz, *supra* note 7, § 21:17 at 21-52.
12. Selz, *supra* note 7, § 3.06, at 3-36.
13. See *supra* note 9, at article 9.4.
14. Press Release, JAMS, *Video Conferencing*, available at <http://www.jams-endispute.com/welcome/videoconf.asp> (last visited Nov. 11, 2005).
15. See NETCASE, *A secure online environment for ICC Arbitration*, available at: [http://www.iccwbo.org/court/english/news\\_archives/2005/NetCase%20Pamphlet\\_En.pdf](http://www.iccwbo.org/court/english/news_archives/2005/NetCase%20Pamphlet_En.pdf) (last visited on Dec. 3, 2005).
16. See generally Litwak, *supra* note 2.
17. See *supra* note 9 at 14.2, and American Arbitration Association, *AAA International Rules Article 31*, available at <http://www.adr.org/sp.asp?id=22090>, (last visited 12/11/05).
18. See generally Christian Buhning-Uhle, *Arbitration And Mediation In International Business*, Kluwer Law Int. 1996.
19. Alan Rau et al., *Process of Dispute Resolution*, at 623, 3d ed. (2002).
20. United Nations, *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, June 10, 1958, available at <http://untreaty.un.org/sample/EnglishInternetBible/partI/chapterXXII/treaty1.htm> (last visited Oct. 29, 2005).
21. *Id.* at Articles III and V.
22. United Nations, *UNCITRAL Rules Article 32(5)*; Int'l Chamber of Commerce, *ICC Rules Article 21(3)*; American Arbitration Association, *AAA International Rules Articles 21(4) & 28(5)*; Independent Film & Television Alliance, *IFTA Rule 9.3*.
23. See generally Litwak, *supra* note 2.
24. IFTA requires: 1. Special knowledge and expertise as an attorney in the entertainment field with at least seven years experience representing sellers and buyers, particularly in the international licensing of film. 2. Experience in arbitration. 3. Familiarity with litigation. Independent Film & Television Alliance, *IFTA Arbitration Frequently Asked Questions* available at <http://www.ifta-online.org/Arbitration/faqs.asp> (last visited 10/29/05).

25. Rau, *supra* note 19, at 601.
26. See Buhring-Uhle, *supra* note 18, at 46.
27. See generally Goldshmidt, *supra* note 8.
28. Selz, *supra* note 7, § 21:17 at 21-53.
29. See generally Soia Mentschikoff, *Commercial Arbitration*, 61 Col. L. Rev. 846, 848-854 (1961).
30. *Id.*
31. Writers Guild of America *Basic Agreement* Article 11.C.2.e(3), Directors Guild of America *Basic Agreement* § 2-304).
32. Selz, *supra* note 7, §21:17 at 21-57 (quoting Writers Guild of America *Basic Agreement* Art. 12.B).
33. Writers Guild of America *Basic Agreement* Article 11.A(2); Screen Actors Guild *Basic Agreement* § 9(A)(3); Directors Guild of America *Basic Agreement* § 2-201.
34. See Buhring-Uhle, *supra* note 18, at 46.
35. See Daniel C.K. Chow & Thomas J. Schoenbaum, *International Business Transactions* at 681 2005 (quoting Jay M. Vogelsson, *Dispute Resolution*, in *Negotiating and Structuring International Commercial Transactions*, American Bar Association, Section of International Law & Practice, 1991).
36. Int'l. Chamber of Commerce, *International Court of Arbitration*, available at <http://www.iccwbo.org/court/english/arbitration/introduction.asp> (last visited Oct. 30, 2005).
37. Toni L. Worthery, *There's No Business Like Show Business: Alternative Dispute Resolution in the Entertainment Industry*, 2 Va. Sports & Ent. L.J. 162 (quoting Gerald F. Phillips, *Casting Call*, Cal. L. Bus, Sept. 15, 1997, at 32).
38. Press Release, *JAMS Leading Mediation Providers Join Forces To Create the First Global Mediation Alliance*, available at [http://www.jams-endispute.com/press/show\\_release.asp?id=220](http://www.jams-endispute.com/press/show_release.asp?id=220) (last visited Nov. 11, 2005).
39. Int'l. Chamber of Commerce, *Introducing ICC Dispute Resolution Services*, available at: [http://www.iccwbo.org/court/english/intro\\_court/introduction.asp](http://www.iccwbo.org/court/english/intro_court/introduction.asp) (last visited on Dec. 3, 2005).
40. Gary B. Born, *International Commercial Arbitration*, at 19 (2001).
41. IFTA, *About IFTA*, available at [http://www.ifta-online.org/aboutafma/about\\_afma.asp](http://www.ifta-online.org/aboutafma/about_afma.asp) (last visited on Nov. 12, 2005).
42. E-mail Interview with Dorian Dawson, Counsel & Arbitral Agent, IFTA Jan. 11, 2006.
43. Paul D. Supnik, *Motion Picture Production and Distribution—An Overview of the United States Perspective*, at <http://www.supnik.com/film.htm> (last visited Nov. 12, 2005).
44. See American Film Marketing Association, *AFM 2005 Guidelines § 3B*, available at <http://www.ifta-online.org/afm/documents/2005guidelines.pdf> (Last visited Nov. 12, 2005).
45. Mark Litwak, *Risky Business, Financing & Distribution Independent Films*, at 211 (2004).
46. E-mail Interview with Elizabeth J. Champnoi, Esq., AAA District Vice President, Dec. 13, 2005.
47. Am. Arbitration Ass'n. *About Page*, available at <http://www.adr.org/sp.asp?id=26079> (last visited Jan. 11, 2006).
48. Rau, *supra* note 19, at 625.
49. E-mail Interview with Larry Parker, Corporate Communications Officer, AAA, Nov. 1, 2005.
50. JAMS-Endispute *Arbitration Brochure*, available at [www.jams-endispute.com/welcome/arbitration.asp](http://www.jams-endispute.com/welcome/arbitration.asp) (last visited Oct. 30, 2005).
51. *Id.*
52. E-mail Interview with Melissa Anderson, Communications Manager, JAMS (Nov. 2, 2005).
53. JAMS-Endispute *Rules for Comprehensive Arbitration*, available at <http://www.jams-endispute.com/rules/comprehensive.asp> and [http://www.jams-endispute.com/rules/international\\_arbitration\\_rules.asp](http://www.jams-endispute.com/rules/international_arbitration_rules.asp) (last visited Nov. 12, 2005).
54. Born, *supra* note 40, at 13.
55. 20-8 Mealeys International Arbitration Report at 13 (2005).
56. Int'l. Chamber of Commerce, *ICC Conference Schedule*, available at <http://www.iccwbo.org/conferences/id994/index.html> (last visited Nov. 12, 2005).
57. Int'l. Chamber of Commerce, *International Court of Arbitration; Introduction*, available at: <http://www.iccwbo.org/court/english/arbitration/introduction.asp> (last visited Oct. 30, 2005).
58. *Supra* note 15.
59. *Supra* note 20 at Article 5(2)(b).
60. Chow, *supra* note 35, at 522.
61. People's Republic of China, *Regulations on Administration of the Films Industry*, PRC State Proclamation 342, available at <http://www.cfcc-film.com.cn/en/cooperate/tiaoli.htm> (last visited Nov. 12, 2005).
62. *Id.*
63. 28 U.S.C. §§ 1602-1611 (1976).
64. See *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964).
65. *Cargill Int'l SA v. M/T Pavel Dybenko*, 991 F.2d 1012, 1018 (2d Cir. 1993) (applying 28 U.S.C. § 1605 (1976)).
66. China Int'l Economic & Trade Arbitration Commission, *Arbitration Rules Article 2*, available at [http://www.cietac.org.cn/epop\\_1.htm](http://www.cietac.org.cn/epop_1.htm) (last visited Nov. 30, 2005).
67. China Int'l Economic & Trade Arbitration Commission, *Introduction*, available at [http://www.cietac.org.cn/english/introduction/intro\\_1.htm#2](http://www.cietac.org.cn/english/introduction/intro_1.htm#2) (last visited Dec. 3, 2005).
68. People's Republic of China, *PRC Trade Union Law Number 62, Article 21*, available at: <http://www.acftu.org.cn/unionlaw.htm> (last visited Nov. 7, 2005).
69. *Id.* at Article 20.
70. North American Free Trade Agreement Implementation Act, Pub. L. No. 103-182, 107 Stat. 2057 (codified in scattered sections of U.S.C.) Article 2022.
71. See Heidi Wicker, *Making a Run for the Border: Should the United States Stem Runaway Film and Television Production through Tax and other Financial Incentives?* 35 Geo. Wash. Int'l L. Rev. 461, 465 (2003).
72. See generally UK Film Council, available at <http://www.britfilmusa.com/> (last visited Dec. 3, 2005).
73. See generally UK Film Council, available at <http://www.ukfilmcouncil.org.uk/aboutus/overview/> (last visited Dec. 3, 2005).
74. Writers Guild of Great Britain, *Agreement for Television Production Between the Writers Guild of Great Britain and the Producers Alliance for Cinema and Television*, Article 25 (vi), available at [http://www.writersguild.org.uk/downloads/PACT\\_WG\\_2002.pdf](http://www.writersguild.org.uk/downloads/PACT_WG_2002.pdf) (last visited on Dec. 3, 2005).
75. See generally EC Council Regulation 44/2001 §5, *Articles 18-21* (2001).

76. *Wilko v. Swan*, 346 U.S. 427 at 436 (1953).
77. E.g., I.F.T.A. Article 8.1, 8.3, The Arbitrator shall have all jurisdiction and powers to make rulings as to the procedures for the conduct of the arbitration including, but not limited to the arbitrability of any claim. Available at [http://www.ifta-online.org/Arbitration/intl\\_arbit\\_rules.asp](http://www.ifta-online.org/Arbitration/intl_arbit_rules.asp) (last visited Oct. 29, 2005).
78. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 618 (1985).
79. Federal Arbitration Act, 9 U.S.C.S. § 1 (1925).
80. *Selz*, *supra* note 7, § 21:20 at 21-68 (quoting N.Y. Civ. Prac. L & R 7506(c) (McKinney 1984); Cal. Civ. Proc. Code § 1282.2(e) (West 1982)).
81. See IFTA Arbitration Rules § 14.1.3, SAG Basic Agreement § 9E5.
82. See WGA Basic Agreement article 11.A(3), DGA Basic Agreement § 2-305, specifying Los Angeles or New York.
83. *Chow*, *supra* note 35, at 684.
84. *Volt Info. Scis. v. Bd. of Trs.*, 489 U.S. 468 at 479 (1989).
85. *Rau*, *supra* note 19, at 936.

Adam B. Kagan is a third-year law student at Pace University School of Law. He received his Bachelor of Fine Arts Degree in Film and Television Production from New York University's Tisch School of the Arts, Institute of Film and Television. Before attending Pace Law School, Kagan was the head of production at Fourth of July Productions, Inc., a New York City television commercial production company. Under his tenure, Fourth of July produced award-winning campaigns for diverse clients such as James Taylor, MSNBC, ESPN, USA Networks, Citibank, British Airways, and Sony Music. In addition to producing at Fourth of July, Adam was also the Line Producer on the film "Spin the Bottle" and the Assistant Director on the first season of the Bravo television series "Queer Eye for the Straight Guy." Adam graduates from Pace Law School in May 2006 and hopes to pursue a career in the entertainment industry.

## Recordings of the Section's 2005 and 2006 Highly Regarded and Well Attended Annual Meetings Now Available

Each program qualifies for New York MCLE credit for experienced attorneys (admitted to practice for more than two years) and is available in DVD or videocassette format.

Each album includes a copy of the program's written materials. For additional persons in a firm or office to utilize these recordings for MCLE credit, they must purchase their own individual copies of the course materials.

### 2005 EASL Annual Meeting

Some of the more controversial and highly debated social and legal issues in the realm of mass media, advertising and governmental regulation are tackled in this lively program by a well-rounded faculty of media executives, lawyers and a representative of the FCC.

#### Program Contents

- Sex, Drugs, Rock 'n' Roll and the First Amendment
- Branding of Entertainment, the Media and the First Amendment: Social Questions and Legal Challenges
- Indecency, the Media and the FCC

Total MCLE Credits .....3.5

Ethics MCLE Credits .....0.0

### 2005 EASL Annual Meeting

DVD Album (PN: F615) (includes one coursebook)

\$130 NYSBA members

\$190 non-members

Videocassette Album (PN: 3615)

(includes one coursebook)

\$130 NYSBA members

\$190 non-members

### 2006 EASL Annual Meeting

An experienced, engaging and highly qualified faculty examines the legal issues arising with the increasingly popular and widespread activities of videogaming and cybergambling in today's society.

#### Program Contents

- Videogaming
- Online Gambling

Total MCLE Credits .....4.0

Ethics MCLE Credits .....0.0

### 2006 EASL Annual Meeting

DVD Album (PN: F669) (includes one coursebook)

\$130 NYSBA members

\$190 non-members

Videocassette Album (PN: 3669)

(includes one coursebook)

\$130 NYSBA members

\$190 non-members

Call our toll-free number to purchase:  
**1-800-582-2452**



New York State Bar Association  
CL2683



# Music, Rootkits and Copy Protection Don't Mix Well for Consumers

## *An Overview of the Sony BMG Lawsuits and the Proposed Settlement*

By Stacey L. Lager

Since the advent of the Internet, the music industry has been working overtime to protect its copyright interests from piracy. The Digital Millennium Copyright Act of 1998<sup>1</sup> provided necessary guidelines for anti-piracy measures. Those guidelines were a welcome relief for the entertainment and software industries. Moving more recently into the digital landscape, entertainment and software companies are now finding that protecting their copyright interests is becoming an increasingly more complex task. It is becoming more difficult to balance the need to protect their products with pleasing the consumers who buy them. No company at this time understands the difficulty of achieving this balance more than Sony BMG.

Sony BMG started using protection software as early as August 2003 by including MediaMax, a content protection software program, on some of its CDs.<sup>2</sup> By January 2005, Sony BMG introduced an advanced software package called Extended Copy Protection ("XCP"). XCP was developed by a British company, First 4 Internet, to be used as copy protection or digital rights management scheme for CDs on upcoming Sony BMG releases.<sup>3</sup> CDs that have either software program encoded can only be played and copied on a computer that has the corresponding software. In addition, the music on the CDs can only be compressed into files and formats that can be read by Sony Digital Music Players or Microsoft operating players and cannot be compressed and converted to mp3 files or similar compressed formats. Therefore, a consumer who purchased Neil Diamond's recent release entitled *12 Songs* can only play the CD on her computer by first agreeing to the software program's license agreement and then loading it on to that user's computer. The consumer can listen to the *12 Songs* album on a computer or standard CD player and make up to three of copies of each song, but will not be able to listen to *12 Songs* on an iPod unless she re-purchases the album from iTunes. In late October 2005, Microsoft Windows expert and security researcher Mark Russinovich revealed that Sony BMG's copy protection system was using virus-like techniques, known as a "rootkit," to run its new encoded anti-piracy software.<sup>4</sup> The XCP software package employed a rootkit to hide the proprietary media player used to play tracks on fifty Sony BMG artist album releases sold throughout the U.S.<sup>5</sup> The process to remove the software is arduous, as it cannot be removed by the "Add/Remove" option on a user's computer (under a Microsoft operating system). In addition, XCP and

MediaMax are not listed as programs installed on the computer. Any attempt to uninstall the software manually will damage the user's computer.<sup>6</sup> Instead, the user must go online and download an uninstall program.<sup>7</sup>

By the time the news broke about Sony BMG's "rootkit" software, consumers had already begun to learn of the damage that had been caused to their computers. The inevitable filing of consumer lawsuits commenced. Overall, the plaintiffs allege that the End-User Licensing Agreements ("EULAs") are dissimilar to federal and state laws, in that the EULAs neglect to disclose certain relevant facts about XCP and MediaMax software, including the following about the programs:

- 1) they cannot be readily removed by the computer user;
- 2) they collect information about the computer user and his or her computer;
- 3) they exchange information between the user's computer and Sony BMG's computer servers;
- 4) they are only compatible with Sony's, BMG's and Microsoft's digital music file formats;
- 5) they are not compatible with iTunes or mp3 audio file formats;
- 6) they manage all XCP CDs or MediaMax CDs subsequently inserted in the computer; and
- 7) the information on the jewel cases of the Sony BMG CDs that contain the XCP and MediaMax software is not adequate information for consumers.<sup>8</sup>

The allegations in the complaints run the gamut of federal and state laws, and are based on any one of the following legal platforms addressing Sony BMG's conduct as unfair or deceptive trade practice, fraud, or false advertising:

- 1) The Computer Fraud and Abuse Act, 18 U.S.C. § 1030;
- 2) California Penal Code § 502 (which prohibits the unauthorized introduction of a "contaminant" into a computer that transmits informa-

tion about a computer to third parties without authorization);

- 3) California Business & Professions Code § 22947.3 (which prohibits deceptively taking control of a user's computer, modifying computer settings or preventing users from uninstalling software);
- 4) Consumer Legal Remedies Act, California Civil Code § 1770, a state consumer protection statute applicable to consumer transactions involving goods (this statute forbids, among other things, the imposition of unconscionable contractual terms on consumers, misrepresentations about a product and misleading advertising); and
- 5) New York General Business Law §§ 349 and 350 and the California Business & Professions Code §§ 17200 and 17500 (each only applicable in the appropriate state).<sup>9</sup>

In the sole lawsuit filed by a government authority, the Texas Attorney General relied on the Consumer Protection Against Computer Spyware Act, Texas Business & Commercial Code § 48.053, which prohibits manipulating software in order to prevent a computer user from detecting, locating and removing the software. The Texas statute also prohibits intentionally misrepresenting the installation of software as necessary for security or privacy reasons. § 48.055(1).<sup>10</sup>

A select number of lawsuits filed in federal court were consolidated in a Stipulation and Case Management Order ("CMO") by the United States District Court (S.D.N.Y.) on December 1, 2005, and assigned the CMO to two law firms to handle the consolidated lawsuit.<sup>11</sup> A Consolidated Amended Class Action Complaint (the "Complaint") was filed on December 28, 2005, on behalf of persons or entities in the U.S. who purchased, received, came into possession of, or otherwise used one or more MediaMax CDs and/or XCP CDs.<sup>12</sup> The Complaint alleges that Sony BMG engaged in unlawful, unfair and deceptive conduct in using and selling CDs with XCP and MediaMax software without properly explaining how the software operated and how it would affect a user's computer.<sup>13</sup>

Upon the Court's consolidation, Sony BMG and the co-lead counsel for the class action began negotiating a settlement. This proposed settlement offers consumers a number of options for rectifying the various problems that the software has caused. Sony BMG has been very receptive to the settlement negotiations by trying to provide quick solutions to consumers whose computers are now at risk for virus attacks.

The proposed settlement offer has been made on behalf of those consumers who obtained or used CDs with XCP and/or MediaMax from August 1, 2003, through the effective date of the settlement. The proposed settlement offers a broad range of compensations while remaining fair to Sony BMG. Its benefits provide for, among other things: compensation for buyers of XCP and MediaMax CDs (a CD exchange program or compensation via downloads or monetary payments of \$7.50); software utilities to update and uninstall XCP and MediaMax software from consumers' computers; an agreement by Sony BMG to immediately recall all of the XCP CDs and not manufacture MediaMax CDs for a period of at least two years; a series of injunctive measures governing any Sony BMG CD manufactured with content protection software over the next two years; Sony BMG's agreement not to collect personal information on Settlement Class Members through XCP, MediaMax and future content protection software, without their express and affirmative consent; Sony BMG's agreement to waive certain rights currently contained in the EULAs for XCP and MediaMax CDs and software; and a "most favored nations" provision that would enhance the benefits available to all Settlement Class Members if Sony BMG provides additional benefits to a subset of such class members through an agreement with any government authority.<sup>14</sup> These provisions have been devised and negotiated in order to appeal to all members of the Settlement Class.

U.S. District Judge Naomi Reice Buchwald tentatively approved the settlement on January 6, 2006.<sup>15</sup> Judge Buchwald then certified the class and set guidelines for the settlement process for the Settlement Class, including opting out, commenting, or attending the fairness hearings. The Court has set a Fairness Hearing of the Settlement Agreement to take place on May 22, 2006 at 9:15 a.m.<sup>16</sup> The Court will hear all interested parties at that time on whether (i) the requirements for certification of the Settlement Class have been met; (ii) the proposed settlement of the law suit in accordance with the terms set forth in the Settlement Agreement should be approved as fair, reasonable and adequate; (iii) the Judgment approving the settlement and dismissing the law suit on the merits and with prejudice against the Plaintiffs and Settlement Class Members should be entered.<sup>17</sup>

The deadline for any member of the Settlement Class to file claim forms is December 31, 2006.<sup>18</sup>

For Sony BMG, beginning the settlement process was immediate, as it was required to notify those affected by XCP and MediaMax by sending e-mails, posting a notice on its website, displaying a banner when an affected CD is used, and publishing advertisements in major newspapers and magazines.

This settlement is not only groundbreaking for the music business, but the entertainment industry as a whole. While Sony BMG's intention was to develop a fail-safe way to protect its copyright interests from digital piracy, it acted under the assumption that consumers would not be willing to cooperate. The settlement is fair, and it shows that consumers are willing to work with content providers seeking to protect both their copyright interests and to promote legal downloading. As long as consumers feel they are being treated fairly by a company struggling to find reasonable methods to protect against digital piracy, they should continue to purchase that company's products.

## Endnotes

1. The Digital Millennium Copyright Act of 1998, *available at* <http://www.copyright.gov/legislation/dmca.pdf>.
2. *In re Sony BMG CD Technologies Litigation*, No. 1:05-cv-09575-NRB, Motion and Memorandum of Law In Support of Plaintiff's Application for Preliminary Approval of Class Action Settlement, December 28, 2005 at 3 (hereinafter "Proposed Settlement").
3. Wikipedia, "Extended Copy Protection" at Wikipedia.com, *available at* [http://en.wikipedia.org/wiki/Extended\\_Copy\\_Protection](http://en.wikipedia.org/wiki/Extended_Copy_Protection).
4. BBC News, "Sony Sued Over Copy-protected CDs," November 10, 2005, *available at* <http://news.bbc.co.uk/1/hi/technology/4424254.stm>. A rootkit, for those not technologically savvy, is a set of software tools frequently used by a third party (usually an intruder) after gaining access to a computer system. These tools are intended to conceal running processes, files, or system data, which helps the intruder maintain access to a system without the user's knowledge (Wikipedia, "Rootkit" Wikipedia.com at <http://en.wikipedia.org/wiki/Rootkit>).
5. Wikipedia, "Rootkit" Wikipedia.com at <http://en.wikipedia.org/wiki/Rootkit>.
6. *Proposed Settlement*, p.3
7. Sony BMG Entertainment, "XCP Software Updates," *available at* <http://cp.sonybmg.com/xcp/> and <http://cp.sonybmg.com/xcp/english/updates.html>.
8. *Proposed Settlement*, at 4.
9. Von Lohmann, Fred, "Sony BMG's Copy Protection Quagmire," Law.com, December 19, 2005, *available at* <http://www.law.com/jsp/article.jsp?id=1134554712419>.
10. *Proposed Settlement*, at 6.
11. *Id.* at 7.
12. *Id.*
13. *Id.*
14. *Id.* at 9.
15. MSNBC.com, "Judge Tentatively OKs Sony BMG Settlement," January 6, 2005, *available at* <http://www.msnbc.msn.com/id/10741465>.
16. *In re Sony BMG CD Technologies Litigation*, No. 1:05-cv-09575-NRB, Hearing Order, January 6, 2006 at 3.
17. *Id.* at 3 and 4.
18. *Id.* at 8.

Stacey L. Lager is an associate at the entertainment law firm Serling Rooks & Ferrara, LLP. Prior to becoming a lawyer, Stacey spent five years in the music business working in marketing and artist development for Epic Records, Arista Records and Capitol Records. Working with a wide range of artists, from Beth Orton and Dido to Radiohead and Sade, Stacey was involved in the grassroots process of establishing artists, as well as working with veteran acts to maintain their achieved levels of success. She may be reached at [sll@srflp.com](mailto:sll@srflp.com).



## REQUEST FOR ARTICLES

**If you have written an article, or have an idea for one, please contact *Entertainment, Arts and Sports Law Journal* Editor:**

Elissa D. Hecker, Esq.  
90 Quail Close  
Irvington, NY 10533  
[heckeresq@yahoo.com](mailto:heckeresq@yahoo.com)

*Articles should be e-mailed or submitted on a 3½" floppy disk, preferably in Microsoft Word or WordPerfect, along with a printed original and biographical information.*



New York State Bar Association

# Entertainment, Arts and Sports Law Section Annual Meeting

Monday, January 23, 2006 • New York Marriott Marquis

**Section Chair**

**Elissa D. Hecker, Esq.**  
Law Office of Elissa D. Hecker  
Irvington

**Program Co-Chair**

**Peter V. Glass, Esq.**  
Anderson Kill & Olick  
New York City

**Program Co-Chair**

**Michele C. Cerullo, Esq.**  
Labaton Sucharow & Rudoff, LLP  
New York City

**Program Co-Chair**

**Kenneth A. Nick, Esq.**  
Guggenheim Partners  
New York City

## Videogaming and Cybergambling: Legal Issues Impacting the Videogaming and Online Gambling Industries

**Welcoming Remarks**

**Section Chair**

**Elissa D. Hecker, Esq.**  
Law Office of Elissa D. Hecker  
Irvington

**Program Introduction**

**Program Co-Chair**

**Michele C. Cerullo, Esq.**  
Labaton Sucharow & Rudoff, LLP  
New York City

**BMI/Phil Cowan Memorial Scholarship  
presented by:**

**Judith A. Bresler, Esq.**  
Cowan Debaets  
New York City

**Gary Roth, Esq.**  
BMI  
New York City

---

### Videogaming Panel

**Panelists:**

**Tom Salta**

Composer/Producer/Writer  
Norwalk, Connecticut

**David M. Ehrlich, Esq.**

Roberts & Ritholz LLP  
New York City

**Barry Rutcofsky, Esq.**

Executive Vice President  
Take-Two Interactive  
New York City

**Scott D. Brown, Esq.**

Skadden, Arps, Slate, Meagher & Flom LLP  
Boston, Massachusetts

**Lisa S. Rothblum, Esq.**

Atari, Inc. SVP, General Counsel 2000-2004, EVP, 2005  
New York City

### Gambling Panel

**Panelists:**

**Robert Penchina, Esq.**

Levine Sullivan Koch & Schultz, LLP  
New York City

**Bennett Liebman, Esq.**

Coordinator, Racing and Gaming Law Program  
Government Law Center  
Albany Law School

**Adam Snukal, Esq.**

Executive Vice President and General Counsel  
Spiral Solutions Ltd.  
Teaneck, New Jersey

**MS. ELISSA D. HECKER:** My name is Elissa Hecker, outgoing Chair of this Section. And before I start with my official remarks, Vince Buzard, the President of the Bar Association, would like to address everybody about some of his plans for the year. And Richard Raysman of the Bar Foundation is going to speak very briefly afterwards.

**MR. VINCE BUZARD:** Thanks very much. I'm not actually self-invited; I was invited. But you can thank the fact that Elissa runs such an efficient Executive Committee meeting. I was to have talked there, but I was hung up with the Membership, so now you're going to have to listen to me for a few minutes, but I very much appreciate the opportunity. And I want to thank Elissa for the great job she's done as Section Chair, be it the Handbook and pro bono efforts, and a whole bunch of other things.

So this is a very vibrant Section. And one of the great thrills for me as President of this, is to go around the sections and see what is going on. We have so many really terrific sections, and some of them are more unique, and this would be one of those because it's in New York and we are, of course, the capital of entertainment and sports.

But I do want to take the opportunity to tell you a few things, very briefly, about what we're up to this year. I have the fundamental belief that when people see the legal system and how it works and understand it, then some of the animosity and mystery and mystique is taken away, and public understanding of the legal system is critical to the functioning of the legal system. So I've started a number of programs this year with the idea of improving public understanding, announced them in Cooperstown, and I'm pleased to say that they're now, to some extent, a reality, one of which is The People's Law School. We had a number of people speak in areas that affect people in their daily lives, a number of able lawyers. We've taped it. We've updated the book on what you should know about New York law, so those tapes and audio, video, and CD, will be available in February to the people of the state to hear about what their legal rights are. I did one on taking some of the myths away from the legal system, to help people understand their rights and help them see that the law makes sense. And I found that when we do that, when we did it in Albany, we had publicity, and I believe that when we talk about it, when we announce the fact that it's available at a nominal cost to the people of the state, that people appreciate it. Even if they don't buy the tapes, they appreciate the fact that we're reaching out.

But it's an ongoing project as more and more areas can be added, and I think your areas would be very useful to have.

People don't have to buy the whole series. They can buy individual parts, so after this spring semester, I think we ought to talk about plugging you in as well because we also have involved you in another little project. I say "little"; this is very retail. You have to chip away. We can't spend the same amount of money that people do who attack the legal system, so it's very retail, but the more we do, the better it is. The Ask-the-Lawyer column, this is another project that I used when I was President of the Monroe County Bar, in which we asked the sections to submit typical kinds of questions and answers that people want to know about that affect them in their lives, and then distributed that to newspapers to see if they were interested. Well we now have fifteen newspapers and we're still growing around the state, some weekly, some dailies, who will run these Ask-the-Lawyer column, and then readers will write in and they'll be referred to the respective sections for answering. One of the things I also found, and you can also tie into this, is that some of the business journals want to also be involved, so we're going to run a special business series as well.

The public service announcement program that we've had for a long time, I changed somewhat this year. I did it myself. I should announce this to the Section actually. I taped them myself and identified myself as the President of the NYSBA for the radio. I've done a fair amount of radio and television. I even got paid during one period, which was particularly nice, in the early 1980s for going on the air and flapping my lips. I thought I was sort of stealing their money, but I taped these radio shows, radio PSAs, and people have commented favorably on them, trying to get cameras into Appellate Courts, which I think is important, because when people see what we do, they understand better. And also attempting to use issues of the day to not only defend the legal system, but to explain how it works. And that includes the *Kelo*<sup>1</sup> decision on eminent domain, which is very hot in some circles. We've gotten—we've gotten a great deal of coverage out of that. And also, we're doing something about the misunderstandings. The Katrina disaster which I asked people to contribute to, got national coverage.

And so that—those kinds of things are what I've been doing to do to try to improve public understanding and defend the legal system. And the lawyers are all in it, and I thank you for what you're doing. The backbone of our work at the Bar is the sections, and you certainly are a terrific Section. Thank you very much for letting me impose on your time. I assume they won't deduct this from your credit.

**MS. HECKER:** Thank you. Richard?

**MR. RICHARD RAYSMAN:** My name is Richard Raysman and I'm here as a representative of the New York Bar Foundation, and we're a rather formal group, and I forgot that I was with the Entertainment, Arts & Sports Law Section. I didn't have my downtown look when I came in here.

But I wanted to tell you a little bit about the New York Bar Foundation. This is not exactly a solicitation, but it's sort of a prelude so that when you get your solicitation, you'll know what it's all about. It's a charitable arm of the New York State Bar Association. And it is a rather high-level group. There are something like nine former Bar Association presidents who are on the Board of the New York Bar Foundation.

Last year, the Bar Foundation gave out grants of over \$500,000. By the way, there's a little booklet in the seventh-floor lobby if you want to see what they've done, which is about two-thirds of the money that they collected. I think that's—if you think of any charitable foundation, that's quite significant.

The president of the Bar Foundation is Bob Haig, who a lot of you do know. He's been very active in the Bar over the years, and he's taken over the presidency and he really wants to do something with the Bar Foundation. And I think I'm going to give you some examples of some of the grants that the Foundation gives out. But I think that we, as lawyers, have been—the law's been good to me and I think it's been good to most of us, and so this is a way for us to get involved and help those people who can benefit by our contributions and our knowledge. And the Bar Foundation is somewhat in competition with all kinds of charitable donations, so people give to their religious organizations or medical organizations and so on which they might feel maybe more strongly about. I'm here to preach that the Bar Foundation, we should also feel strongly about.

The Bar Foundation itself supports law-related programs throughout New York State, not just New York City. This is the State Bar Foundation, both charitable and educational. It gives grants to legal organizations, legal services organizations, non-profit agencies, bar associations, and other associations. It gives grants in four related areas, which is delivery of legal services, improving the justice system, enhancing professional competence and ethics, and increasing the public's understanding of the law. And I just wanted to give you some examples of grants that were given out over the last year. One was to an organization called "Unity House" in Troy, which was a grant to help victims of domestic violence in Rensselaer County. Another was to an organization called "My Sister's Place" in White Plains, which is for the legal assistance and relief for immigrant victims of abuse. Those are both documented and undocumented immigrants. It gave a grant to the Workers' Rights Law Center in Kingston, which is a—

was an educational grant, "Know Your Rights for Workers" in the Hudson Valley. There were 64 stand-alone workshops reaching 1,176 low-wage workers.

It gave a grant to the New York State Commission on Quality of Care for the Mentally Disabled. That was in Albany. It created a new video transitioning for the disabled to transition from school to adult living for persons with disabilities. And this particular video was shown on public cable TV by at least 60 stations. So those are just some examples of grants and it's given many, many grants around the state. It does receive funding from a dues check-off and from the people who are part of the Fellows.

And so what I'm suggesting is that next time you get your renewal for the Bar Association, there is a check-off part of that where you can actually contribute a little bit more to this organization, and you might want to consider contributing to the Bar Foundation for the good work that it does for us lawyers throughout the state. And I thank you for allowing me to present, and nice to have seen all of you. So long.

**MS. HECKER:** Thank you. All right. Welcome again. This is now the end of my two-year term and it's been a privilege and an honor to serve as your Chair. I am extraordinarily proud of the accomplishments of this Section, and particularly the Executive Committee. We have provided a sample list of our CLE programs that were held in 2005. I believe it's with the membership materials out front and should be included in your program materials as well. This is literally just a sampling of the tremendous programs that have been going on. And as you can see from what's happened in the past year, you can just anticipate what's going to happen this coming year.

The Committee Chairs have been working very, very hard, and all successes of the Section are really due to the Executive Committee working together as a phenomenal team, to Committee members and to Section members. I want to just do a shout-out to Juli Turner in Albany, for she's our wonder woman and we couldn't do anything without her.

One thing I'd like to do very quickly—is tell you that all of the Executive Committee members have yellow Ambassador ribbons. If you could all stand up for a moment. If anyone has any questions about our Section, about joining, about membership—about anything that has to do with it, find someone with a yellow Ambassador ribbon at any time during the cocktail party or when we mill about during our break. These are the people who can help you out. And overall, I really want to thank you for a great, worthwhile ride.

Now I want to put on my Editor's hat and congratulate the 2005 Law Student Initiative winners. As you probably know, the Law Student Initiative is a writing



contest for law students who are EASL members, and for more information about the contest, because I know we want to start the program, you can always check the *Journal* or our website, at [www.nysba.org/EASL](http://www.nysba.org/EASL). And for 2005, we had Brian Danitz of Fordham Law School, and he wrote "*Matignon and Kiss Catalog, Can Live Performances Be Protected?*" And Julie Chelico of St. John's University School of Law for "*The Use of Intellectual Property Protection in the Jewelry Industry.*" We have many more coming out with each *Journal*, and I look forward to reading many, many more good student articles.

Putting back on the hat of the Chair, it's now my great pleasure to announce the slate of 2006 to 2008 Officers as unanimously approved by the Nominating Committee. Your Chair-to-be, provided you vote with enough "yeas," is Alan Barson; Vice-Chair would be Ken Swezey; Treasurer, Steve Richman; Secretary, Judith Prowda; and Assistant Secretary, Michele Cerullo. The information is in your packet. There are also our District Representatives and the Officers to the House. And what I'd like to do now is take a vote. All those in favor of electing the 2006 to 2008 slate as presented, please raise your hand and say yea. [ALL SAY YEA]. All opposed. [NO AUDIBLE RESPONSE]. Congratulations to the incoming Officers. You've all made a wonderful choice.

I will shortly turn over the lectern to Judith Bresler, Chair of the Phil Cowan Memorial/BMI Scholarship, and Gary Roth of BMI, but first, I want to say, I know you'll enjoy today's program. I very much look forward to seeing you at this evening's cocktail reception, which has been sponsored by XM Satellite Radio.

I've also been asked to promote once more *Entertainment Law, Third Edition*,<sup>2</sup> which you can get at a great discount price and free shipping if you choose not to pick it up today. And again, it's really been my pleasure. This has been an amazing two years and I want to thank you all for making that happen. So Judith and Gary, if you'd like to come up and present our Scholarship award.

**MS. JUDITH BRESLER:** Thank you, Elissa. This is the second year of the Phil Cowan Memorial/BMI Scholarship contest. It is a writing contest, originally created in honor of one of the founding members of our Section, Phil Cowan. And we are delighted today to award this to Jerome Glasser. Jerry, are you here? Please come up. Jerry wrote a phenomenal paper which will be published in the *Entertainment, Arts and Sports Law Journal*. And it is about Intellectual Property products that are all parodies. It's called "Trouble in Parodyse."

Wait until you read it. It is an incredibly sophisticated work. I should also say that Jerry has a very interesting background. He's an inventor, has a number of patents pending, created a game, which has a patent, using parodistic images of well-known movie stars, and spent a lot of time in China before going to law school looking at different factories and finding factories that

were creating products that were unauthorized. And also speaks a number of languages, including a fluency in Mandarin Chinese. Anyway, it is our pleasure and privilege to award this scholarship to Jerry Glasser.

**MS. HECKER:** Thank you all, and congratulations Jerry. Michele?

**MS. MICHELE CERULLO:** I am probably the fifth person to welcome you, so welcome here. I'm going to introduce our program. I am the Program Committee's Co-Chair, along with my Co-Chair, Peter Glass, who would like to welcome you.

Today, our program is about online gambling and videogaming. And the reason why we picked these two topics is because, one, they're timely, and, two, they kind of cross over all areas of the law, meaning attractive to our litigators, our transactional attorneys, and our regulators. So hopefully it'll spark an interest in all of you.

We have eight great panelists here today, some businessmen and women, transactional attorneys, litigators, and even a creative person, not to say that lawyers aren't creative.

Also, remember there's a cocktail party at the end of the program. XM is our sponsor, and it's also providing us with a friends-and-family package for those of us that are EASL members. Members of this Section will get a friends-and-family special, and look in your e-mail for that.

So welcome, enjoy, and I turn it over to videogaming.

**MR. PETER GLASS:** Good afternoon, again. My name is Peter Glass, and it is my pleasure to finally introduce our first panel, "Legal Issues Impacting the Videogaming Industry." I'd like to just briefly introduce our panelists. First, we have Tom Salta. Tom writes and produces music for film, video, television, and videogame soundtracks. His game score credits include the original soundtracks for Tom Clancey's "Ghost Recon Advanced War Fighter," "Cold Fear," and "Need For Speed Underground 2." He also records under the name "Atlas Plug." Tracks from his debut solo album, "Two Days or Die," released on his independent label, Persist Records, had been licensed for numerous television shows, commercials, movie promos and videogames, including "Project Gotham Racing 3" and "MLB 2006."

Next, we have Barry Rutcofsky. Barry's an Executive Vice President of Take-Two Interactive Software, Inc., overseeing mergers and acquisitions and strategic relationships of the company. Prior to joining Take-Two, Mr. Rutcofsky was a partner in the Corp Department at the law firm of Tenzer Greenblatt LLP, now known as Blank Rome LLP. Mr. Rutcofsky received his law degree from Hofstra University in 1983.

Next, we have Lisa Rothblum. Lisa's held General Counsel positions at Atari, the computer game company, as well as at Polygram Records, providing hands-on familiarity with the customs, challenges, and issues facing the entertainment industry. Prior to joining Polygram and then Atari, Lisa was a litigator at Greenbaum, Wolfe & Ernst, a well-known literary property firm which unfortunately split up, and was a staff attorney in the New York office for the SEC's branch of enforcement.

Next, we have Scott Brown. Scott is an attorney with the Intellectual Property and Technology Group at Skadden, Arps. He worked out of Skadden's New York offices until 2004 when he relocated to Boston to establish and help his firm grow its Intellectual Property practice there. Scott's practice includes work on a wide variety of Intellectual Property matters, including drafting and negotiating license agreements, as well as litigating disputes.

Finally, we have David Ehrlich. David is Of Counsel to the New York entertainment law firm of Roberts & Ritholz, LLP. He's also a Principal in DME Management, a personal management company that represents artists and producers. David counsels clients in the fields of music, interactive entertainment, videogames, film, TV, and theater.

So without further ado, I'm going to turn it over to the panel, and I'll throw out the first question: How does the videogame industry compare to the movie, music, and television industries?

**MS. LISA ROTHBLUM:** I think that with every entertainment or IP-based company, you always deal with issues relating to the creation of new medium using sometimes all the existing elements, as well as creating from scratch those elements.

Therefore, what always comes up in each of the entertainment companies, I believe, is trademark issues, copyright, any kind of warranties or representations from licensors of these products, that there are no third parties making claims. And basically, all of the proprietary rights that are attendant to making yet another IP asset.

**MR. DAVID EHRLICH:** I think from an acquisition standpoint, there is interest in similarities and differences among the industries. In the music industry, the barrier



**Videogaming Panel: (l-r) Scott D. Brown, Lisa Rothblum, Tom Salta, Barry Rutcofsky and David M. Ehrlich**

entry is fairly low. Sometimes it's not, but often-times, you can acquire rights on fairly low economic terms. With film, it's a little bit all over the board. But generally, the acquisition of rights is higher, and then when you get into videogaming, there's a lot of investment required. So in order to acquire rights and actually develop those rights, it's probably equivalent, or even more expensive in certain instances, than the film industry.

**MR. BARRY RUTCOSKY:** I think that's right. What we're seeing is, over the last couple of years, as videogames become more popular and a more robust form of entertainment, the licensing process has become more akin to what we see in the movie business, both in terms of licensing fees and types of controls that the Intellectual Property owners are trying to exert over the creators of the medium.

**MS. ROTHBLUM:** I think in the specific industry of videogames, the number of elements goes to the increased cost, obviously, as David mentioned, but also goes to the difficulty of time-negotiating and acquiring all of the rights you need as a publisher of videogames. There's a lot of contractual work and a lot of issues as far as who gives what rights to whom.

**MR. SCOTT BROWN:** I think it may be helpful at this point to stop for a moment and talk about the constituent parts of videogames. I'm sure—we don't mean to talk down to anyone in the group, but just to set the table a little bit, I think it might be helpful to go through. And we conveniently have documented them. So the general elements of a videogame: You've got characters, character development, storylines, graphics, branding and logos, and that can be both the branding and logos involved in the game itself, as well as the branding and logos of any third party you want to import. By way of example, if you want to market an NFL-labeled football game, you would need to go and talk to the NFL about garnering a license. Music and voice-overs. And I think bringing it back, bringing these elements back to what we were just talking about, I think certainly, there are very strong ties to the movie industry in respect to this.

And I think Tom, as a composer, can talk about where the videogame industry and the music industry overlap to a certain extent. But certainly, in videogaming, music is as much a constituent part and helps to shape the game experience as many of the other elements.

**MR. TOM SALTA:** Yes. I mean as far as music goes, just briefly, I'm on kind of two sides of it. I'm on the artist side, where I license my music whether it be to a game or a commercial or a movie trailer. And then on the other side, I'm also a composer who is hired to score original music specifically for a game. So those are the two ways that I deal with music pertaining to games.

**MR. RUTCOWSKY:** Tom and I, in preparation for this panel, had a little bit of a discussion, because he was concerned about how videogame companies tend to—when we're buying an original score, will buy it strictly for use in that medium, unlike movies or other media where Tom has sold his work where he will be able to retain the rights to exploit the score for other uses. We typically will try and lock it up as an exclusive use for our medium, and particularly because it's just easier to manage the Intellectual Property that way. Tom wasn't very happy with that answer.

**MR. BROWN:** I think this brings us conveniently to the next topic that we were hoping to cover today. And forgive us a little bit. This is going to ebb and flow as the discussion goes on. We're trying to set the framework and then get into additional detail. So in terms of what rights are needed for a videogame, we've just gone over the different constituent parts that make up the game. And taking it back a step, when you've got to actually function as a lawyer, either in-house or outside counsel to a videogame company, and you've got to consider what you need to see in a license agreement, what you need to see in a development agreement, what you're talking about really is sort of the big three, copyright, trademark, and patent, as well as, I think, the rights of publicity and privacy.

And the patent element, I think, is one of the unthought-of components, at least at first pass to someone who's not familiar to the industry because you can find yourself in a situation, thanks to the *State Street Bank* case years and years and years ago, where you've got a software patent on, by way of example, a gaming engine or even methodology. And it's not something people often consider, but certainly should be among the laundry list of things to be considered. And then the question is how does—how do you, either as an executive or in-house person or outside counsel, go about assisting your client or your company in getting those rights.

**MS. ROTHBLUM:** One thing I want to say about patents, I think that's a very good idea, very good thing to mention because no matter how great the in-house or outside lawyers are who represent videogame companies, as patents are very difficult. And just as in the music or other industries, you have rights holders and claimants saying that they have rights that you've infringed. I found that there are lots of would-be or purported patent owners, IBM being one of them, that will

write letters to videogame companies giving full lists of all of their patents. And to research them and make any kind of an analysis of whether or not it's a fishing expedition on their part or whether, indeed, a patent has been infringed or even is similar to the patent that they own, is a very, very difficult and frustrating adventure, to say the least. Have you had that experience?

**MR. RUTCOWSKY:** Oh, way too many times. One of the difficult things about the patent issue is typically, the business people and the legal people are uninvolved in the development process. You're really unaware of the potential issue that may come up and usually comes up only after the game has been released and you're in a very weak negotiating position. And it requires a technical analysis typically beyond the capability, certainly beyond my capability, of others in similar positions. I'm a lawyer by training. I have to go to one of our software developers and say, "Look at this patent. Is this a problem for us?" And more often than not, the answer is, "Yes, it is." And it may not be—there wasn't a copying issue, it's just the result is the one that's protected by the patent and now you're in a position where you have to negotiate with a patent holder, and, again, from a position of weakness, because the evidence is fixed and right in front of you, making guys like Scott very happy.

**MR. EHRLICH:** It was interesting in the prior slide that you talked about the elements that you have to acquire. One of the things that was missing from that list that's important is the source code to develop the game. So in addition to the musical elements and graphics and all the other things that you need that you actually see, there's obviously an underlying source code that powers the game, and that typically is the element that the videogame publisher is acquiring from the developer.

And then a lot of companies work differently, but generally after the source code and the concept are acquired from the development company, then the two—generally, the videogame publisher will go in and be very active in acquiring a lot of those other rights.

**MS. ROTHBLUM:** And I think also whereas the music industry and the creation of an album may involve one artist and several producers to produce each track and maybe other songwriters and publishing rights to use other composers' music for the particular artist's song, there aren't that many participants in the negotiation and creation of the finished product. Whereas here, simply because the developer of the source code may have the overall idea and be the key person in a negotiation, the fact is that all of the other elements of a videogame are often licensed from other third parties, so the number of agreements can very often equal thirty or forty just for one game. And that means the more negotiations, the more legal issues, and the different leverage with each third party, and the entity in licensing sets rights.



**MR. BROWN:** And I think all this raises a care-and-feed-ing issue of what we've been discussing here, which is the team of artists and programmers and other folks that are driving the creative vision and the implementation of the game. And it's exceedingly difficult to get any truly creative person to sit down in the same room with a lawyer, let alone to actually listen to what the lawyer has to say. They come with certain preconceived notions about how lawyers always say no, even though they're right more often than not. It's always, in my experience at least, beneficial to counsel these people that, no matter what their personal opinions are, they ought to involve counsel early so as to avoid Barry's situation where you get—I mean the IBM situation, I think, may not be navigable. You may not be able to navigate around that, but certainly, there are other issues that may arise that by getting counsel involved early, can be addressed and will not later become a problem.

And one of those is actually something that Tom and Lisa were discussing earlier today in respect to movie rights. Maybe this is a good time for you to bring that up, Tom.

**MR. SALTA:** Which—

**MR. BROWN:** The clearance right in respect of what remains with the artist as compared to what flows to the contracting party.

**MR. SALTA:** Oh, I see, okay. I think one little point here that I wanted to point out, and I will quickly leave this to the lawyers to clarify, but when—pertaining to original underscore in a game, if I am or anyone else is hired to create original underscore and they're credited as such, there is inherently that writer's share in there, if there were ancillary use of it. I'm not saying there would be, but if there were to be down the line, technically speaking, that writer should be able to be paid if it were to be used in some movie trailer. And I think a lot of composers don't even understand this. And this—I think it's worth a discussion just to make sure that the wording is in the contract even though it can be argued even if it isn't in the contract, unless the writer deliberately says, "Okay, I'm giving up my writer share and I'm not the writer anymore." I believe legally in the United States, we're always entitled to a further royalty.

And it—I guess it's just a matter of setting that precedent, getting that paragraph or that wording in there. I would pass that on to anyone else to clarify what that—what I'm describing in legalese, but I think that's just the point we were talking about, right?

**MR. BROWN:** Yeah. I think to bring it back to the tune of what we were talking about and to bring it back to the specific topic here, the ancillary use point is really where you want to have counsel have accessibility to the cre-

ative team, because if they conceive of an ancillary use, let's say—I know that Tom is fortunate enough to have had his work actually used in a television commercial. So bridging the gap between creating a score for a videogame and then having that score actually end up in a television commercial, if the creative team or the implementation team weren't to have perhaps involved counsel and said, "Hey, we're going to go ahead and engage in this ancillary right, is there anything we need to make sure we have on paper from the legal perspective?" Then they might find themselves in a situation where they've gone ahead and exploited a right without the underlying ability to do so.

**MR. RUTCOSKY:** And that's really an excellent point in terms of how videogames actually get into the public's hands. There is a multi-part process, but the obvious dividing line is developers and publishers. And typically, developers, or what we call software programmers, tend to be a little less commercially sophisticated, certainly less litigation sophisticated. A publisher, which is what Take-Two Interactive is, tends to have more of a robust organization to support those kinds of functions. And when you're negotiating the contract, you allocate the responsibility for the content within the game.



**Tom Salta and Barry Rutcofsky**

Developers are typically responsible for the programming issues, and then as you start migrating away from that core competency towards the things that Lisa was talking about, music, likenesses, voice-over, all those kinds of things, the dividing nature becomes a little less obvious and the publisher may assume a greater role, but it should be specified in the agreement who is going to be responsible for these, what I'd call ancillary elements to the videogame.

**MS. ROTHBLUM:** When I first got to Atari in September 2000, I was struck by how, and I don't say this figuratively, innocent or amateur, or immature, the industry was, as compared to other entertainment companies.

Again, I have to compare it to music because that was my prior experience. But in any music company, you have a huge and somewhat powerful Business Affairs Department that interacts with the A&R Department, and then a whole separate Legal Affairs Department that drafts and negotiates, administers, and implements, and opines on all of the different contracts.

I was shocked to see that in the videogame industry where frankly the stars, just like the artists in music, were the developers, very often were very, very young kids. They worked out of their basements. They worked alone on their computers. They didn't have managers. They didn't have artists. They didn't need tour support. They didn't have all of these intellectual advisers behind them to tell them what to do. And they would negotiate with their good friends, the producers at the videogame companies. And while they might have been able to speak the same language, they often did so without communicating it to anybody else.

So they worked on their deal. The developers started doing the work. Everything was understood as between them. And then the lawyers, once they got involved, however few there were at the videogame company, tried to come in and resurrect or explain or even sometimes change the deal, which doesn't always work. And I don't think that was a product of disrespect or any nefarious sort of methodology within the industry. But I think it just shows the evolution of an industry from almost a cottage, shorthand, technologically savvy but intellectually immature or inexperienced group, to what is really now big business in a real and exceedingly successful entertainment form.

**MR. BROWN:** So let's talk about how the sausage is made. What specifically happens? Tom? Barry? David? When you're behind the scenes, someone somewhere has an idea and says, "Hey, wouldn't it be great to create a game where you could navigate your way through the underside of a city?" What is exactly the process from sort of cradle to implementation?

**MR. RUTCOFSKY:** Well that—that would be the subject of an eighteen-hour panel. But if you condense it down to its most basic elements, as obviously, the conception of an idea and just as an aside, obviously—I shouldn't say obviously, because of the position I'm in, people come up to me all the time, "I've got a great idea for a videogame." And I remind them, "Well, ideas aren't protectable, so you really want to keep it to yourself and maybe develop it a little further."

If you think of videogames as pieces of entertainment that will ultimately be an experience for a user of twenty to fifty hours, an idea is obviously just a start. And the first process is a design document which will lay out the multiple different levels that will be contained in the videogame. And this will be probably a fifty-page document, which will have maybe some artist representations, illustrations of what the look and the feel of the game might eventually look like.

Once that design document has been set, the developer will try and get a publisher to fund the development of the game, and the development of the game now for this current generation of platforms, namely, the

XBox 360 and Play Station 3, is a process that's going to be anywhere from eighteen months to three years. And our expectation is for a triple-A game with budgets approaching \$20,000,000.

So it's now become a completely different medium than it was even when I joined Take-Two five years ago where games cost \$3,000,000 to develop and took a year. So you have a much more sophisticated process.

Anyway, so there's a development team that's built. It's anywhere now between—starts out ten, twelve people who work on the basic source code and engine for a game, which it controls, the most basic elements to physics, the things that you tend to ignore in reality, but are the absolute, the baseline for a software game. Once that's up and running, the artists come into play. You start illustrating the game. And the process becomes more complicated and more highly orchestrated as you try and build something that's going to be captivating over a two-year process. It's software development with trying to have the element of a movie—the storyline, and music elements. It becomes a very complicated process.

Two years later, usually twenty percent late and twenty percent over budget, a game is ready. Before the game is released, three or four months, you start marketing it. A year before it's released, you'll start doing PR for it to try and start building some buzz. Three months before it's released, you start selling it to your customers either through trade advertisements—and we have a sales force that's going out to the top 20 retailers, and then on a magic day, it actually gets released into the public's hands.

For a console game, Sony and Microsoft and Nintendo are all in it; they've been part of the process. For a PC game, you're really on your own because there's no manufacturing gatekeeper. Is that enough information? Too much information?

**MS. ROTHBLUM:** Parallel to the creation behind the scenes of the true game are the myriad searches lawyers have to go through with the title of the game. There's trademark research. It might only take three seconds or ten seconds to do a quick search, but the titles of the games that are submitted very often go to maybe a hundred titles. You have to search and make sure that by viewing it sometimes, each of the buildings or locations that might be rendered or used as illustrations do not have their own separate copyright rights.

Same thing with any kind of inadvertent, not-planned-for product placement. If you have a Poland Spring bottle, you had better make sure that somebody realizes it's there and were the proper rights acquired.

So it really is sort of a catch-up sometimes, with hopefully the lawyers knowing what's in the game at a decent time so that they can make a decision of whether

or not it can stay there or might have to be altered or removed.

**MR. RUTCOSKY:** Just one point, talking back to the original question, how are movies and videogames alike? One of the ways they are different, and that's really the television versus movies, is in television. In videogames, you have a problem because you have a fixed medium, and once your product's out there, you can't really get it back. Unlike television, where if you get an offending use, you can just stop running it. Movies, I guess, is a similar problem. Once it's out there, you really can't do it, but you can always alter—it's a little easier to alter the final cut if you have something that's that egregious. But we found with videogames, if something's out there in a videogame and you want to reprogram it, that's a problem, and if you want to try and pull it back from the shelves, that has the obvious issue of—that's normally associated with a recall.

It's a little greater jeopardy with videogames in terms of clearances than there are in some other medium.

**MR. BROWN:** And how deep is the file cabinet on a game? How much paper is there and with whom?

**MR. RUTCOSKY:** It depends on which games you're talking about. We typically—if a game like "Midnight Club," which is a racing game, where previously what we had done, we had used unlicensed vehicles, vehicles that we created, so you always had to check each vehicle to make sure it didn't appropriate anybody's Intellectual Property in an inappropriate manner. That game is a little more simple. You have your music file and we have a clearance file vetting each of the individual designs in the game.

Now we went for the latest iteration, we used licensed vehicles. The file cabinets really filled up on that, because you have to go—I think we ended up with fifteen car manufacturers, and then the way the game is constructed, you can build your own custom car, so you have to then license each individual after-market product. So it became a remarkable exercise in—I think Lisa had alluded to this before, in just coordination, just making sure you had everything done before the game is out, because once the game is out, the negotiating leverage shifts dramatically. You can use it as a marketing opportunity for a licensor. "Look, you're going to be in my game. I'm going to sell two million copies, isn't that great?" "Yes, that sounds like a good idea." Once it's out, they come to you and say, "You misappropriated my Intellectual Property. Please pay me lots of money." And it's hard to say no.

**MR. BROWN:** That brings us to the next issue, which is what do you do if you can't acquire the rights?

**MS. ROTHBLUM:** Wait, can I just go back to one of the points that Barry made? I think an additional reason why the jeopardy is so great and the costs are so large, if, by chance, there are some rights that would otherwise require the videogame publisher to pull a product is unlike movies, although there is now more convergence between DVD and theatrical release. But still and all, unlike movies and some other products where the life and lifespan of the product is longer and has perhaps different permutations. The videogame industry is a business, is much more hit-driven, and it seems not to have as long a shelf life these days so far as some other entertainment products.

So even though retailers are now, it's been said, doing their initial reorder in smaller amounts and waiting to see what the consumers do and reorder again, it's not as if the reordering will go on for so long that a videogame company that has to change a product will really have that much of a window or be able to afford to do it within the amount of time that the consumer is clambering for the product.

**MR. EHRLICH:** The interesting characteristic that's developing in the business is that there is a demand for greater realism which creates the demand for more process, more paperwork, more clearances, and more difficulty in designing the games, and it also increases the cost factor for the developer, for the publisher, and then also increases the risk factor.

So even though it's a more mature business than it was say five years ago, it's still actually a very immature business, the videogame business, and it still remains to be seen how it's going to develop. As videogames become more realistic, they become more similar to movies, but the creation process is very different in how all those factors are going to combine.

**MR. BROWN:** And I think the fair answer to the question of what happens if certain rights can't be acquired and you're aware of it at a moment in time when you can do something about it, is that it increases the twenty percent over budget and twenty percent longer time, that Barry was discussing earlier. And we're going to get into, in a moment, some of the particular issues that present themselves in terms of rights, clearance, and other usage rights.



**David M. Ehrlich**



Before we get there, there is a case that I had thought, forgive me, was in the materials. I didn't see it when I passed you earlier, which is the *Gridiron.com v. National Football League Players Ass'n Inc.*, case that is a special circumstance, I think, which is unique to sports leagues. And by the way, if anyone would care for a copy of the PowerPoint presentation or any of the cases we're talking about here, feel free to contact anyone on the panel. For ease of reference, my e-mail is sbrown@skadden.com. I'm happy to share this stuff with you.

In any event, the *Gridiron* case stands for the proposition. Basically, it was a settlement of a lawsuit, but it raised the issue of—Gridiron went out and got a license to use the names and likenesses of a handful of NFL players and it got into a bit of a scuffle with the NFL Players Association which said, "No, you can't actually use those individuals' names and likenesses because they have contracted the right—their right to use their names and likenesses in connection with a videogame to us, and therefore, if you want to create a game using," I don't know—I'm at a loss for—"if you want—if you want to use Phil Simms' son's image in connection with a quarterback in an NFL football game, you've got to come to us. You can't go directly to Mr. Simms." And that, I think, obviously in the sports business per se, and, in particular, if you're involved in the NFL Players Association, you may be aware of this, but in the broader spectrum, people may not be aware when they interact with the sports leagues. And I can't off the top of my head think of other instances, but I'm sure there are some in which even though you approach an individual for rights, you may find out later that that individual has, in fact, given the representation right to a third party.

And with that in mind, we turn to our first interesting issue of the day, I think—of particular significance—which is how this would appear at first pass to be a no-brainer, but has been the subject of significant debate and there have been some reported cases on the subject, the use of landmarks and videogames. And further to David's point about how there's this drive to realism, what do you do if your gamers, your programmers, your storyboarders come to you and say, "We would like to create a videogame that constitutes people driving the streets of Manhattan, and we want to make it a photo-realistic game and, accordingly, we want to have Times Square replicated in the videogame exactly as it exists today." What happens then?

**MS. ROTHBLUM:** On every Times Square building, number one is the building. Number two, and there was a case about this, a billboard showing another ad that might compete with a real ad, or maybe you're going down past the boathouse in the Metropolitan Museum and Museum of Natural History, and each one of those has to be researched. And it wouldn't do well to simply

tell the developers, "Well, just change it a little bit so that we won't recognize it." That really isn't the answer.

**MR. RUTCOFSKY:** Well, two reasons; one is because there is a demand, perceived demand on the part of the game players that they do want photo-realism. And also as—going back to my discussion before about the gaming, how in the game development process, when you are trying to create an environment, it's not uncommon for the developers to send out a team and photograph the particular locations. And with the advent of digital technology, there's no longer a transaction cost between the image and how it appears in the videogame. It now can be an exact replica because you can transfer the medium from your camera, your movie camera to your computer, which then becomes the source for the artistic material in the game. So the issue is even greater. I was trying to get some free advice from Scott. He's going to give us the resolution of this.

**MR. BROWN:** Well I think there's—the first point is how is it being handled. And my understanding is that more and more companies in the business, more and more videogame companies are being forced to take a license to use landmarks or buildings and how they're being forced to do it creatively enough, and hats off to the lawyer who thought of this, is to the extent that there is a controlled environment where you can dictate terms like this, "In order to create a video or take photographs of my building that you can then covert to use in your videogame, you must sign a contract with me, the provisions of which specify that if you use my building in your videogame, you acknowledge all rights, title, and interest, and into the image contained representing the building, and you agree to pay me a royalty of X percent."

**MR. ROTHBLUM:** You haven't paid a royalty?

**MR. EHRLICH:** Not yet.

**MR. BROWN:** Well . . .

**MR. EHRLICH:** But it's early.

**MR. BROWN:** Exactly. And that's where I think the people in the business are moving. And the reason they're moving in that direction is because we've got at least two cases that are out there, two cases that I'm aware of at least, where building owners, sometimes trademark owners, have asserted a right to attempt to control use of the representation of their building in other context.

The first, and I think the more interesting of the two cases, is what is nominatively referred to as the "Spider Man case," which is the *Sherwood 48 Assoc. v. Sony Corp. of Am.*<sup>3</sup> case. And basically, the particulars of that case were that you've got the "Spider-Man" movie and Spider-Man's web is leaning through Times Square. And as one of my colleagues pointed out to me a few hours ago

this morning, is that number one, they created a new building, and so okay, how do you handle that. That wasn't really the issue in the case, although it's interesting to think through the issue. More importantly, even if you create a photo-realistic version of New York City, can you take a Pepsi billboard on the side of a building in Times Square, and because you have a product placement agreement with Coca-Cola, replace it with a Coke billboard. And that was exactly the issue that was litigated in the Spider Man case, because the advertisements that appear in the "Spider-Man" movie were placed on the side of the building without regard to what actually was there at the time in which they filmed the movie. And they did some computer-generated images and some realistic, real-life filming.

And what the District Court, Judge Owen, if I recall correctly, said was, "No, this is not an Intellectual Property infringement." And so that's given people who want to use likenesses and façades of buildings a little bit of an emboldening push. And the other big decision, that I'm aware of at least, in this area is the *New York Stock Exchange v. New York, New York Hotel, LLC*<sup>4</sup> case, and that was a case in which the New York Stock Exchange brought a lawsuit against the New York, New York Hotel and Casino. And for those of you who have never been there, it's a hotel in Las Vegas that has a New York theme and it's an amalgamation much in the same way that Barry's company has a game called "Civilization." And it's sort of an amalgamation of, I guess, what you'd say the high points of architecture and not that are thrown together in one little metropolis. And so the Stock Exchange took particular umbrage at the fact that the New York, New York Hotel and Casino had built a replica of the façade of the New York Stock Exchange which they asserted was the embodiment of all that is good in the world, and dared to put it next to the slot-machine floor of the casino.

And they took umbrage at the fact that this had been done and were greatly offended by it. And so they sued and it went all the way up to the—we—I—full disclosure, I represented the hotel in that lawsuit along with some of my colleagues, and we won summary judgment on a trademark infringement claim and a trademark delusion claim, went up to appeal to the Second Circuit. The Second Circuit affirmed in large part, but gave the Stock Exchange a little bit of hope for final judgment on the merits as follows: The Stock Exchange happened to have a registered trademark that was the equivalent of the façade of the Exchange. And so what the court said was, "Yes, it's a building, and yes, you might otherwise just have the right to go ahead and copy it and use it as you will, but because they've got a registered trademark

that matches the façade of the building, they may have a right to claim trademark dilution because you are effectively associating gambling with investing in the stock exchange."



Lisa Rothblum

So to bring it to a point, although there are strong arguments in favor of "It's the streets of New York, I ought to be able to replicate it and to drive my car down the streets or have my characters interact in front of the building," I would venture to guess that if you were to create a game in which someone was doing a drug deal in front of the New York Stock Exchange, they are going to come after you both guns blazing and say, "This is appalling and is infringing on our rights."

**MS. ROTHBLUM:** When I was at Polygram, even before, there was—any concern one way or the other of uses of buildings, there was a Kiss video. This is over ten years ago. And I remember getting a claim letter from the manager of the Woolworth Building claiming that there was an image of the Woolworth Building in the Kiss video that rendered it such that it looked too much like a phallic symbol and, therefore, was degrading to the building.

And the fact is there will be lawyers, there will be claims, and there will be time having to be spent. I hate to tell you, we did settle that case. I don't think we paid money, but sometimes cases like this can be handled by saying, "The Woolworth Building," "Courtesy of the Woolworth Building," or "This is not intended to operate as an endorsement or defamation." Any sorts of things that you could put on the packaging might assuage them, but it—it really is a headache and there are more areas of headaches that can come up, including trademark of buildings these days, copyrights.

**MR. EHRLICH:** What I think is interesting is that if you're counseling a videogame company on this issue, there's actually no case that has been, at least to my knowledge, that has been brought in the videogame context, which again speaks to the point of it being a fairly immature business. You will get a game like "True Crime, Streets of LA," where, if you look at the game, it's actually like going on Google to Earth and actually seeing all the different elements of the streets of LA. And, again, these are the type of things that how do you counsel a company like that into how they should develop the game early in the process to protect against potential claims when you're not really sure how those issues are going to come out?

**MR. RUTCOFSKY:** That's true. The most frequent advice we get is, "Well if it were a movie, you would do

this.” And the precedent for videogame exploitation is limited, and it really comes down in a large part just to—you’re often left with a commercial negotiation, litigation costs versus the potential settlement because you don’t have that grounded learning in a particular subject matter.

**MR. BROWN:** And we were internally, among the panel members, discussing this earlier. There are some instances in which, notwithstanding the perhaps uncertainty as to what the ultimate rights are and the litigation costs versus settling out, where gaming companies may, because much of the demographic—much of the target audience here—sort of likes the irreverence of certain games, they may actually be benefited by getting into a scrap with another party, for whatever it’s worth. And so that’s one consideration that lawyers don’t often think of, but might be relevant to representing or otherwise being involved with a situation like this.

And I think the next sort of ticking through the issues is—the next thing that presents itself when working in this medium, and it’s true of any medium really, is when you find yourself in a situation with regard to using artwork or images in the game itself. And this is, of course, just a recitation of the classic statutory fair-use factors in the Copyright Act, which is section 107 of the Copyright Act.

**MR. RUTCOFSKY:** Actually, it’s a little bit different with the building situation, because if you are doing a photo-realistic environment and you can get by with showing New York, but you happen to incorporate, let’s say, a piece of graffiti, the buildings may not be protected, but the graffiti is protected.

**MR. BROWN:** That’s actually an excellent point. And forgive me, I forgot the name of the case, but there was—long ago, there was a case involving a poster of a quilt that was a backdrop to the television show “Roc,”<sup>5</sup> and there was a copyright infringement action brought for literally the appearance of the poster hanging on the wall on the set of “Roc.” And the court found that was a copyright infringement.

**MR. RUTCOFSKY:** We have a painting in our office that is the result of a settlement because we had to settle up with a graffiti artist and did so by purchasing some art.

**MS. ROTHBLUM:** Just as Scott talks about how sometimes a brouhaha will increase the marketability or consumer reaction.

We had a marketing director at one time at Atari who thought it would be a good idea with one of our chase games if we had one day where we—this is true, where we promoted that whomever got the most speeding tickets in LA would get a game for free. And it took me more than thirty seconds to convince her that that might not really be a good thing for us to do. So . . .

**MR. BROWN:** Which actually raises the relating issues of many people’s notions of fair use, and compared to our realization of what it really is as attorneys is a little bit conflated. I mean there are certainly in respect to music, there is a culture of people that think and other media as well, very well-educated, reasonable people think that just because they have a CD or they received an e-mail, that they are free to do with whatever the contents of that work are as they see fit. And I’m sure Tom is seething over this sort of thing because I mean unless you have—no, I mean as a composer, I would expect to hear—perhaps not.

**MR. SALTA:** Well, I—again, I’m wearing kind of two different hats. I’m fully aware that once I create—if I’m hired to score or create music for a game, once I’m done, see you later. People e-mail me all the time, “Yo, yo, that’s so great. I love this music, man. How do I get it?” I’m like, “Call such-and-such,” or if they ask for us to release a soundtrack. So I do know that, for sure.

**MR. BROWN:** So another issue that arises, and I don’t think this is again unique to videogames, it certainly presents itself, is use of celebrity names and likenesses. And we briefly touched upon this in the case of sports leagues. You’ve got a certain cache to having a game with Tom Brady’s mug on the cover. And so the immediate question is, is permission required to use a celebrity’s name or likeness?

**MR. RUTCOFSKY:** This is where the fixed medium becomes a problem. We did a game based on MTV “Celebrity Death Match.” Do you remember that? It was Claymation figures, wrestling, and when they showed the TV show, they didn’t typically get clearances. It’s caricatures of celebrities. They typically didn’t get clearances from the celebrities, and they were doing some pretty offensive things. But if someone really objected, this is to your point, the author who received the scholarship today, they would protect it based on parody and they would typically agree not to show the episode. When we made our game, because of the fixed and repetitive nature of the medium, we had to go out and get these clearances. And part of the clearance is how much content approval do you give an artist. You really don’t want them impacting on the creative process, but it’s one of these sticking points of videogames that once it’s out there, you really can’t do anything about it.

**MR. BROWN:** And so, following the question, what if it’s only characterization? The “Celebrity Death Match” is a perfect example. One of the leading cases in this area is the Vanna White case,<sup>6</sup> which has been roundly criticized in the academic literature, at least, but the facts of the case are Samsung did a commercial for televisions, and what they were trying to advertise was that if televisions were of a particular quality, they would still be around in many, many years, and still have the picture



quality that they do today. So to illustrate this, among other things, they created a robotic version of Vanna White in the year 2050, turning letters on a “Wheel of Fortune”-like game show. Vanna White objected and said, “Forget it, you can’t do that. That’s my persona. That’s my likeness.” And the defense, on behalf of Samsung, was “Are you kidding? It’s a robot. It’s not Vanna White.” And actually, Vanna White prevailed and got that use enjoined.

So I think everyone can be sympathetic to Barry’s position in that even though as lawyers, our gut may be that how can Vanna White possibly prosecute a claim that characterizes her as a robot? Well, unfortunately, we’ve got a case out there that says she can. And it doesn’t help that it’s a characterization of a character instead of an individual. And you may argue that Vanna White is a character, but notwithstanding that.

This case, the George Wendt case,<sup>7</sup> basically Host International had hotel bars in which they had an animatronic figure of Cliff from “Cheers” waving and welcoming people to the bar for whatever happy-hour special they had, buy two beers, get one free. And George Wendt, who is Norm, if I’m correct, and Ratzenberger, I forgot his first name, John Ratzenberger, is Cliff. They sued the bar saying, “Look, you’ve got a mailman and a plus-sized individual standing there welcoming people to a bar. That’s us. No one who’s in their right mind is going to enter that bar and see those characterizations, is not going to think of us unless they’ve been in a cave for the last twenty years.”

And then the last question, which I think again, and forms Barry’s example, is what about the parodic intent? How do you—and as Barry points out, the gentleman who wrote the paper that was the topic of the award today, what happens if it’s a parody? And I think then you break through—if it’s a true parody, I think you break through into another level, and that level is all right, what are you doing to poke fun at the original. And this case, the *Cardtoon* case,<sup>8</sup> was a situation in which the Major League Baseball Players Association didn’t like the fact that Cardtoons was distributing cartoon-like, comical characterizations of baseball players. And the court ultimately found that those cards were sufficiently parodic in nature, that they were permissible. And Major League Baseball couldn’t stop them from the use that’s being made.

Other sort of famous tongue-and-cheek parodies, some of you may have seen “Muppet Treasure Island.” There’s a character on there called Spam, which is a wild boar that runs around and eventually becomes friends

with the Muppets. The folks who make Spam, Hormel, actually sued Jim Henson and said, “You can’t do that. That’s an infringement of our rights.” And he—Henson, through his media company, ultimately prevailed on the grounds that it was, in fact, a parody.

The next issue is, and I think this goes hand-in-glove, the use of statistics. And this is really truly the province of sports games, I think. I’m not on the ground enough here to know otherwise, but there are two cases that are out there. The first, although I apologize—a copy of the complaint that I have in the first case, the *C.B.C. Distributing* case,<sup>9</sup> is dated in 2004-2005, and yet news reports are that it was just filed. This is a situation in which there is a company that creates the software and provides information for the fantasy baseball, I think they do basketball and football, too, but in any event, sports leagues that are out there that you can get by means of the “USA Today” website and others. And the folks at Major League Baseball wrote them a letter in which it was very carefully worded, but the guys at C.B.C. Distributing thought it was enough to file a declaratory judgment action, which they did, of non-infringement of use of historical player statistics.

And if you’re Major League Baseball, I think you can see the rationale as to why you would want to try to control those rights, because it’s one of the byproducts of your League as you de-create statistics and you’d like to be able to get the revenues straight from those statistics. On the other hand, if you’re C.B.C. Distributing and you can see where—why it is that they would want the rights to create a fantasy league. And simultaneously, you can see why a videogaming company would want the right, whether or not it uses the moniker of the sports league to create a game based on the real-life statistics because it provides a model from which to allow people to game.

**MR. RUTCOFSKY:** This also highlights one of the most vexing issues that we face, which is as videogames develop, they become different ways to exploit the medium that were unanticipated when you initially draft the contract, unanticipated when you initially acquire Intellectual Property rights, and all of a sudden—I mean an example would be now typically, videogames are distributed in packages, right. We go and pick them up in the store. Sometime over the next two to five years, and that’s been the same two to five years since I started working in this industry five years ago, you’ll be able to acquire the game or the principal means of distribution will be over the Internet and how you monitor and monetize that relationship. Now, it’s covered by contracts, but when I first joined the company five years ago, typi-



Scott D. Brown

cally it wouldn't be covered, even though there's a significant difference in the economics if you're distributing through a packaged good or over the Internet.

So it's just one of the things that we always face as lawyers, which is what's going to happen five years from now? But it's particular in videogames where you're doing—particular entertainment where you're licensing other people's Intellectual Property.

**MR. BROWN:** And the *Gionfriddo* case,<sup>10</sup> which is on the screen, is a case that's in the materials, and that was a case in which someone sued Major League Baseball in State Court in California and won at the trial court level on an assertion of non-infringement of the use of statistics. So I mean it's certainly, and I don't know for sure, but I venture a guess that the team over at Major League Baseball is actively appealing that case and/or has settled out on terms favorable to them. But the reported decision is at least out there for reference.

Now the next issue is branding. We touched upon this earlier and I think maybe David can comment on some of the issues that arise in terms of trademark clearance. I mean if a client comes to you and says, "Hey, what do we need to do here to make sure that we have the rights to call Brand X Brand X?"

**MR. EHRLICH:** You're referring to if we—if there's a particular product that's placed in the actual games?

**MR. BROWN:** Both, the game itself. Let's say "Need For Speed" is a sort of a household title. "Grand Theft Auto" is another household title, if one of your clients were to come to you and say, "I'd like to call a game 'Grand Theft Auto.'"

**MS. ROTHBLUM:** Or the trade dress.

**MR. BROWN:** Or "I'd like to package it in blue and pink" or . . . If someone comes to Barry and says, "I've got this really great idea for a game. It's called 'Need For Speed,'" and you say, "Hm, I think somebody out there has a game that might be called 'Need For Speed.'"

**MR. EHRLICH:** Well I think what the process that would occur is twofold. One is obviously as early on in the process as possible, trying to do a search and making sure that some of the key elements that are going to appear in the game, including the title, obviously would be something that's available. And the other thing that you sort of have to be cognizant of is, as the development process occurs and as time goes on, some of the elements become more set and less changeable. And we were talking again about how the ability to change certain things in videogames, the difficulty of doing so because of the programming elements versus the way that music is created or a film product is created. If you have a song, for example, that's recorded that has a sam-

ple in it, it is not a difficult process before the song is released to probably remove the sample.

Of course, sometimes, and when I say sample, it's probably obvious to everybody, but it's prerecorded musical material that's embodied in an existing or a newly created musical work. Sometimes you can't release the new music work because the sample is very integral to the new song. But at least you have the ability to do so, whereas if you go down the line in a videogame, it becomes much more difficult because of programming issues. So you want to early on in the process, for those elements that need to be cleared, such as the title, obviously, but likenesses, products that might appear in the game. Those are things that you have to address early on or as early on as possible.

**MS. ROTHBLUM:** I think also, when you talk about the fixed image and the timing within which you should really do your search and make your decisions, you have a situation where, again, because videogames are hit-driven and you don't really know whether the consumer is going to react well or not and whether or not it's going to be a worldwide hit or maybe just a local one, a lot of times, you spend a lot of time, effort, and money, as you should, in searching, at least in the key territories, for the same trademark titles or logo rights to make sure that you don't have to change the name of the game that might end up being a franchise, but you really don't know at the time that you search it. Overseas are in key territories.

I don't know whether you know that Polygram Records had quite a good number of titles in the classical field, London, Deutsche Gramophone, and Phillips. And overseas, they used the name Decca as one of their classical labels, whereas MCA in America owned the Decca label in the U.S. for a different type of product. So you really want to try to avoid that, but sometimes in an effort to avoid it, you spend a lot of money and effort only to find out that it becomes kind of moot because maybe the game doesn't sell, or maybe even worse, Sony doesn't accept it, so it never gets released.

**MR. BROWN:** And a big point, and I'm sure many people know this, perhaps not all, a big point to keep in mind in respect to trademark clearance and use is that in the United States, trademark rights accrue from use that is not the rule predominantly in the rest of the world. In the remainder of the world, trademark rights typically accrue from registration. And so if you find yourself in a situation, and this is a bit of crystal ball work, but if you find yourselves in a situation where all signs are toward a particular title being a hit, it may be worth the time and effort to go ahead and register it in certain core countries. China comes to mind—major-market countries, Europe, China, Brazil, where you can prosecute a

mark for relatively comparatively low cost, the point of comparison being having to go out after the fact and fight to get the rights for yourself and/or to buy those rights from the third party that has basically pirated your mark.

**MS. ROTHBLUM:** You also can deal with palming off issues or allegations of them. Atari had a game called “Deer Hunter,” which is a very popular game, and some of you might know the name for the sort of target view that you have, the cross something.

**MR. SALTA:** Cross hairs.

**MS. ROTHBLUM:** And there was another company, that probably, in the videogame industry used a similar cross-hair rendition or rendering, which at first blush, could very easily make a consumer think they’re grabbing “Deer Hunter” and they aren’t. So you’re talking about the copyright, as well as the trade dress, as well as the name, as well as even the coloring of the package.

**MR. BROWN:** And color, believe it or not, is, I think, one of the emerging issues in trademark law. And there are some cases along the way, one of which protects pink dry-cleaning pads, if you can believe it. Another sort of example of the use of color is that trademark would be the blue color that Tiffany uses in connection with its boxes.

Another example of colors as arguably at least, if not protectable in Intellectual Property, is the color schemes that professional sports teams use. They feel very strongly that those are their inherent rights, and I think that they have a very strong argument in that regard, but certainly, there are detractors.

Another big issue is fair use of marks. And I think this is more—fairly put, this is more of a dilution, trademark dilution issue than it is an actual use of an issue because if—I would venture to guess, and I’m just sort of pulling this out of thin air so Barry can pull his pad out, but I think if you had Superman drinking a Coca-Cola before he went and saved a train full of people from a certain peril, that Coke would not take exception to that particular product use or placement, whereas if you had a protagonist in a shoot-em-up videogame drink a can of Coca-Cola before he or she went out and took out a village of whomever, let’s say small children for maximum shock value, I think Coke would be on the phone, if not in the courtroom, within thirty-five seconds.

**MR. RUTCOFSKY:** I think Coke would be on the phone in either case. Just one would be a much easier conversation. [Laughter]

**MR. BROWN:** So the technical rule pursuant to the Supreme Court’s recent and much valued decision in the *KP Permanent* case<sup>11</sup> is that basically, as you might anticipate, if you accurately depict the goods of issue, i.e., I mean whether in the virtual world you can ever accu-

rately depict anything or not I think is open to debate, but assuming you can, I can call a can of Coke a can of Coke. Certainly in a movie, I can do that. There are arguments to the contrary, but I think those are the four corners of the thing.

Now we sort of shift gears a little bit and talk about—we talked earlier about the sort of care and feeding of employees and the creative team in working from cradle to grave in the life cycle of a videogame, and now all right, how exactly do you deal with people who are contributing to the sum total of the game? And we’ve got, by way of representative examples, writers, composers, programmers, artists, and some of the issues that we see as arising in this context are work made for hire, licensing, mechanical royalties for music, and compensation issues.

We talked in general about these and I think they touched and they infect the rest of the conversation, but in particular with regard to how it is that videogames interact with these folks, and maybe, Tom, you can shed some light on some of your experiences as a composer and acknowledging your sort of function in many roles, but at least as a composer and how you’ve been approached and how the right to issues have been handled with respect to your compositions.

**MR. SALTA:** Okay. Again, to repeat just briefly, I’ve been approached in two different ways. One as an artist where a game company like Electronic Arts or Microsoft would approach not me, but my publisher with whom I have an agreement that represents my solo record. So me as Atlas Plug, whatever, gets approached and says, “We’d like to use this song, this song, and this song.” And they can use it just like any other commercial can use it, and it’s a straight license and that’s great. So that’s the easy part.

The other side is, again, being approached to create original content for a particular game. And in that case, basically, there’s usually a buyout and—there’s always a buyout actually, and I just create the music. It’s done. I get paid a one-time fee, and that’s the end of it. I think one thing I want to clarify, and many of my colleagues, composers, might not like what I’m about to say, but it’s the harsh reality of it, it’s the arguing or trying to push developers or publishers to convince them how important it is to exploit the music that we create for a game isn’t really worth all the effort because at the end of the day, I mean you’re not going to get that many, if any, uses of your underscore in anything, and it’s not really worth going through all that trouble. It’s not really important.

I make most of my money from licensing my music that’s already created, that no one owns but myself and my publisher, into a game or movie trailer. But I want to clarify that. There’s very little money.



And another main concern, which Barry pointed out, was that developers or public, game publishers don't want to concern themselves with policing this. And I fully agree, that's not their job. They're there to make and sell games, not worry about getting this music in a movie trailer. It's not their job. It would be interesting to point out that game companies like Electronic Arts recently formed a partnership with Cherry Lane, Cherry Hill, one of those Cherries. And basically, that's their responsibility to exploit the music in any way that Electronic Arts is comfortable with. So they deal with the policing, and that's not the developers' job or concern, nor do I think it should be. It's not really worth the effort. But it is interesting to point out the difference between those two things.

I mentioned something before the panel started where I had a unique situation with Microsoft and Volvo. Before I finished my record, my publisher was contacted by Microsoft to use three of the songs off my record in a game called "Rally Sport Challenge 2." Great, super. So they decided on a fee and that would be it and I'd still retain my rights to use it elsewhere. But then Volvo came along, made a deal with Microsoft to do a commercial, and some of you, I'm sure have seen this, an S40 commercial using actual graphics from the game "Rally Sport Challenge" to advertise a real car, but it was actually videogame footage. And Volvo said, "Hey, what's that music? We'd like to use that." Fortunately, it was licensed to Microsoft, so I got paid upwards of \$40,000 from Volvo to use that same song on a television commercial, on a worldwide television commercial.

Now, that was a grand slam in terms of licensing because it was a double hit.

It would be interesting what would happen if I were to be hired by Microsoft to create that same music as a buyout and Volvo came along. That would be an interesting situation. I would expect that little topic that we mentioned earlier, that if something were to magically happen where a company walks right up to a game developer and says, "What, we'd like to use that music," and the developer says, "Well, okay, that's good. It wouldn't hurt us. We don't really have to worry about policing it. Go ahead and use it." In that case, I guess the issue or the wording of having the composer be entitled to receive his royalties would be helpful if it were in the contract just to clear up any misunderstandings. Does that—does that make sense? Is that accurate?

**MR. RUTCOFSKY:** It would be helpful for you, yes. You would get paid in that instance.

**MR. SALTA:** Right, right.

**MR. BROWN:** It raises a very interesting issue, which we touched upon in a prior meeting among the panelists, which is, there are certain exploitations that con-

tributors may want to reserve for themselves, one of which from the music side is ringtones. And the storyline goes something like this. You create a hit videogame, and one of the cross-licensing/marketing opportunities is the ability to get that jingle that you just can't get out of your head because you just spent the last twenty hours playing the videogame as your ringtone. And the target demographic, again, I think in large part is sort of the teenage group, although there are certainly older gamers as well, and they may want to have the right to have that new hit background theme music as their ringtone. And if you're a composer and you want to retain that for yourself and you come to the company and say, "Look, I'm willing to assign all rights away to you, but what I'd like to reserve for myself is the right to license the thing out as a ringtone." I mean the question is, well, in your experience, has that happened or is it simply that the game companies are taking a hard line saying, "We own it, we'll compensate you accordingly and you're not retaining any rights."

**MS. ROTHBLUM:** I think the latter.

**MR. SALTA:** Right.

**MR. RUTCOFSKY:** When we can, and other times you will concede that what we're really more concerned with as long as we have the right to exploit in its obvious way, which is videogames and the commercials relating to the videogames will probably end up being okay with letting other exploitation, provided we have some consent rights or things like that to be retained by the creator. But you want to prevent, here we have a mature-rated videogame and you're going to use the song in a Disney film. It may create a little bit of a dilution, right.

**MR. SALTA:** Or the opposite.

**MR. BROWN:** Confusion.

**AUDIENCE SPEAKER:** Exactly. Can I interject a question?

**MR. BROWN:** Please.

**AUDIENCE SPEAKER:** When game publishers clear music rights, do you not only have to deal with the composer for the composition, but under the DMCA digital distribution, I'm thinking Internet, do you have to go to the RIAA Sound Exchange route and get labels to clear rights as well?

**MR. RUTCOFSKY:** Yes. We typically hire outside clearance firms to do, just take care of that. But I mean if I understand your question, we have to get publishing and performance clearance, yes.

**AUDIENCE SPEAKER:** On the record labels.

**MR. BROWN:** Yes.

**AUDIENCE SPEAKER:** Sound-recording rights.

**MR. BROWN:** Um-hum. Now, Tom mentioned earlier, if he's sort of approached to do a project, there is an inter-relationship and there's eventually a contract that comes of it, and we'll get to some specific contractual provisions that are sort of from the forum industry agreement in a minute. But I think one of the interesting issues to consider is that in a structured environment, you have a certain amount of control over what's done. You've got employees. You have independent contractors who are under contract. But if you're in an unstructured environment, one of the important things from the work-for-hire perspective is making sure that you, in fact, have a roster of people who have made contributions and that you've got the appropriate paper on each because, of course, the default under copyright law is that if someone creates a work for made-for-hire in the absence of a contract to the contrary, they retain ownership of the copyright and the work.

One of the things that we like to do, and I'm sure this—the practice of others as well, is you sort of—you have your T-square. You've got people on the left who have touched the game, and people on the right are the people who are either employees or who are not employees and you have paper on them. I trust that's the general experience. So with that in mind—and this—by the way, if anyone has any questions before we sort of get into the specific provisions, or at anytime really, feel free to speak up because we're in the last twenty minutes or so of the panel discussion. So we don't want to talk ad nauseum about contractual provisions and miss the opportunity to have a meaningful dialogue with someone about a question. Yes, sir.

**AUDIENCE SPEAKER:** I'd like to—if someone could address the seeming overlap. When you mentioned the elements in the beginning, you mentioned characters, character development, storylines and graphics, and those seem to overlap each other rather seriously. I mean characters, first of all, you can't really copyright characters because there's no copyright for an image of a character. You can copyright a description of a character, but not a character itself because it falls in between those two things.

Now, if an artist comes up with a game idea which has a cast of characters, they do a series of drawings of the characters with a back story for each one of them and they registered that so they come in and it's copyrighted, and they have a rough storyline which could also be incidental text. And possibly some collateral graphics for the environment which these characters are going to interact. How do you respond to that, if somebody shows up with this and it's their property, they've taken the appropriate steps to protect it? And how do you distinguish between characters and character development,

character development and storyline, characters and graphics?

**MR. BROWN:** Look, I can talk to it in a vacuum. I think the real perspective you want is from the folks on the panel who are on the ground in this, but in a vacuum, what you do is you establish a firewall, to use an Internet term in the real world. Basically, you've got a conduit. You've got one person who's responsible for making a go or no-go decision and who enters into an appropriately protective agreement on behalf of the company that says, "We'll take your idea to the creative team and allow them to look at it and make a further decision as to whether or not they're going to run with it."

**MR. RUTCOFSKY:** Was that your question, because I thought it was coming from the other way, which was if they come to you and it seems like it's violative of somebody's rights, how do you break down the various elements.

**AUDIENCE SPEAKER:** No, no. I'm asking if someone has actually done some of the basics for designing a game, this is some independent . . .

**MR. RUTCOFSKY:** Right.

**AUDIENCE SPEAKER:** . . . independent artist, they've got some of this stuff, I was looking for a little differentiation between say, where characters stop and character development begins, or if the characters are basically a graphic representation that an artist brings in off the street, what's the dividing line between characters and graphics? And assuming that this has all been protected by the creators, the freelancer who's come up with this, how do you deal with somebody? If you're working with the gaming company, how do you—the game developer company, how do you deal with someone who comes in and you say, "Well, gee, this looks like it could really fly." Where do you go with it?

**MR. RUTCOFSKY:** It's as Scott indicated, there'd be a non-disclosure agreement, right, where we'd talk about it.

We would also, as the publishers say, "Look, we're in this business. We do lots of these kinds of things with similar themes, similar characters under development, so unless we're doing the exact same thing, you have no action against us." And then they'll either disclose it to us or not. It's a kind of gray area and if you're representing the developer, typically they come with a design document that will be a well-documented embodiment of their ideas and the concept. That should be enough protection for you. You should advise your client that, "This is protective enough for you."

**MS. ROTHBLUM:** So . . .

**MR. RUTCOFSKY:** Go ahead.

**MS. ROTHBLUM:** If I understand your question correctly, which means there's a third interpretation, then I think my answer would be that as a collaborative effort, a game publisher, and again, I speak more concerned about their rights than third parties, frankly, because of my orientation, they would theoretically be covered for the overall work by the sum of its parts. So if you have a game developer coming to you and saying, "I have this great idea where there's going to be Martians running around in the city and they're going to have cars that they're driving," and you license the cars from GM and whatnot, and you go through the trademark steps, and you get an illustrator to do a rendering of the character that the developer and producer like, if each of them has warranties and reps in the contract, license or buyout, that says the rights won't infringe on any third parties and it's owned free and clear, then as among all of your contributors, I think the game publisher would be covered. And that would give me comfort.



Lisa Rothblum and Tom Salta

**MR. BROWN:** I'd just add as a final point, or maybe this is a trigger for the discussion, with respect to the difference between character and character development, my understanding is the difference between a character and character development is what the character says, how did the character come to be at this point in his or her career, what really is going on. In your words, the back story, what is it that's driving this individual. And I think the storyline then is, all right, you've filled in to a point. You now have a certain understanding. This is—for any of you who have sort of played a game, to put it in movie terms, the trailer, right, so what led you up to the point in time in which this movie commences or this character begins to interact with other characters. And then that's when you get into the storyline. And I think the graphics representation is different than the words on the page or the idea of an individual so that they're placed in time. Yes.

**AUDIENCE SPEAKER:** Quick question. I know that Sony PlayStation, for example, releases its NBA game on PlayStation 2, while simultaneously releasing it in other formats. How common is it, and if so, what happens if you're using, for example, someone's music, never licensed it, and you've got all these issues? You say it's very difficult to recall. What kind of things go on at that point if you keep using the same music and product after product after product each year? What kind of issues are raised?

**MR. RUTCOFSKY:** Well you typically won't do that because one of the things you strive for in each iteration is to have it a little bit different, so it's unlikely you'll continue to commit the same offense. And conversely, if you're going to release on several different platforms, your license for the music will cover all iterations of a particular game. So you cover it that way.

**MS. ROTHBLUM:** It's in the title.

**MR. RUTCOFSKY:** Right. And then if we do inadvertently include something we're not authorized to, that's just another—it just increases the amount we have to pay in order to get out of it.

**AUDIENCE SPEAKER:** The point that the gentleman was making about the dividing line between characters, characterizations and the like, was something that the motion picture companies were confronted with decades ago, so that if you look at their agreements, you'll see that they're requiring the characters, the characterizations, the themes, the stories,

the character names, just because they didn't want to leave anything out.

**MR. BROWN:** And to tie it to what's on the screen, if you look at the third line, that's exactly what form videogame license strives to do. And, of course, the operating principle here when you are working with a party whom you have under contract is to say effectively two things; a) you own all of the Intellectual Property associated with what you are purporting to license and/or assign to me; and, b) in the event that your representation and warranty proves untrue, you will indemnify me for any losses associated with that.

Now, of course, if you're dealing with a twenty-something programmer who's got a ten-year-old vehicle, a rental apartment, and a computer to his name, the indemnity is not worth the paper it's written on, but it's the emotional factor that's nice to have.

And I think I'm happy to keep talking about the development point and the difference between the various things. I think the reality of it, though, is that you never really divorce all these things. And to tie it to a copyright principle, you can't copyright or otherwise protect something—it's sort of a room full of lawyers listening to a CLE presentation. What's protectable about that? I've got this great idea, the elevator speech. It encapsulates what I have to say to you in fifteen seconds or less. Chances are, it's been done before. Where do you



go from the pitch to the implementation? In the intervening time period, that's most likely what's protected. And that's not a hard-and-fast rule, but I think it's a fair characterization.

So specific contractual terms, and again, if anyone would care to get a copy of the PowerPoint, I'm happy to forward this along, or—it's my understanding from Barry that there is a sort of industry form, much in the same way that there's an American Bar Association form MNA agreement that has sort of commentary to it. And some of this is a modified version of that. That the intent of this is that okay, all of the Intellectual Property that is bundled within what the developer creates for you is owned by the developer and is here, by means of this provision, assigned over to the company.

**MR. RUTCOSKY:** This case is owned by the publisher. No surprise there.

**MR. BROWN:** Exactly. And this would, of course, if you're representing a publisher, be the form that you would want to go out with, which is "our company owns everything, including the sun and the moon." And if you're a rights holder or a developer, you're going to want to go in, I think—with the acknowledgment that you're not going to be able to retain ownership as an initial matter, and perhaps you can, at best, during the course of a negotiation, present some carefully carved-out areas in which you would like to have the continued right of exploitation, subject perhaps to Barry's example of a right of approval.

**MR. SALTA:** Just to clarify. Even me, in an ideal world as a composer being hired to write music for games, I'm not really too interested in trying to push the idea of me retaining rights so I can exploit it elsewhere. I mean—in certain situations, it would be handy because if I'm hired to write like stand-alone songs, then they can actually be useful outside of a game. But if I'm writing the tension music behind an epic battle, I don't really want to worry about retaining the rights to exploit it on my own.

The only thing, if anything, I'd like to just make sure is in there, which I believe is implied legally, is that if someone does exploit this music which I've been hired to do, that I, being the writer, am entitled to performance or mechanical royalties. That's about it.

**MR. BROWN:** We've pigeon-holed Tom as the representative artist-rights guy and acknowledging that that's not a fair pigeon hole for him. Yes, sir.

**AUDIENCE SPEAKER:** Just one other carve-out point from the technologist's perspective. This is—I've just picked up talking with some friends who work on that side, is that the game engine and the development tools, oftentimes because of the sort of modular way these projects come together, aren't necessarily the type of owners to give to a publisher. The analogy might be

"Star Wars," you get the movie; you get the characters, but you don't own the technologies of Industrial Light and Magic—the product and the tools themselves, which are often quite valuable, may reside with a separate entity.

**MR. BROWN:** And that is an excellent point, which, in one moment, the sort of generic open-source code, this thing doesn't have any open-source because of course if it did and the code intermingled, then you could be subject to a claim that it had been devoted to public domain, comes the technology provision which specifically excludes, to your point, the game engine.

So brilliantly enough, those who know and operate in this space acknowledged that very fact, and for that reason, it's an excellent point and one that I'm sorry we didn't get to before now. But certainly, that's a great point and it raises an ancillary issue, which is to say that, if the assignment doesn't include the right to the game engine, which, of course, it typically would not, how then do you have the right to operate using that game engine?

**MR. RUTCOSKY:** It can be handled one of two ways, either through the assignment or you'll get a license, a non-exclusive, perpetual, royalty-free license to continue to use the underlying game engine and development tools to the extent they're embodied in the final product for as long as you commercially exploit the videogame.

I thought you might be addressing a different point, which is game engines occasionally are built off of standard foundational elements. I don't know if you've heard of a videogame called "Doom" or "Quake." These are very popular engines. Again, if you look at the most baseline, if you throw a ball, how it's going to move through the atmosphere, that kind of baseline element. Occasionally, those are licensed to a developer. So the extent that a developer is basing its game on someone else's license, they cannot assign to you the rights. All they can do is provide you with an ancillary license to continue to use what they have done, how they've modified that underlying game engine in the game they're developing for you.

But just, again, typically, developers will hold on to their game engine and development tools as their property. And that's a very common give on a publisher's point of view, even if you've funded the studio for them. That will be something that resides with the studio, the development studio, not the publisher.

**MR. BROWN:** And my apologies again for the slicing and dicing, but these are representations and warranties, and as you can see, sort of in two. The stock rep and warranty is that the developer either owns the game engine and development kit outright or has procured the necessary license rights to pass them through to the other party to the agreement.

And I notice that we have five minutes left, so we can either sort of keep giving broad brush strokes to these contractual terms—And by all means, again, if you have any questions, feel free to jump in. So the reps and warranties, this is pretty stock stuff. You see it in basically any license agreement, but because it's got some terminology here, the first one is standard rep and warranty that, as we discussed earlier, that they have either owned or obtained all rights to enter into the agreement, and that both parties agree that executing an agreement is not going to violate any other agreements that are out there.

**MR. RUTCOWSKY:** I was going to say, I mean this is pretty standard. There is a new provision that this agreement doesn't retract, which will probably become part of the standard practice in videogames. One of the requirements for videogames to get sold in North America and in many foreign countries, they get rated. And the rating process is a volitional process where the developer/publisher will submit to the rating organization the content of a game and will identify the most objectionable or inflammatory parts of the content, so that you get the highest—the most restrictive rating possible based on that content. We will start providing in our agreements, now that the developer has identified to us, the publisher, all of these particular elements, so that when we make our submission to the rating organization, to be sure that we've been as comprehensive as possible in identifying the material that needs to be rated.

**MS. ROTHBLUM:** I don't know whether you're aware of the derivation of that new development, but do you want to explain?

**MR. RUTCOWSKY:** Absolutely not. No, it would be premature to talk about it.

**MS. ROTHBLUM:** Okay.

**MR. BROWN:** In any event, so another stock rep and warranty that you would expect to see in the agreement is three in the hole here is your non-infringement rep, gain, pre-stock stuff. And then the fourth is a waiver of moral rights. And that's—moral rights is a topic of much debate and little understanding. And I confess that this is not my individual area of expertise, but I'll give you my take on it anyway.

Moral rights is there to protect an artist's rights of attribution and to prevent the sort of mistreatment or use of an artistic work in a context in which it wasn't intended. I don't think as a practical matter that this is of great concern in the gaming industry, but certainly, there are people out there who make business deals, who have seller's remorse, and who after the fact look for ways in which they can undo a deal, and moral rights is one of the toe holds that's out there that people can take advantage of.

I have not handled a case in which that's been an issue, but this type of provision is typical to contracts I've seen, and so it's not surprising to me at all to have it in there.

Okay. This is some pretty stock stuff as well. Everyone who's a party to the agreement has the authority to enter into it and has not submitted itself to bankruptcy.

**MR. RUTCOWSKY:** This is in every contract.

**MR. BROWN:** Right, every contract. Certainly those who are steeped in licensing will recognize these, and this is just a representation and warranty that there is not any limitation on the right of the people to perform, and that their rights haven't previously been distributed to a third party. The Gold Master—Barry, why don't you explain what the Gold Master is.

**MR. RUTCOWSKY:** Sure. As the development process proceeds, the developer will submit to the publisher, and I think we may have ignored one basic thing. Developers are the people who actually develop the software program. Publishers are the people who market and sell it. They're often combined, but in many cases, they are separate entities. So as the product is developing, in order for the publisher to assess where the product is, they will get what's called a build, which is a software program on a CD or a DVD and they'll then pop that into a specially modified console and play the game.

When the game is ready, when it's completed and all the polishing has been done, it gets submitted to the, in the case of a Play Station or Xbox or Nintendo, to the manufacturer, Sony, Microsoft or Nintendo, for approval.

Once it is approved, typically, the approval process involves playing the game from start to finish. Once it is approved from the manufacturer, you then have a game that is ready to be manufactured, and that is the Gold Master. So it's the final iteration of the software program as it's going to be promulgated to the public.

**MR. BROWN:** And the real interesting part of this contractual provision that sort of tickles me funny is videogames, as a matter of course, have things called Easter Eggs, and Easter Eggs are little, hidden aspects of a game that are released by what are called "cheat codes," and those can be, depending on whether you've got a controller, some sort of "click-left-twice," "click the A button once," "stand on your head," do a cartwheel," and then the game will magically have a new room you can enter into a house or a character will do or say something, and it's sort of this secondary culture to gaming where people all compete to see what Easter Eggs they can get to first, and they pass codes around and whatnot.

And part of the stock provision, as you can see, is that there are going to be no Easter Eggs whatsoever, no

content other than as approved by the publisher. And there are occasions, of course, where programmers take some liberties, and this is creative people being creative people, and they will, in fact, hide some Easter Eggs that no one's aware of, or have some content that's accessible by means of some sort of electronic key, password, or other that the publisher may not be aware of. And so what this provision does in its last clause is, it says, "I don't want any surprises. If you surprise me, I'm going to stop paying you." And I think it's a very helpful provision to have because I know that in one of Barry's company's games, there was, in fact, some unauthorized content that came out in a game that didn't have as a story-board item the ability to do this. A player could go out and have his virtual character engage in some lewd conduct. And if I understand the story correctly, Barry's company wasn't real happy about that.

**MR. RUTCOFSKY:** No one was. The difference is, unlike Easter Eggs, which are typically additional programming elements that the publisher or developer will release to the public, in our case, it was an unauthorized access to source code that revealed content that we never intended to have as part of the game. In fact, was specifically disabled, but was re-enabled by a hacker, an unauthorized third party's action.

**MR. BROWN:** Right. And so as you can imagine, having a provision like this where you can just turn off the spigot and say to the people who put the code in there in the first place, "You shouldn't have done that. You should have disclosed it to me. You didn't. I didn't approve it, therefore, you're done." And it is the sort of contractual equivalent of the nuclear weapon, but it can be effective.

The next provision is sort of stock as well, compliance with laws. I think this is—certainly anyone who's ever negotiated or drafted a software agreement has seen this type of language. I mean, I think it's broad in scope. If I were representing a developer, I'd pare it back a little bit, but I think it does its job in terms of what it claims to do.

So we've got a couple of more slides, and I think we'll see if there are any more questions and bring it to a halt in our allotted fifteen minutes. In terms of the pitfalls in the industry, and this is the topic of some hot conversation among the panelists, some of the pitfalls can be, but not necessarily are, and I think this is a buyer-beware situation. The inexperience of management shortcuts, and this goes to Barry's twenty percent over budget and twenty percent over time point. If you, for economic or other reasons, have to get a game to market in time and you take shortcuts, are you at risk of finding yourself in a position where either your game doesn't function properly, was poorly conceived, or is poorly received by the marketplace because it doesn't have all the features you said it would?

And interesting enough, as a sideline, we have a client that's been sued in a consumer class action case for releasing a software program without all its features to meet a deadline in which they're being sued for false advertising, breach of representation and warranty and lack of functionality.

**MR. RUTCOFSKY:** That's nice.

**MR. BROWN:** Yes, it's—not very. So there can be associational problems in this sort of ever-growing strike suit plan. And now they're turning their attention to things like computer software and computer games.

Rights clearance. We talked about that a number of times, making sure that you get everything you need to get your product to market.

And then my personal favorite issue, overprotective rights holders, which I think is not everyone, but certainly, there are people out there that are hot in the marketplace about making sure that no one engages in any use of their work, authorized or unauthorized, whether it has appropriate paper behind it.

And then our last slide, exploitation. So how can videogames be exploited in comparison to how they are today, right. So the gold mine is, you've got a lot of creative content put in one place. You've got music. You've got graphics. You've got characters. You've got storylines. There are instances where videogames have spawned movies and movies have spawned videogames. And I think you can sort of see the opportunity to cross-sell and cross-license and otherwise make use of it.

Same point, exploitation of content and other media. Tom's offer of partnership and publishing income, certainly if you've got a musician or otherwise a publisher who is situated to have a distribution network that you, as an attorney representing a gaming company or as a member of a gaming company, don't have access to, it might be helpful to . . .

**MR. SALTA:** Just to clarify, composers don't get or should be asking for partnerships and publishing income because the publisher is the game publisher in the case of music. So publishing income isn't even an issue. I think it's the writer's share which is a different pie, and it gives me a headache to explain all that kind of stuff, but there's actually 200 percent in a piece of music. So really, the publishing, that's not even an issue, just to—please continue.

**MR. BROWN:** Thanks for the clarification, Tom. You know, sort of more of the same, licensing out to third parties and rights clearance and distribution in terms of the net effect on the strategic alternatives, which is if you don't have the rights, you can't exploit them.

**MR. RUTCOFSKY:** I agree.



**MR. BROWN:** Anything else? Any questions? Okay, thank you, everyone. I'd like to personally thank Tom, Barry, Lisa, Scott, and David. That was a great panel.

[Break]

**MS. CERULLO:** All right, everybody, we're going to get started with the second panel.

First, I'm just going to introduce the panelists, and then I'm going to throw out some small statistics and interesting tidbits. This panel is on Internet gambling and legal issues surrounding that. We have three esteemed panelists here with us today. First I'll introduce Bennett Liebman. He's a professor at Albany Law School. He's the first coordinator of the Government Law Center's program on Racing and Gaming Law at Albany. He has held that position since February of 2002. He also teaches courses on Sports and the Law and the Government in Gambling. Mr. Liebman served as a Commissioner at the New York State Racing and Wagering Board from 1988 to 2000. Prior to his service at the Racing and Wagering Board, Mr. Liebman served as Assistant Commissioner for Legal Affairs at the New York State Department of Taxation and Finance. He previously served as Special Deputy Counsel to the Governor, and as Counsel to then-Lieutenant Governor Mario Cuomo. Mr. Liebman is a summa cum laude graduate of Union College, and cum laude graduate of New York University School of Law.

Next is Mr. Robert Penchina. He's a partner at Levine, Sullivan, Koch & Schultz in New York City. Mr. Penchina's practice concentrates in Intellectual Property, media, sports, entertainment, and gambling-related litigation and counseling. With respect to gambling, Mr. Penchina advises racetracks, Internet-wagering providers, and thoroughbred racing interests in connection with issues relating to interstate and international wagering on horse racing. Mr. Penchina has represented media and sports organizations before Congress and numerous state lawmaking and regulatory bodies. He has also appeared frequently as a legal commentator on the BBC, Court TV, and CNN networks. Mr. Penchina is a magna cum laude graduate of Queens College, and also received his law degree at New York University School of Law.

Last but not least, Adam Snukal, is the Executive Vice President and General Counsel of Spiral Solutions, Ltd., which is an international interactive marketing agency and mobile gaming systems developer. Before joining Spiral in 2004, Mr. Snukal served as outside counsel to the company since 2000.

Throughout Mr. Snukal's tenure at Spiral Solutions, he has been directly involved in originating, negotiating, and consummating numerous gaming transactions, ranging from financings and acquisitions, to licensing and technology deals, as well as advising Spiral on interna-

tional regulatory gaming matters. Mr. Snukal graduated from Yeshiva University in New York. He obtained a master's degree in Modern History from the Bernard Revel Graduate School, and received his law degree at Brooklyn Law School.

So for our panel today, we're going to follow the outline that's found on page seventy-seven of your CLE materials, more or less, to help you navigate through the different laws of the gambling industry.

So just to start, a few interesting statistics or tidbits for those of you that don't realize the actual magnitude of online gambling currently. In a survey of 1,086 randomly selected Americans, 67 percent of those over the age of 18 had gambled in 2005.

Online gambling is estimated to be approximately five percent of the total global gaming market. There are approximately 2,500 gambling websites. What else, 45 percent of the global gambling market, with 31 percent coming from Europe.

In 2004, the poker market was estimated at around \$1.5 billion. There was a recent article in *The New York Times* on December 25, 2005, entitled "Wall Street Bets on Gambling on the Web," and it discusses how many of the financial analysts in investment houses are finding that the Internet gambling industry may be an opportunity for profit that is too good to pass up, with Internet gambling projected to reach almost \$12 billion in business in 2005, up from \$8.3 billion in 2004.

Forbes recently reported that American consumers are spending about twenty times more on gambling than they spend on downloading music, which is an interesting tidbit for us in the entertainment industry.

So without further ado, I turn it over to our panelists. Bob.

**MR. BENNETT LIEBMAN:** Before I actually get Adam involved in this, I think those stats don't really indicate how large the gambling business is. Basically, we're talking now in the United States, probably about an industry that—with revenue of about \$80 to \$90 billion, and that's the amount that's actually won by the house in gambling games. That's not the amount that's bet. When you try to figure out how much is bet, you're going to come up with a figure well in excess of a trillion dollars. It's hard to explain how much gambling has multiplied in the United States in the last twenty years. A good part of that is due to Indian gaming, but it is an absolutely enormous industry.

Now, the stats, again, Internet gambling, who really knows what the stats are. I mean I gave a speech last month in which I said, "Well, you might have to downplay those Internet stats because they are from a firm that wants to make the Internet gambling business look larger than it is because they do work for these firms."

And after I gave those remarks, a number of people ran up to me afterwards and said, “You’re totally wrong.” Happens to me a lot, but those stats actually downplay how big this industry is. It is enormous.

**MR. ADAM SNUKAL:** A comment to that. A couple of other statistics, without going into the subject matter, but just a couple of general industry statistics, 29.1 million unique visitors visit online gambling sites each month. Well that was the number in 2005. A unique visitor for Internet parlay is somebody who hasn’t gone to that site previously. So each month, twenty-nine million users go to various gaming sites, gambling sites, on the Internet for the first time. Poker, I don’t think anybody here could have missed the tremendous fad that poker has taken on, not only in this country, but worldwide. In 2005, \$2 billion was wagered. And I’ve seen on a couple different reports, that each day, upwards of a \$100 million is wagered on online poker sites. What that means is, that’s not necessarily a house take, but money trading hands, money being bet, \$100 million every single day. And just to add to what Michele was saying, how common is this in the U.S.? Well, I can tell you by personal experience and also by scholarly journals, that the U.S. contributes up to fifty percent of the global Internet gambling. So U.S., fifty percent, the rest of the world, fifty percent.

**MR. ROBERT PENCHINA:** And I guess it’s my task to start going through the outline and giving you the legal overview. And beginning with the legal overview, the first thing I want to point out is you’ve heard the statistics. It’s all illegal, and that’s sort of the interesting thing. We’re done, thank you for coming. This is one of the areas of the law that is just absolutely confusing because the law, on its face, seems clear, but your eyes tell you something entirely different. And the statistics were just given to you. This is everywhere. It does seem to be unlawful with the limited exception of, or at least as I’ve been arguing for many years with my colleague, Ben, that as it relates to horse racing, that is lawful. And the difference between horse racing and other wagering is that there is a federal law, the Interstate Horse Racing Act, that deals with it, and we’ll get into that as a panel a little bit later.

But what I wanted to start with is, first, giving you an overview of the federal laws that apply to Internet gambling, some looking into, but certainly not a fifty-state survey of what type of state laws are involved. And as we do this, rather than wait until the end, if folks have questions, interrupt us as we go through because . . .

**MR. LIEBMAN:** We’ve got a lot of time.

**MR. PENCHINA:** We have plenty of time, and also because this may be an area that folks are less familiar with, and no sense in waiting to the end.

On the federal law side, the primary statute that applies to Internet gambling is called the Wire Act. Some people call it the Wire Wager Act, and the text of it is in the materials that were handed out, but it is section 1084 of the Criminal Code. And essentially, the Wire Act says that it is unlawful to transmit a bet or wager via a wire communication facility. It also makes it unlawful to transmit information assisting in the placement of bets or wagers unless that information relates to a wagering activity that is lawful in both the state where the transmission begins and is received.

So in short, the Wire Act is intended to prohibit the use of wire communication facilities, whatever that may currently mean, for the purpose of transmitting bets. This statute, which is the cornerstone of the federal law in either combating or unfortunately prohibiting Internet gambling, was a centerpiece of Robert Kennedy’s war on organized crime and was passed in 1961 or 1962 when the Internet was about six generations from even the thought of personal computers at that point in time. But the concept of betting from a remote location is not new. In fact, there’s a U.S. Supreme Court decision addressing the issue going back over 100 years when folks bet—I guess betting has always been something that has interested people, whether it’s legal or not, and there are cases addressing bets transmitted by telegraph as well as by telephone—and now Internet.

**MR. SNUKAL:** Can I jump in for a second?

**MR. PENCHINA:** Sure.

**MR. SNUKAL:** I’m sort of coming to the business as a participant, as somebody who’s, in one shape or another, actually doing business in this particular industry. And I can tell you, and I’m sure you’re going to get into it in a second, that it’s not absolutely clear, at least from my perspective, my humble opinion. It’s not absolutely clear that online gambling in this country is illegal.

The statute that was just cited is the position that the Justice Department in this country is basically hanging its hat on, okay. But first, for one thing, not all the courts, the state courts and the federal district courts in this country have agreed that the statute actually covers the activities that the Justice Department intends to outlaw. And, number two, you have to ask yourself a question, what was the intent behind the law? 1961, Mafia, you had back-room number running that was going on. And so the Justice Department said, “Okay, let’s pass a law to stop that.” Now we have a completely different form of gambling, and the Justice Department is still trying to use a 1961 law to tell us that it’s illegal. So, to say that it’s illegal, you’re definitely toeing the Justice Department line, but not everybody in this country agrees on that point.

**MR. PENCHINA:** Well—and to put a finer point on it, I’m not sure that I agree with that point either . . .

**MR. SNUKAL:** Right, right.

**MR. PENCHINA:** . . . having sat across the table in the Justice Department representing folks who are engaged in activities. But I think that the accepted position is that it is unlawful and I think it’s for those of us either in the industry or representing folks in the industry to make our arguments . . .

**MR. SNUKAL:** Right.

**MR. PENCHINA:** . . . and to get around it to the extent that we can or get it changed. And in following on that point, what does the Wire Act apply to on its face? And it applies clearly to sports betting. It was intended initially to go after bookmakers, and so the question is in the current Internet world, where you have online casinos, or online casinos within the reach of the Wire Act. And there is at least one Federal Circuit that says it is not within the reach.

**MR. SNUKAL:** Right.

**MR. PENCHINA:** And that is the Fifth Circuit, and the case came up in kind of a roundabout way. I believe a group of folks who had engaged in online casino activities and lost lots of money couldn’t pay their MasterCard, sued for declaratory judgment saying that MasterCard could not enforce the agreements to pay with them because it was for unlawful activity. And maybe it’s because of the context in which the case came up, but the District Court said that the Wire Act applied to sports betting. It did not apply to casino betting, therefore, those transactions were not unlawful and, therefore, MasterCard could collect them, and the Fifth Circuit affirmed.

**MR. LIEBMAN:** So that under that case, poker, which is the game we seem to be talking about most here, would not be a violation of the Wire Act.

**MR. PENCHINA:** And I think that’s correct. But that seems to be—it certainly is not the position held by the Justice Department as they have widely announced repeatedly, including with threatened if not actual prosecutions, I believe that some of the entities—yes.

**AUDIENCE SPEAKER:** Have many Circuits gone the other way, in other words, held casino gambling to be illegal?

**MR. PENCHINA:** I am not aware of a Circuit that has directly addressed the online casino gambling. Circuits have addressed, the Second Circuit in particular, has addressed the application of the Wire Act to online book-making and have upheld a conviction of an Antiguan book-maker. But I’m not aware of a case.

**MR. SNUKAL:** It raises an interesting point, which is why isn’t the law more tested in this country? And the reality is, that when the Justice Department has taken action, for example, has seized funds—there was a case about a year ago where a large TV channel was going to advertise some poker commercials, made about a \$2 million deposit. The Justice Department went in, took the money. So at that point, the poker operator has a choice, either he can actually step foot in this country and try to defend and get his money back or he can just say, “What, I’ll take a write-off.”

And the fact is, most people, other than the case you’re mentioning in the Second Circuit, which I’m sure you’re going to discuss in a second, most, in almost every instance, people basically will just walk away from anything the Justice Department tries to seize because it’s not worth subjecting one’s self to civil and obviously more importantly, criminal prosecution.

**MR. LIEBMAN:** The upshot of that also is something that happened on Friday, which is that *Sporting News* basically paid out, based on a complaint by the Justice Department, that \$7.2 million as a settlement, obviously not accepting any criminal responsibility, but for advertising Internet and phone gambling. So the Justice Department may not bring a ton of prosecutions, but it does have the hammer here, and it chooses to use it; it certainly can. One other point here which is I think—we can’t make enough.

This is what’s going on here is prohibition-cubed. Under prohibition, actually, the amount of people who used liquor declined, I mean obviously, organized crime increased, but the actual use of liquor declined. Here, this is the opposite. Not only is Internet gambling not going down, it is skyrocketing. You could not come up with a law-enforcement situation that is less effective than what’s going on right now.

**AUDIENCE SPEAKER:** Has the position of the Justice Department changed at all depending on the Administration, or has it been consistent?

**MR. PENCHINA:** Yes. It’s gone further right. Absolutely. It’s going further against it, as we’ll see the position that they took in the WTO proceedings. The Justice Department has been absolutely wedded to the same position, has not changed it, at least since the advent of the Internet. And I guess in echoing Ben’s point about what’s going on, my sense is that the three of us probably would agree that the way for the government to handle this would be to legalize it, regulate it, tax it, and so on. I think we’re actually seeing efforts in the opposite direction. We see more and more legislation introduced to try and curtail it and not recognize the reality of what’s taking place in the marketplace.



**AUDIENCE SPEAKER:** Are they going after people who advertise for these sites? You know, if they place it in magazines or on the television?

**MR. PENCHINA:** Well, what they're doing, and this also goes to one of Adam's points before about people walking away from it. Generally, because the folks who are handling the wagers, the Internet casino sites, the Internet book-making sites, are located offshore. While there may be personal jurisdiction in the sense that those folks are transacting with people here, the fact is, they never set foot here, with very few instances, so there's nothing that the Justice Department really can do directly against what it perceives to be the main violators. So the path that it's taking is to utilize the concept of aiding and abetting, which is that if you assist in the commission of a crime, you can be held as liable as a principal in the commission of the crime. So since they can't get the people placing the ads, what they've actually done is gone after reputable newspapers, magazines, and going beyond the *Sporting News*, but to major publishers of just about everything that most people in this room read.

I think it was about a year and a half or two years ago, the U.S. Attorney's Office in the Eastern District of Missouri issued, I don't know what to call the letter because it's not a formal cease and desist, but . . .

**MR. LIEBMAN:** It's called a warning.

**MR. PENCHINA:** Oh, to the Magazine Publishers of America and to all of their members, and it said, "If you continue to take these ads, you are running the risk of being prosecuted." And they've selectively picked off some, like *Sporting News*.

**MR. SNUKAL:** And some websites as well. I can tell you from personal experience, being the counsel to an interactive marketing agency, effectively a full-service advertising agency where we have everybody from graphic designers to copyrighters, to media—we actually have a media-buying division within the company, that it became increasingly more difficult over time in the last couple of years to find advertising opportunities in the U.S. And our specialty happens to be online advertising, and it was like a domino effect. First Yahoo! said, "Sorry, we can't accept your casino ads." And then MSN, and then AOL, and one large new media publisher after another just—and again, whether they received a letter or not, they sort of knew that these letters were in circulation and were just afraid to come under the umbrella of the Justice Department.

**MR. PENCHINA:** And it creates a very interesting dynamic in the media marketplace because a lot of the money from the gambling sites to purchase advertising was coming at a time when all other advertising was way, way down. So very big companies were faced with very serious questions about do we accept these. And for

the most part, they have tended to back down. And one would think that there could be a First Amendment challenge somewhere in there, but I think on an individual basis, each of the companies that gets involved in this looks at it and doesn't need an entanglement with the government over this ad, particularly in a day when you have Congress considering all sorts of legislation that can impact cross ownership and other issues. So they've tended to sort of let it slide. And I think where you see the line drawn is there is a fair amount of advertising for poker sites on even network television that say things to the effect of "Learn to play poker." And the site that they direct you to, let's say is poker.net instead of poker.com, and on poker.net, you can't bet, so that's how they're apparently getting away with not running afoul of the Justice Department, but the advertiser all the while is hoping that you will enter poker.com when you actually go to the site, and that's where you can bet.

**MR. SNUKAL:** There was a First Amendment case that was brought, if I'm not mistaken. It was the *Casino City Press* case.

**MR. LIEBMAN:** Yes. They brought it, but it was dismissed.

**MR. SNUKAL:** But I actually heard—don't quote me on this. I probably shouldn't be saying that sitting on a dais like this.

**MR. PENCHINA:** Do you see the camera, by the way?

**MR. SNUKAL:** Yeah, yeah. But I heard from an insider that in that case, the Justice Department—and that was a case where you had a publisher who was selling ads in their various publications to the industry players. The Justice Department was prepared to concede a little bit of ground that under some First Amendment right, advertising would be permitted. They wouldn't put it in writing, but the unspoken word around the halls and at the water cooler of the Justice Department is that they weren't going to prosecute publishers. But the case got dismissed, I think, on grounds of mootness or something like that, so we didn't actually get a decision on that.

**MR. LIEBMAN:** There really also is a question as to whether or not this is truly aiding and abetting in a crime.

**MR. PENCHINA:** Right. There are cases in other contexts, for example, tax avoidance, where courts have come out and said, "Where you're counseling to things that you clearly know to be illegal, that somehow the First Amendment right is overcome," and Justice is making a similar argument here. There are also, I think, murder-for-hire cases. Years ago, with an ad in *Soldier of Fortune* where the First Amendment argument wasn't as strong as it could be. But I, again, tend to agree with Bennett, but I think as we'll see as we go through other

stuff, because the folks engaged in the activity generally are offshore, they have no way of enforcing our laws against them, so the Justice Department and the enemies of Internet gambling are looking for ways to get to the folks that either facilitate the activity or advertise the activity as opposed to making a direct assault.

**MR. LIEBMAN:** About three years ago, the assault from law enforcement was really against credit card companies and against PayPal, and they succeeded in basically stopping credit card companies and PayPal from engaging in, giving credit for Internet gambling opportunities. But the fact is, that appears to have worked. You won't hear anything about the Attorney General in New York or the U.S. Justice Department going after credit card companies in the last three years. But the fact is that if you go to—it's extraordinarily easy to reach a service that will take money out of your bank account directly and let you play poker games or casino games online. Just go to netteller.com and you'll be able to finance all your Internet gambling opportunities and activities.

**MR. SNUKAL:** And the same dynamic is happening. The casino goes offshore and the payment processing solutions also go offshore.

**AUDIENCE SPEAKER:** Has there been any consideration to the possibility that the Justice Department or governments would go after the individuals who place the bets?

**MR. PENCHINA:** Under federal law, under the Wire Act, which is the only one that we've mentioned so far, it is not directed at the individuals, and it is perfectly legal for individuals to—it's another sort of quirk of all of this. There's no federal law that prohibits individuals from engaging in the wager. It's being in the business of conducting those wagers. State law varies on that. New York is a state where it's similar that we don't make it unlawful for patrons, but we make it unlawful for the company. There are states that do prohibit individuals from engaging in the transactions. And what you then wonder about these offshore companies whether there is an aiding and abetting claim against them even if you couldn't get them as a principal because they're aiding the resident who is violating his own state law by making the bet in the first place.

**AUDIENCE SPEAKER:** Have they tried to go after servers for not blocking the sites or requiring them to block the sites?

**MR. PENCHINA:** I have not seen it, have you?

**MR. SNUKAL:** Not here, not in the U.S. It's happened in France, and I'll get into that a little bit later, where the French authorities, much like the U.S. authorities, really couldn't do anything against the operators themselves, so went after ancillary services. And there is a case where they went after an ISP, but the problem, and I'll

touch upon that, in France, for example, was that was in direct conflict with a European Community law that provides a safe harbor to ISPs.

**AUDIENCE SPEAKER:** Sort of a continuation of the question about going after the individual. For starters, it would make me very nervous knowing if I give my personal bank account, anyone in an offshore company can pretty much drain it. Has there been any issue of fraud brought up with that? And the second question is, can the Justice Department go after the banks because most of the banks are based in the United States where the personal accounts are held?

**MR. SNUKAL:** I think I can speak to the first point. In my experience, I wouldn't tell you that fraud doesn't occur, and that theft doesn't occur. But this is a highly regulated industry more so than probably most of the industries that we're familiar with in this country. I can tell you, for example, in my company, we have people who do nothing all day, every day but assess and analyze fraud.

**MR. PENCHINA:** Oh, you went to the next sentence. I was going to say in my company, we have people who do nothing all day, every day.

**MR. SNUKAL:** We have people who analyze fraud every day. In addition to that, the industry is very much self-regulated. There are actually industry groups. There are, for example, server farms that will host many of the casinos, will have very strict regulations so that if there's any question whatsoever of improprieties or fraud going on, they'll immediately shut off the casino.

And I think while we're talking about millions of people around the world or even in the U.S. that play, it's still a relatively small market, close-knit market, so that if a casino develops a reputation that there's some funny stuff going on or that there's been problems with fraud, people will run in the other direction. And I know of cases where a casino—where it was just a rumor, in fact, but a casino had to close down in about seven days. The players just left.

**MR. PENCHINA:** On the banking aspect of it, some of that is anticipating where things are going because this proposed legislation that would enable the Justice Department to do that, but as far as going after the banks, for example, the New York State Attorney General did get an agreement with Citibank, that Citibank will not let cards issued by Citibank be used for these purposes. Ben mentioned before that whether it was state Attorneys General or somebody going after the credit-card companies.

And just to let you know how effective going after these ancillary services can be, they focused on Visa, which was the sponsor of the Triple Crown, the Kentucky Derby. And it sunk millions and millions of dollars

into that. It offered a \$5 million bonus for anyone to win, so it's deeply involved in the sport of horse racing. Visa got scared off, and in order to satisfy the Justice Department or the New York State Attorney General's request that they stop handling Internet wagering, they issued some sort of code that would disable the use of the credit card, which also disabled the use for legal transactions at the Kentucky Derby which Visa was advertising as the only card that you could use at the Kentucky Derby and so on. So these are very, very effective when you can't get the principal. The problem is, you're also sweeping in activity that the law clearly was never intended to effect.

**MR. LIEBMAN:** I'd just like to reiterate Adam's point. I mean, you can do your basic Nexus search and look for it, fraud, by any of these services, you won't find it; you won't find it. And it's hard to believe because you really expect to find it. But it's much the same way as Indian gaming works in this country. When Indian gaming was legalized, the major problem people were saying was, "Well the mob's going to take over," and "How are you going to trust that, the tribes to do a legitimate job on dealing with gambling." And the fact is now, Indian gaming is a \$20 billion industry.

**MR. SNUKAL:** Bigger than Vegas?

**MR. LIEBMAN:** Yes.

**MR. SNUKAL:** Bigger than Vegas.

**MR. LIEBMAN:** Probably twice the size.

**MR. PENCHINA:** To complete the federal law picture, because we've been talking about the Wire Act, which is the primary statute, the other statutes in the federal arsenal are the Illegal Gambling Business Act, which is section 1955 of the Criminal Code, and the Travel in Aid of Racketeering Act, which is section 1952. And what's interesting about these two laws, these are federal gambling statutes, among other things, federal gambling statutes, but they use state-law violations as a predicate for a federal prosecution.

So if you are engaged in Internet gambling and, for example, if you are in the sport of horse racing where, again, I will just keep saying it until it sinks in, it's legal. Believe me, folks, it's legal. But you're doing so in a state that prohibits it, and you're violating that state's law. You now have also violated federal law, even though the activity is legal under federal law because of your violation of the state predicates.

So it's an important tool that the federal government has. And it sorts of ups the ante on your state violations because you can be prosecuted for both.

On the federal side, there is also something called the Professional and Amateur Sports Protection Act,

which has been in existence since the early 1990s. And this is not a criminal statute, but it provides civil remedies, primarily injunctive relief that can be sought by the Attorney General or by leagues or teams that are affected by violations. And essentially, the law prohibits people from operating gambling schemes or gambling businesses based on sports involving either professional or amateur athletes. So I think that pretty much covers all the sports.

There is—when this law came into being, the state of Delaware had a lottery that was based on the outcome of NFL games. And the NFL was quite upset about it. There was trademark and Intellectual Property litigation on it, but one of the results—that was one of the, not the only, but one of the reasons that this came into existence. But because Delaware already had that scheme in place, as well as the fact that Las Vegas already had sports books, those were grandfathered in. So anything that was legal at the time remains legal, but it is—essentially, even if your state now authorizes you to conduct gambling on a college sport, for example, the federal law would provide remedies to the NCAA. To prevent you.

**MR. LIEBMAN:** This is basically the status quo. It enacted the status quo on sports gambling.

**MR. SNUKAL:** But again, just to get back to a point made earlier. I don't see what application this particular statute would have to somebody who plays blackjack on the Internet or . . .

**MR. PENCHINA:** Right. And I—and I would say none.

**MR. SNUKAL:** Yeah, none, right.

**MR. PENCHINA:** Which brings us to our friend, Jay Cohen,<sup>12</sup> who's already been mentioned. Jay Cohen is the guy who was operating the Antiguan offshore book-making operation that was, in fact, prosecuted in New York by the U.S. Attorney and was convicted, and served his sentence and, in fact, is the person who is behind the WTO proceedings that Alan mentioned.

And to me, in some ways, he's a sympathetic figure because unlike a lot of other folks, he looked at the law, he had advice, and he really read it the way that some of us are suggesting, that the law shouldn't reach some of these activities. He also looked at OTB in New York and said, "They're engaged in telephone wagering and why shouldn't I be able to do that. I model my business the same way that they do it." And he was so sure that—just to give you more of his background, I think he was an investment banker or something to that effect, retired, went into this offshore gaming business, and was so sure that this was right and that this was the wave of the future, he came back and subjected himself to the jurisdiction to be a test case. Whoops. Hope he didn't make book on it, too.



**MR. LIEBMAN:** This is almost the equivalent of Rudolf Hess flying into England during World War II.

**MR. SNUKAL:** And it was ten-to-one odds he was going to get prosecuted.

**MR. PENCHINA:** Basically, what he set up is an—and this is the mainstay of the horse racing industry, pari-mutuel wager, and what they do in terms of Internet and phone betting, is something called account wagering, which is you have an account with a wager and provider. You have money in the account. And then if you're in a state where it is lawful to do so, you can then contact the account wager and provider, issue instructions as to wagers that you would like placed from your account, and then it gets acted upon.

In pari-mutuel wagering, which is what is done in horse racing, you're not betting against the house. All of the bets go into a single pool among all of the players and that's what determines the odds, who they've bet on. And at the end of the day, if it's not a one-on-one transaction where I say I'll bet on X and he takes it and we exchange. Book-making is different. And while the racing industry, which has relied on the pari-mutuel wagering setup in order to say that all that is occurring when you make an account wager and transaction is the transmission of information. The reason why account wagering on horse racing says that is because the bet has to get taken into the pool.

So if you're my account wager and provider and I call you and I give you an instruction, you can't just say, "I accept" and we have a bet. He then has to turn around and get it accepted into the pool that's managed by them. So until that happens, there's no bet. So my transaction with you is essentially information.

That's the argument that the horse racing industry made with varying success and, ultimately, the Interstate Horse Racing Act was amended so that they don't have to rely on that argument. But at the time that Jay Cohen was prosecuted, he said, "That's what OTB is doing, and that's what I'm doing. You want to bet on the New York football Giants and you have an account that I'm holding. When you call me from New York, I will then act on it entirely in Antigua." And the court said, "Not so fast, because there's no bet in this transaction. It's just between us, and as soon as you say 'I accept,' then I must have been transmitting a bet." And, in fact, the judge was infuriated by that argument and he didn't have the context of horse racing to change it, but he just looked at it and sort of read Cohen's attorney the riot act about who in their right mind would rely on such an argument. Me.

**MR. SNUKAL:** So I wonder, though, there's a very large, very successful company in the U.K. I know the CEO's based in Ireland, so the whole operation may be based out of Ireland or the U.K. It's called "Betfair." And Bet-

fair basically is a matchmaking service that if I want to, I'll take the Giants on three-to-one. Not the Giants. I'll take the Steelers, in a couple of weeks, three-to-one odds. They'll find somebody who's happy to take the Seahawks and they'll put us together.

**MR. PENCHINA:** They'll find somebody who's happy to take the Giants.

**MR. SNUKAL:** Yeah, that's true.

**MR. LIEBMAN:** We tend to call it sort of the eBay of sports.

**MR. SNUKAL:** So I wonder, though, along the lines of the pari-mutuel, whether that would be considered illegal.

**MR. LIEBMAN:** Here's the problem. And it deals with Bob's Professional and Amateur Sports Protection Act. The act basically says what's okay—pari-mutuel betting on horse racing and dog racing. The problem is, is this pari-mutuel? And I think, though, the greater likelihood is that it won't be seen as pari-mutuel, that it will be seen as person-to-person betting. But you can sort of make the case that—wait, maybe—if pari-mutuel only means betting between people where the operator takes vigorish like a racetrack, then maybe you can make a half-decent argument that it's pari-mutuel. I wouldn't want to make that case.

**MR. PENCHINA:** I think it would lose.

**MR. LIEBMAN:** Yeah.

**MR. PENCHINA:** You need to be clear. What Betfair is, it's equivalent . . .

**MR. LIEBMAN:** Exchange, electronic stock exchanges.

**MR. PENCHINA:** Right. So they're just putting together buyers and sellers. I think it violates the Wire Act based on—the reason that the horse racing industry was making the argument was to qualify for the exception that we're not transmitting wagers, we're transmitting information. But that exception only applies . . .

**MR. LIEBMAN:** Right.

**MR. PENCHINA:** . . . where the transmission of information is from a place where betting on that activity is legal to a place where betting on that activity is legal. So in the Cohen case, the court went into this whole thing rejecting his—that it was just information, but then the court hit the crux of it, which was, since betting on sports is not legal in New York even if it's information, you're still violating the Wire Act.

**MR. LIEBMAN:** There's sort of, again, where reality trumps the law in this case, while Betfair will not take bets from United States residents, there are similar matching services that will be using Net Teller or Citadel or Fire Pay, will take bets on using this kind of eBay-style

matching. So if you're bored out there, you can start making your bets in between our comments.

**MR. PENCHINA:** We'll probably find some takers, too.

**MR. LIEBMAN:** Yeah.

**MR. PENCHINA:** Just moving on a little bit more with the framework, moving from the federal into a very brief overview of state law. And although we started with federal, generally, states have the primary regulatory authority over gambling. It historically is something that's within states' purview rather than federal. And most states, virtually all states prohibit gambling at least in the broad sense, and then some states have exceptions to that prohibition. And that some states has now grown to that there are forty-three states in which pari-mutuel wagering on horse racing is lawful. Most states support themselves through state-run lottery and so on. But there are still a handful of states, such as Utah and a few others, that prohibit all gambling.

In Utah, a person is guilty of gambling if he participates in gambling. That's it. There are no exceptions. And what I found—which kind of interested me, Utah does have, I didn't notice, they have a horse racing statute that talks about the horse racing Commission and setting up the races and the rules of racing with no gambling.

**MR. LIEBMAN:** I have a friend of mine who was a steward on the Commission.

**MR. PENCHINA:** But just so no one is confused, in the statute where it sets up the Racing Commission that says, "Nothing in this chapter may be construed to legalize or permit any form of gambling, so don't get any ideas." This is what the statute is saying. They run it as a sport.

**MR. LIEBMAN:** They actually run—it sounds ridiculous. They actually run cutting races in Utah more than anything else. And cutting races, it's like watching "Ben Hur." It's almost a chariot race, a short chariot race. It combines "Ben Hur" and quarter-horse racing.

**MR. PENCHINA:** That's pretty funny. So we've got, at this state, the majority of states permit at least pari-mutuel wagering on horse racing. New York is typical of that. There are prohibitions against gambling, but there is a provision, I think it's section 222 of the Racing Law, that says something to the effect of, "Betting on horse races shall be lawful in this state if conducted in accordance with this chapter, notwithstanding any other law to the contrary."

In racing itself, some states get very restrictive and say you can only conduct betting on horse racing even though that's legal within the enclosure within which the race is run.

So New Hampshire is a state like that and you may only bet, although they've since loosened it, you may only bet at the racetrack. Of course, we all know, New York expanded and other states expanded to have off-track betting.

There is simulcasting, which is, you go to one racetrack, but you're betting on the races that are run somewhere else.

And ultimately, they have started to move into telephone and Internet betting. And currently, there are about eighteen states that expressly authorize telephone or Internet betting. And New Jersey is typical of that in terms of a more recent statute. It says, "The account holder may place a wager in person, by direct telephone call, or by communication through other electronic media." The New Jersey statute has other problems in that it violates the commerce clause of the Constitution because it only allows operators in New Jersey to accept those telephone calls, but at least in terms of the technology, that's more or less how the states are doing it. And so they're not necessarily saying Internet-specific, but they're saying through other electronic media.

Some states have gone in the opposite direction. Louisiana outright prohibits betting on the Internet, separate and apart from whether or not it's barred by the federal laws. And Louisiana passed this, oh, in 1997 way back in the dark ages of the Internet when it was just getting started, and so they called it "gambling by computer." And they have a statute that is not completely clear just how far it reaches. You have jurisdictional issues; you have who-does-it-apply-to issues, so.

**MR. SNUKAL:** But it's ironic, though, that the most online gambling friendly circuit in the country happens to be Louisiana also.

**MR. PENCHINA:** Well, then, while Louisiana prohibits gambling by computer, there is, of course, an account wagering statute in the racing laws that say, notwithstanding any other Louisiana law to the contrary, a Commission may permit account wagering for horse racing, and that's true, the Fifth Circuit. So even within the state, they go both ways, but the Fifth Circuit has been very good.

States that want to prohibit Internet gambling have recognized some of the pitfalls of the early statutes like Louisiana, so the most recent state to pass an Internet gambling ban is Indiana, which became effective over this past summer. And they try and cover it from every direction, so they say anyone who knowingly uses the Internet, and it lists a whole bunch of categories, such as engage in pool selling, engage in book-making and so on, casino gambling and what have you, that says if they either do so in a transaction directly involving a person located in Indiana or an Internet site accessible to resi-

dents of Indiana or on a server located. So they're trying to fill all the holes where there were arguments that we were making. If I'm in Indiana and I'm calling offshore, if the bet takes place offshore, am I violating the state law? Indiana is saying, "Yes, we're going to get you no matter what. We're going to put all of that into the statute."

And we also talked about this, information exception. There are some states that try and close that information exception to the Wire Act. In other words, transmitting information assisting in the placement of wagers is maybe lawful under federal law but Texas, for example, makes it a felony to knowingly communicate information as to bets, betting odds, or changes in betting odds. And by that, they're not attacking newspapers, but they're attacking that phone call that I'm going to make through my Internet provider to place my bet.

**AUDIENCE SPEAKER:** I have a question. Does the state where it's legal to do Internet gambling within that state, as long as you confine it to that state where the person placing the bet and person processing the bet is within that state, you do not implicate the Wire Act and it would be considered legal?

**MR. PENCHINA:** I believe that's actually the position that the Justice Department is taking. There is an argument in the opposite direction that because you are using the means of interstate commerce, even though you are staying within the state, since you're using telephone lines or Internet connections, that arguably, you're now within the purview of the federal statute. But as a practical matter, the Justice Department has been very consistent in saying that if something is entirely within the state, we don't care.

**AUDIENCE SPEAKER:** And how many states, or do many states actually have it to be legal to conduct gambling within the state?

**MR. PENCHINA:** In terms of horse racing, there are forty-three. There are nineteen in which it arguably is lawful to conduct Internet wagering within that state. In terms of sports betting and other than at a Sports Book in Las Vegas or casino gambling on the Internet—on an Indian reservation, Las Vegas, Atlantic City, I'm not aware, although it's a growing number of states.

**MR. SNUKAL:** Well I think it's important to note, though, that last year, in 2005, the state of North Dakota tried to pass a law legalizing online poker, which overwhelmingly passed in the House of Representatives, but got voted down in the Senate. So that actually came pretty close.

**MR. LIEBMAN:** It actually was derailed because . . .

**MR. PENCHINA:** Right, the U.S. Department of Justice sent a letter to North Dakota.

**MR. SNUKAL:** Right, saying, "We don't care what you pass. You better not pass it."

**MR. PENCHINA:** Right. And they will also—in that statute, as I remember reading, it was intended to make a hub . . .

**MR. SNUKAL:** Correct.

**MR. PENCHINA:** . . . where they can handle it from many states.

**MR. SNUKAL:** People would get licensed out of North Dakota.

**MR. PENCHINA:** That's right.

**MR. SNUKAL:** Well I think—I mean I was going to bring up the topic a little bit later, but I think this addresses the question. There was a very important and very interesting development in Nevada earlier this year. In May of 2005, the Nevada legislature overwhelmingly, almost unanimously, passed a bill that authorized wireless gambling devices within licensed gaming facilities. Bill 471 would allow a Nevada casino, for example, to hand its patrons or its guests some kind of wireless device whereby the individual would not only be allowed to gamble while inside the actual casino, they'd be allowed to gamble while sitting at the pool or while listening to Celine Dion or having dinner with their family. There were—a couple . . .

**MR. SNUKAL:** What?

**MR. PENCHINA:** Why would you ruin a gambling experience by listening to Celine Dion?

**MR. SNUKAL:** That's the best thing to do is to gamble, while your wife schleps you to Celine Dion. At least you can play blackjack. The Nevada Gaming Commission still has to issue regulations as to how exactly this is going to play out, but a couple of the restrictions that are stated in the law are, number one, only an establishment that has a minimum of one hundred slot machines and one other game is allowed to offer this to their patrons. That ensures that the small bar at the end of the strip doesn't have people gambling on wireless devices. So you have to have at least one hundred slot machines and one other game. The wagering must be a closed-loop system, so the actual network upon which you're betting cannot be, for example, the Internet, it has to be what's called a closed-loop system.

The third requirement is that the gambling could not be done in non-public areas. You couldn't take the device up to your room, for example, and play it, or you couldn't leave the facility and play it. And lastly, which I think is probably the most interesting, you can't keep it overnight. So at a certain time, all the devices either have to be returned or be shut off by the facility.



**MR. LIEBMAN:** This is likely to be either a hand-held or a tablet computer. It's interesting to note that the technology has been developed by Canter Fitzgerald, which we know largely here from the World Trade Center disaster, and they had expanded all over the gambling industry. They're absolutely huge in Great Britain in terms of sponsoring horse racing . . .

**MR. PENCHINA:** Right, right.

**MR. LIEBMAN:** . . . and they have been the major developers of this type of gaming, and they believe this will be a homerun.

**MR. SNUKAL:** And I can tell you from actually speaking to a number of the Nevada executives, that they are cautiously optimistic. I mean if you take a large casino, for example, like Caesar's Palace, it's a huge facility for those of us who have been there, but really, only about fifteen percent of the entire facility can you actually gamble within. And so what this does is it really opens up just a whole new world for the casinos.

**MR. PENCHINA:** And also it's interesting just observing it from the outside, the casinos have been conflicted from the outset of Internet gambling, not knowing whether to fight it to maintain its physical location or to push to get it legalized so that they can expand their brand into that sphere. And I think there's starting to be divergence, and this was one of the first things where there—it's a toe in the water, "We're going to do something that looks like Internet, but we're going to do it within our own facility."

**MR. SNUKAL:** Although, two years ago, the MGM Grand launched its own online casino, and being a public corporation and not wanting to wake up the SEC or the Justice Department, from day one, they did not accept any U.S. bets, and they invested a lot of money in a proprietary gaming engine, a random-number generator. They built this tremendous website, and it was closed in about six months. Because the reality is, today, fifty percent of all bets come from the U.S., and if you're not taking bets from U.S. punters, as the British refer to players on the casinos, you're going to be out of business before you know what's happening.

**MR. LIEBMAN:** And, again, what you want to really look for in this area is MGM and Harrah's, which have been the most aggressive of the large casinos in trying to push the envelope. Watch Harrah's in terms of general expansion and Indian gambling, it has tended to be the leader. Just watch what they're doing in terms of Internet gambling to see where the industry is going.

**MR. SNUKAL:** Yes. No, you're absolutely right. I mean I've heard Terry Lanni, the Chairman of the MGM Grand, I heard with my own ears, say if he had his way, online gambling would be completely legal. And you might think that it takes away business from Vegas, but

actually the way they see it, it increases business because, if a 42-year-old woman in South Carolina, I'm just using that as an example, because the reality is, that is largely the demographic. That's who's playing online casinos in this country. If the 42-year-old woman is having a great time playing slot machines at her computer, there's a strong likelihood that she's either going to make a trip to Vegas or to some other casino nearby to do it in person where she can be served a free drink.

**MR. LIEBMAN:** Another issue here is that the large strip casinos that we're talking about here make most of their revenue not from gambling, but from hotel entertainment-type activities. And this is a way of increasing their gambling activities at the hotel. I mean we think of them as huge gambling palaces, but the fact is, by now, Las Vegas has been so transformed, it's not Atlantic City. The monies come actually from the hotel operations.

**MR. SNUKAL:** I was speaking to an executive at Harrah's, he said that Caesar's Palace, for example, which was acquired by Harrah's earlier this year, they generate about—the split of revenues, casino revenues versus, hotel revenues, is 50/50 today. And if you enter the new Wynn Hotel, you wouldn't believe how small the casino actually is. And I was speaking to a security guard there, they're predicting that the split is going to be 70/30; 70 from the food and the clothing and the shopping and all the entertainment, and 30 from the actual casino itself.

**MR. PENCHINA:** In moving down our outline, I think our next group of subjects is the Pari-Mutuel Wagering Interstate Horse Racing Act.

**MR. LIEBMAN:** Yes. And this is the segue into horse racing, which I'll try to keep short, so that Adam really can do his thing on Internet gambling. I will try to keep it short. I'm not sure how successful I will be.

New York State has always been the major state for horse racing. It's where horse racing started in America back in 1665, and it once was not just a big deal, but an enormous deal.

It wasn't too long ago in an era made famous by "Guys and Dolls" that this area where there actually was an Astor Hotel and not an Astor Room, we were comfortably ensconced in an area which was the hub of regular illegal gambling activity. Yet, this era of Times Square as "Guys and Dolls" and the age of horse racing success seems to have faded into ancient history.

For years, horse racing was the nation's best-attended sport. If you look at the end of World War II, the big sports were probably baseball, college football, boxing, and horse racing. You may remember the sport of harness racing. In the 1950s, harness racing was the NASCAR of its day and was widely considered to be the fastest-growing sport in America.

Just to give you some stats. In 1964, Aqueduct Race-track, which to many of you is probably an exit off the Belt Parkway in Queens, raced 210 days and had average attendance in excess of 30,000 fans. Yonkers Raceway, which again to many of you, is the first exit on the N.Y. State Thruway, in 1964, raced 131 programs and averaged 25,400 fans. By contrast, the New York Yankees in 1964, with their fourth consecutive pennant victory, averaged less than 16,000 fans for 66 home days. Now Yonkers Raceway averages 550 fans a night and the Yankees average 50,500 fans. And despite all this, New York still is the nation's leader in actual hands-on racing.

Well, what accounts for what's happened to horse racing? I mean there are obviously numerous culprits. We've seen a general decline in the popularity of individual sports, with the exception of golf, boxing, bowling, track and field. They just don't seem to attract the same kind of interest that once occurred.

For years, outside of Nevada, the racetrack was the only place you could bet. Now, you're never more than a few blocks away from a lottery vendor or a short drive away from a casino. Horse racing's had a host of fixing and drug scandals. OTBs have siphoned customers away from the actual racetracks, and the atmosphere at OTB, or the lack thereof, has stripped whatever luster remained of the "sport of kings."

Many people believe that horse racing lacks a young fan base, and obviously, it's not the X Games. In fact, if you want to be part of the Fountain of Youth, go to Aqueduct on an afternoon and you'll feel very young. But the fact is that horse racing's always been the Geritol of sports.

It's also a sport that's uniquely regulated. It's the only sport, save jai-alai, that has legal gambling. It's also the only sport, save boxing, that's actually regulated by state government. We don't try to regulate baseball or football, but all participants in racing are licensed by state racing commissions, and these commissions set the actual rules under which the races are conducted. Racing commissions tend to be composed of political appointees, which basically explains why I could be on a commission for eleven years.

Under this setup, New York now has six harness tracks and four thoroughbred tracks, and no one is doing well. The three main thoroughbred tracks, which are run by the New York Racing Association, Belmont, Saratoga, and Aqueduct, still have some handle, but the others have not.

There are six OTB corporations which are regional public-benefit corporations whose members are selected by local governments. The largest and oldest is New York City OTB, which is located down the block at 1501 Broadway. You can also blame OTB for the decision in the *Cohen* case. It's Judge Keenan who wrote the Court of

Appeals decision who used to be the president of New York City OTB.

So what we've just done is we've substituted the color of Sky Masterson and Nathan Detroit for the cheerlessness of the OTBs. And the emphasis of racing has changed. While in 1964, you had to be at the track to make the bet. Now close to ninety percent of the bets are made away from the track. That means you need account wagering. If you don't have account wagering, that's the only area where there's a potential for growth in horse racing. So the issue is, where can you bet, who can you bet on, and who can you bet with?

I mean can you place horse racing bets from home, on telephones, or the Internet? Can you bet on racetracks operating outside the state? Can you bet with an account-wagering firm located outside your state?

Again, much of the history of this runs through the OTB down the block at 1501 Broadway. The original OTB law in 1970 contained not one word about account wagering. However, there was—and you have to remember that horse racing is kind of the twilight zone of New York law. There was a side agreement between Governor Rockefeller and Mayor Lindsay's office, under which telephone wagering was authorized. So New York authorized phone wagering, not through a law, not through a rule, but through a side agreement. And that's how phone wagering was conducted for the first fifteen years of its existence until in 1985, it got codified. The problem was, it's all nice for Albany to do all these things, what happens when Albany meets Washington. And this happened again, 1501 Broadway, first problem was, what tracks could you bet on?

New York City OTB started taking bets on the Kentucky Derby without the consent of Churchill Downs which runs the Derby. Many racing groups ran to Congress and said, "You can't let them do this. You can't let them take bets on races from outside the state." Eventually, Congress settled on a compromise known as the Interstate Horse Racing Act, passed in 1978 and codified at 15 U.S.C. 3001, et. seq. The law allows an OTB to take a bet on an out-of-state track with the permission of the out-of-state track, with the permission of the horsemen at the out-of-state track, with the permission of their State Racing Commission at the out-of-the-state location, and with the permission of the racing commission inside where the OTB is located. Despite this mess . . .

**MR. SNUKAL:** Do you have to ask the horse?

**MR. LIEBMAN:** Almost. In a sense you do, because the horse is represented by the owner whose organization has to approve this. OTB operated on this somewhat convoluted law until the 1990s when racing economics and technology converged to exacerbate the problems of off-track wagering.

Starting in the 1990s, as Bob has mentioned, race-tracks started accepting wagers directly into their pools electronically from tracks and OTBs outside the state. In short, they started calling them mingling wagers received on races run at their tracks. Additionally, many states were authorizing account wagering and taking bets from individuals who resided outside their state. As a member of the New York State Racing and Wagering Board, I think I aided and abetted this process.

And this all winds up in 1997 when Senator John Kyl of Arizona introduced his original bill, the Internet Gambling Prohibition Act of 1997. That would have prevented horse racing bets being placed over the Internet. In reviewing the bill, and objecting to it, the Justice Department took the position that, a) Internet gambling was covered by the Wire Act; and b) betting on horse races by people in one state betting into a system in another state violated the Wire Act. And even co-mingling of pools by transferring money from one state to the host side of the track violated the Wire Act.

In short, the very basis under which horse racing was conducted in this country was totally illegal under the Justice Department's view of existing law. This placed lawyers and horse racing in a fairly awkward position telling people, "Don't worry. While the Justice Department says you're committing a felony, they're unlikely to prosecute, and if they do prosecute, maybe you can win."

So what happened eventually really, in part, through Bob's good work, advocates for the horse racing industry knew they had to do something. So in 2000, they were successful in amending not the Wire Act, but the Interstate Horse Racing Act to state that an interstate bet includes pari-mutuel wagers where lawful, in each state involved placed or transmitted by an individual in one state, via telephone or other electronic media, and accepted by an off-track betting system in the same or another state, as well as a combination of any pari-mutuel wagering pools. This would seem, to some people, to mean certainly that co-mingling is lawful under the law, and also that when the states—when both states allow account wagering, it should be legal under federal law.

And that's how people conduct business now, but again, the Justice Department which has been consistent both under the Clinton Administration and the Bush Administration, has simply said, "That ain't the way we see it."

They stated in 2000 that they didn't believe that the amendment codified legality of common-pool wagering and interstate account wagering, even where such account wagering was legal in the various states, nor did it view that provision as repealing or amending the Wire Act and Travel Act and the Illegal Gaming Business Act.

So that's where we stand in horse racing. Really, the success of horse racing, to the extent that racing is successful, revolves around this slim thread of law which is not accepted by the Justice Department. And the fact is, under horse racing, this is where we are. I mean account wagering's boomed.

You have to look at Oregon which is kind of like what to account wagering is what Delaware is to incorporations. In 2000, the off-track hubs in Oregon did \$20 million in account wagering business. This year, it's likely that they're going to do more than \$600 million. So this is the one growth area of horse racing, and it's getting—and, again, it's under incredible stress from the Justice Department. So we're . . .

**MR. PENCHINA:** To put just a little color on Ben's description of the Justice Department, in 1997, the Justice Department did take the position that the Interstate Horse Racing Act doesn't allow these interstate wagers by telephone or computer. And so somewhere over the next couple of years, a few industry delegations went to visit the Justice Department and said, "What would it take to convince you? We read the law this way. Congress would not have passed an Interstate Horse Racing Act if they didn't intend this activity. What would it take?" And they said, "Well, you need to have the law amended so that it expressly deals with this provision." So in 2000, the law was amended and the Justice Department immediately said, "Yeah, but that's a civil law."

So even though we said if you amended it, we've rethought our position and we're standing with where we were, it's still unlawful, so—it's a little difficult to find any rational basis for their position. The few cases that they've cited don't support the position, but you can only go so far telling clients, "Well they haven't prosecuted yet." So, thank you.

**MR. LIEBMAN:** Well, this leads us back to where we are in New York. Can you take Internet bets in New York? I can add my personal story to this because in 1996, I unfortunately was in my house on Christmas Day, not going to the movies, not eating in a Chinese restaurant, or whatever, and I answered the phone, it's *The New York Times*. And they asked me, "What do you think about Internet betting on pari-mutuels?" And I say, "I think it's inevitable." Okay, the next day, it's in *The New York Times*. I get the call from the Governor's Office like this, "Could you go slow on this. We really aren't comfortable with what you're saying." And so they basically said, if there's going to be Internet gambling, it ought to be approved by the Legislature and not the Racing and Wagering Board, and that's the way it's been left. The State . . .

**MR. PENCHINA:** One last interruption.

**MR. LIEBMAN:** No, go, go. This adds to our program.



**MR. PENCHINA:** Of course, Ben is taking these positions now, but I remember appearing before him when he was on the Racing Commission arguing on behalf of my client based in Oregon as to why New York couldn't stop us from taking bets. I'd much prefer having him on the panel today to answer these questions.

**MR. LIEBMAN:** I'm just a tool at the Governor's Office, no matter who the governor is. But the state has now taken the position that account wagering can only be by telephone wagering, and we're still awaiting legislative action authorizing Internet wagering on horse racing.

Can the OTBs take account wagers from other states? They traditionally have, but it's clearly illegal, as Bob said, where the state has authorized pari-mutuel wagering and where account wagering is clearly illegal.

Finally, can someone from New York place a bet on horse racing with an account wagering service outside New York? The reality is that this is done every minute of the day, but under New York law, you can't technically do it, but as Bob and I believe, and apparently no one else does, it's clearly a violation of the Dormant Commerce Clause. That leads us back—finally, where are we in New York racing? Not in great shape. We tried to resurrect the tracks by giving them video lottery terminals and the five harness—four harness tracks, and one-third of our tracks upstate that have it are now doing okay, but their horse racing business has never moved. And, in fact, New York's video lottery terminal provision, which was recently found constitutional by the Court of Appeals, is probably the worst, one of the least successful systems in the United States. The average per-machine handle revenue on a machine in New York is \$150 a day, which is about 50 percent less than a national average on this.

We're left with two tracks downstate. Yonkers, which will add video lottery terminals later this year. They're supposed to have 7,500 video lottery terminals, which will mean they will have 13 times more lottery terminals than they've had patrons at their track. The New York Racing Association, which, based on the last panel, probably, if there was any interest in horse racing, ought to be the subject of a videogame, but has had a variety of legal issues, which are too involved to get into this late in the panel, but let me just pass it over to Adam.

**MR. SNUKAL:** Okay, great. I'm going to spend the remaining time today talking about Internet gambling, mostly on an international level. At the very end, I think we'll touch on some current events that are going on the MNA side and on the financing side, but I think hopefully at this point, you have a pretty good understanding of what the law looks like in the U.S., and it's certainly not clear. So I suggest now we go across the pond and we get a little bit of insight into what's going on in places like the U.K. and other countries in the E.U.

Just very briefly, I was going to start with Canada, our neighbor to the north, but we don't have a lot of time, so, bottom line, there's no legislation, federal or provincial, in Canada that expressly prohibits or outlaws online gambling.

One of the reasons why online gambling hasn't taken off, more so in Canada, is because of two basic provincial laws. One says that the provinces themselves are the only ones that are allowed to operate Internet lottery-type or games of skill schemes. And, number two, that in order to roll out an online gambling service, a casino or a poker room, at least two, if not more, provinces would have to agree that its residents would be allowed to play in those casinos. Neither of those have happened yet.

With respect to the actual laws themselves, there is, under the criminal code of Canada, there's something called a common betting house. A person is not allowed to be found in a common betting house. And, obviously, the question is, is a website, a poker site or an online casino, considered a common betting house? And simply put, this question has not been tested yet in the courts.

One important note is just minutes from Montreal is a place called the Kahnawake Mohawk Reservation. Now, the reason why this is important is because most of the largest casinos and poker rooms today are all being hosted out of the Kahnawake Mohawk Reservation. The reservation has formalized their process and procedures to the point where they've actually established a Kahnawake Gaming Commission, and the reservation, or the Commission, actually issues gambling licenses today.

So, for example, Golden Palace, which is one of the largest online casinos today, is being hosted out of the Kahnawake Mohawk Reservation. And it's sort of a funny story that they were about to do some construction on the reservation and they hit some wires. And when they did a little bit of further exploration, it turned out that the wires were actually part of the Canadian government Internet backbone. And the reservation threatened to basically shut down the Canadian government's Internet access if they didn't allow them to host casinos. And reservations in Canada have so much autonomy, the Canadian government said, "If that's what'll take, feel free to go ahead with that."

What's interesting, though, is while the law is certainly unclear in Canada, it happens to be very fertile ground for software gaming developers. Three companies, and I've listed them, are just some examples of some of the largest and most successful gaming software providers in the world. And I guess the point to note is that these are all publicly traded companies, and the government has taken a very laissez-faire approach.

The European Community, if you thought the U.S. was confusing, the European Community is ten times as

confusing as the U.S. regulatory scheme. What you have in the E.U. basically is two legal frameworks. One is obviously the law on the E.U. side, on a Pan European level, and then you have the individual Member States. So the E.U. has a basic principle. The European Commission says, "If we pass a law, the Member States can't have a contradictory law. And if they do have a law, then they have to change it, and if they don't change it, they get punished."

So initially, it's on a sort of a Pan European level, the E.U. has not passed any laws specifically regulating, authorizing, or prohibiting online gambling. They sort of left that to the individual Member States.

In addition, the E.U. did not really want to get involved in the debate of whether online gambling should be legalized or not legalized initially, and, in fact, when they passed their famous E-Commerce Directive of June 2000, there was a specific carve-out just for gambling, that said, "We're not going to touch gambling. We'll let the individual Member States decide whether their citizenry should be allowed to gamble or not." But as is the case today, and we're seeing it even more, a lot of pressure was being put on the E.U. politicians.

With the U.K. gambling law that went into effect earlier this year, with other E.U. Member States like Malta that have legalized online gambling, and more—I think more significantly, with some of the largest and most successful companies in Europe in the space, they've put a lot of pressure on the E.U. to change the law, or at least force the individual Member States to allow their citizens to gamble on Internet gaming sites.

So the E.U.—I'll just touch upon sort of the most important issue here, which is the free movement of services. This is a basic pillar within sort of an E.U. Pan European law. And the principle behind this law says that as long as a company is legal in the state in which it originates, it should be allowed to provide services across Europe, and the French government, for example, because they don't like what a German company is doing, shouldn't be allowed to prevent those services from being offered to French citizens, what is sort of commonly referred to as Article 49.

And what we're seeing is, the E.U., the cases they're bringing are all based on this Directive on services. In addition, the European Court of Justice has ruled on this particular issue, and the three big cases that came before them are the *Atamar* case, which was a Portuguese case, the *Gambelli* case, which is the most famous of them all, and the *Linman* case, which was a lottery case.

So without going into too many specifics, the court in the *Gambelli* case, said, "What, we're going to create a test, a criteria, and we're going to use this test to determine whether or not the individual member states' laws

are legal or illegal, are valid or invalid," in light of the position that the European Commission is taking.

And the three elements of criteria are, number one, is it non-discriminatory; number two, is it proportionate; number three, is it necessary? Are the laws restricting gambling, are those laws non-discriminatory, are they proportionate, and are they necessary?

So, for example, if the government says, "We just don't want a gambling problem to arise within our borders," that would probably pass the test. If, however, a government, and I'll give you an example in a few minutes, if a government said, "The reason we want to have such restrictive laws is because we only want one casino, or one casino operator, and that casino operator happens just to be a state monopoly." The *Gambelli* court, or the *Gambelli* criteria rather, says, "What? That is discriminatory. It's not necessary, and it's not proportionate."

The same way I think it would also apply to a charity. If the government said, "Well, we allow casinos, but only if they're charity-run." The same policy would apply. So really, I think—sort of to use the U.S. analogy, we're talking about police powers; we're talking about real concern with the welfare of the state. If the law is based on the welfare of the state and the welfare of the people, it has a better chance of being upheld.

A classic example, we'll use two examples, but a classic example, in Italy—I'm sorry, I just went too far ahead. When Italy submitted its budget for 2006, there was an expressed provision in the budget, in this federal piece of legislation, that was intended to block all ISPs. Somebody mentioned ISPs earlier. The law says ISPs must block all casino websites other than those that are licensed by the state. To date, Italy has only granted six licenses, and has really no intention of granting any others.

Now most experts, in your belief that the law will be struck down on its face because it's a violation of Article 49, and what's the real motivation? I mean what are we really talking about? Well, fact is, last year Italy faced its largest deficit since 1991, and it really wants to concentrate all the revenues that are being generated by the casinos within Italy so it can keep the taxes, so it can hopefully revive the economy.

Why isn't there a more coherent policy in Europe? Like we said, protectionism against internal markets, public health, consumer protectionism, attempts to safeguard national monopolies, and simply the fact that try to get twenty-five European members into one room and have them agree on one policy, it's next to impossible.

But there actually has been a very important development, as I mentioned earlier, in 2005, and that was the passing of the U.K. Gambling Act, which went into effect

April 7, 2005, although the legislation will not fully go into effect until 2007. The law gave a definition for remote gambling.

In the U.S., we typically refer to this industry as Internet gambling. In Europe, it's typically referred to as remote gambling, but it's really the same thing.

The most important point to note under this legislation is the creation of a Gaming Commission. And the Gaming Commission basically has broad powers to interpret the laws, and also to pass laws and pass and institute regulations as time goes on to meet the demands of the U.K., to meet the demands of the technology. As the technology changes, the commission has the authority to pass laws that will evolve along with the industry itself.

Somebody here mentioned advertising. The rule of thumb right now in the U.K. is basically, "No person shall issue or cause to be issued any advertisement, inviting the public to subscribe for money or money's worth." What that basically means in layman's terms is you can't have an advertisement that says, "Come play at my casino." The U.K. authorities feel that's too dangerous, but what you are allowed to do is simply put the name of your casino up on a huge billboard in the middle of London, where if anybody has been in London recently, I noticed, for example, when I was there a couple weeks ago, when you get into the taxis there and the seats sort of go up, on the back of all the seats, you see "888-casino." So they're finding other ways of complying with the laws without creating too many problems.

But what is typical in Europe these days? Well, the French government basically has four laws that they're trying to argue have application to Internet gambling. One was a lottery law from 1836; one was a law on games of chance from 1983; one was a law pertaining to casinos from 1907; and a horse racing law from 1891. And the French are pretty confident that these laws really address exactly what needs to be addressed with Internet gambling.

And as I mentioned I think a little bit earlier today, the French authorities, while they may be living in a dream world that they think these laws have any application, they at least recognize that they're not going to get the bettors themselves, and so they're going after the various ancillary service providers.

The Netherlands, we can't spend too much time on this, but needless to say, it's probably the most interesting of all the playing fields right now in Europe. The government has taken a very hard position that the Holland Casino is the only casino that's allowed to exist, and the European commission recently sent a letter to the government of Holland or the Netherlands basically saying that, "We believe your policy violates Article 49." And most interestingly, just about a month ago, the

Administrative Court of Breda, one of the major courts in Holland, agreed with the European Commission that, in fact, the state law was not coherent, not consistent, and should be made consistent with the European Commission position on this issue.

I mention Sweden just for one important development. Also in December of 2005, the Swedish government decided to award probably the first official online poker license. It was to a Swedish gaming operator, Svens Gespeld. It was a two-year license. The primary reason, money. The Swedish government said, "Here's \$40 million, we're losing every year because of foreign online poker operators, and there's no reason why we shouldn't keep that in-house." Although they did impose some interesting regulations, the bets cannot exceed \$10,000. The bettor must agree to a limit, to a cap on how much he's prepared to lose. And advertising, all advertising must include the Gambler's Anonymous 800 number or toll-free number in Sweden.

South Africa also, just very interesting. The federal government has—as of December 2005, recommended legalizing online gambling. You see the typical hyperbole to ensure that local gamblers have legal protection and that there's no criminal influences. Bottom line, they want to create an online gambling industry within South Africa. And I think that's really the direction that most companies are heading in.

Now where is remote gambling legal today? Three places. In other places also, but the three major hubs for Internet gambling, Malta, Gibraltar, and the Isle of Man. The reason why Malta's important is because Malta is a member of the E.U. The U.K., for example, has a law that says, and it's consistent with Article 49 with the Directive on services, that as long as you're an E.U. member, you're allowed to advertise your casino within the U.K. If you're not an E.U. member or a Gibraltar, Gibraltar is sort of schlepped into that new law also—you have to submit an application and you have to get on a waiting list. So operators who are licensed out of Malta will be permitted to advertise their casinos and their poker rooms or their betting operations in the U.K.

Licenses are obtained from the Malta Financial Services Authority. Again, this is all about money. It all comes down to money. I mean I think governments can sort of say that they're worried about the welfare of their citizens. In my opinion, this all comes down to money.

Gibraltar, Party Gaming, probably the largest gaming company right now in the world is licensed out of Gibraltar. In December 2005, they passed their laws regarding online gambling, and there's currently fifteen other companies that are licensed out of Gibraltar.

Isle of Man, which is just off the coast of England, it's a very, very beautiful place to visit. I was actually just there a few months ago. Completely open to online casino



no operators who are looking for a safe gambling, friendly jurisdiction. That's right out of their—they actually issue a handbook or a pamphlet to perspective casino operators saying, "Come to Isle of Man."

Another very important point that I want to make a point here, but I also want to mention regarding the U.K., both the Isle of Man and the U.K. have made it very clear that in their opinion, accepting bets from U.S. players is not illegal. So while it may be illegal in the U.S., while the U.S. may take the position that it's illegal, the U.K. says, "It's not illegal, and you certainly can take bets from U.S. players." There's a zero percent corporate tax rate here, but the license is a little expensive. We mentioned Vegas. Let's talk about some M & A activity. What—the point . . .

**AUDIENCE SPEAKER:** Can we go back to the Antigua, the WTO?

**MR. SNUKAL:** Yes, we skipped over that just so that I could . . .

**MR. PENCHINA:** We can pass it, but—just to bring you up to date on that. The WTO proceeding, Jay Cohen and his legal team, after losing the case, actually is behind the Antiguan challenge and it's the same lawyers who represented him, as I understand it. And essentially, under the GATT Treaty, the U.S. committed to treat gambling services the same way it treats other services that are included in the treaty, in other words, that the U.S. cannot discriminate against offshore or remote providers of that service. The U.S. argued before the WTO that that's not what it did, but everyone else, all the other nations who signed on to the treaty checked the right box. The U.S. checked the wrong box.

**MR. LIEBMAN:** Yeah. The other countries exempted themselves from this. The United States failed to do it.

**MR. PENCHINA:** That's the only country that committed to gambling to the treaty. The Antiguan argument is that we have these on—Antiguan businesses that are being prosecuted in the U.S., but we read the Interstate Horse Racing Act, and notwithstanding what the Justice Department says about it, you read it, it says, "Internet gambling is legal." So by keeping our businesses out, you are violating your obligations under the treaty. The U.S. argued that because gambling legislation is an area that relates to health and safety and morals, we have the right to legislate this notwithstanding the treaty. And that position was partially accepted. The WTO panel agreed that it was an area of health and safety and the U.S. could legislate. However, it still could not do so in a manner that discriminated against offshore.

The U.S.'s main argument was that the Antiguan argument is wrong in that we do not discriminate because we do not allow any Internet gambling, and the U.S., in its position to Antigua, to the WTO, said that the

IHA does not legalize Internet wagering on horse racing, notwithstanding what it says.

And so the ultimate ruling of the panel was, "Well, we're not going to rule what U.S. law says, but it sure seems to us like it permits Internet gambling on horse racing. Therefore, the U.S. does not seem to be in compliance with the treaty and we hereby order you to take measures as are necessary to come into compliance." They don't say what measures those are.

So the U.S. could declare itself in compliance in one way. The U.S. can withdraw the gambling commitment which would require it to either compensate Antigua and/or substitute other services in place, or it could make the laws in compliance by doing away with any ambiguity in the Interstate Horse Racing Act.

Interestingly, the argument that the U.S. did not make that the panel tweaked the U.S. for over and over again is the U.S. obstinately said that the IHA does not allow Internet gambling, therefore, we're not discriminating. Because this was an area of health or safety, the U.S. was entitled to take measures that would have a discriminatory effect so long as that effect was not arbitrary.

In other words, if the U.S. made a showing that—which is the argument that they were making generally without taking it to the next step, that because Internet gambling, particularly offshore, is susceptible to money-laundering problems, we need to ban that. In that circumstance, they would have prevailed, but because the U.S. refused to acknowledge that the law was discriminatory, it could not say that such discrimination was justified and, therefore, it lost that argument and now it's in violation.

**MR. LIEBMAN:** The U.S. has until April, I think.

**MR. LIEBMAN:** Yes—to make a decision. April 6th.

**MR. LIEBMAN:** But the problem is that Antigua does not have much of a remedy if the U.S. does nothing. Basically, they can declare, they can do something to the United States in terms of trade, which is nothing. So it doesn't really do that much for Antigua, but I just ask everybody else here what if the United Kingdom . . .

**MR. PENCHINA:** It's something for all of those guys—

**MR. LIEBMAN:** . . . what if the United Kingdom does make this case?

**MR. PENCHINA:** Everybody's closely watching that case, absolutely.

**MR. SNUKAL:** I just want to finish up with two more topics. M & A activity, this is an industry like any other. This is no longer, or this never really was sort of an industry in the back alley. Bet on Sports PLC, which is a publicly traded company in the U.K., recently acquired three gaming companies, all focused almost exclusively

on U.S. players. This just happened last week. Scientific Games Corporation, if you buy a scratch card, at least in this country, there's probably an eighty-five percent chance that the scratch card is coming from Scientific Games Corporation.

Traders on the New York Stock Exchange just announced an agreement to acquire a significant stake in this company, SNet AB, which is an online lottery company, so you can probably figure out where they're planning to go in the near future.

And in my opinion, the most exciting development, the Hilton Group PLC. The Hilton Group PLC was the sister company to the Hilton Group here in the U.S. They sold all of their hotel assets to the Hilton Group PLC. They were left with one asset, which is Ladbrooks. Ladbrooks, for those of you who are not familiar, is the second- or third-largest betting operation in the U.K. This puts about \$300 billion into their hands with obviously market liquidity. It's still a publicly traded company on the London Stock Exchange. And I think in the very near future, we're going to see some major movements from Ladbrooks and from the Hilton Group PLC, probably eating or acquiring some of the other major players in the industry.

**AUDIENCE SPEAKER:** So is Paris Hilton not modeling for that?

**MR. SNUKAL:** Actually, it's funny, what's most interesting about that, about that deal, is that they've basically cut off all ties to the U.S. Even the U.S. directors have since resigned so that there's absolutely zero nexus. And the reason they did that is so that basically Ladbrooks can now go after U.S. players. As I mentioned earlier, the U.K. takes the position that the British-licensed gaming operators can go after U.S. bets.

The last thing I want to mention is a company called Zone 4 Play. It's a very small company, trades on the OTC. What they're most well known for today is developing mobile gaming technology. What that means is basically putting a casino on your cell phone. So I just want you—I want to show you how this is happening under our noses irrespective of what the Justice Department says or does. As I said, it's a publicly traded company on the OTC. This is the language they used in their latest 10QSB.

And I think I highlighted a couple of lines there: "Services the interactive gaming industry; what that means is they develop products for gambling. Play for real interactive games; blackjack, slots, poker, for-real money. They say, "Play for fun and play for real." But

play for real is what it is. We're talking about developing technology, gambling technology. The provision of services on mobile devices; as I mentioned, putting a casino on your cell phone.

Our customers include online gaming operators; it's pretty clear. Betting exchanges; again, pretty clear. How do they make their money? Revenue-sharing agreements, percentage of the net revenues generated from those games. In other words, they take a piece of the house. So, I'm just pointing this out to you because this is clear in a filing in this country despite what the Justice Department has to say. It's a Delaware corporation, and if—at least taking a piece of the house sort of succeeding as the house succeeds. If that's not gambling, I don't know what is. And I'll just finish off with this.

**MR. PENCHINA:** Just a measurement of the fee unrelated.

**MR. LIEBMAN:** It's not aiding or abetting.

**MR. SNUKAL:** Yes. Just take a look at this. This is Bog Dog, one of the most popular betting sites in the U.S. You can go to bogdog.com should you desire to take a bet. And that's it.

**MR. PENCHINA:** I guess we're supposed to go from talking about one vice to participating in another one at the cocktail party.

**MS. CERULLO:** No more questions? We want to again thank the panelists and XM Satellite Radio for sponsoring the cocktail reception. Also, we're going to have two pianists up there playing for your enjoyment and pleasure, so please go. Thanks everybody for coming.

## Endnotes

1. *Susette Kelo, et al. v. City of New London, et al.*, 125 S. Ct. (2005).
2. Edited by former EASL Section Chair Howard Siegel.
3. 76 Fed. Appx. 389.
4. 293 F.3d 550.
5. *Ringold v. Black Entertainment Television*, 126 F.3d 70 (2d Cir. 1997).
6. *Vanna White v. Samsung Elec. Am.*, 1992 U.S. App. LEXIS 19253.
7. *Wendt v. Host Int'l, Inc.*, 125 F.3d 806 (9th Cir. 1997).
8. *Cardtoons, L.C. v. Major League Baseball Players Assoc.*, 95 F.3d 959.
9. *C.B.C. Distrib. and Marketing, Inc. v. Major League Baseball Advanced Media, L.P.* (E.D. Missouri).
10. *Albert F. Gionfriddo v. Major League Baseball*, 94 Cal. App. 4th 400.
11. *KP Permanent Make-Up Inc. v. Lasting Impression I, Inc.*, U.S. Sup. Ct. October. 8, 2004.
12. *U.S. v. Cohen*, 260 F.3d 68 (2d Cir. 2001).

# The Phil Cowan/BMI Scholarship

The Entertainment, Arts and Sports Law Section of the New York State Bar Association, in partnership with BMI, will fund up to two partial scholarships to law students committed to practicing in one or more areas of entertainment, art or sports law.

The Phil Cowan/BMI Scholarship fund looks to provide up to two \$2,500 awards on an annual basis in memory of Cowan, a past Section chair. Each candidate must write an original paper on legal issues of current interest in the areas of entertainment, art or sports law. The competition is open to all students attending accredited law schools in New York State along with Rutgers and Seton Hall law schools in New Jersey. In addition, up to ten other law schools at any one time throughout the United States shall be selected to participate in the competition on a rotating basis. Students from other "qualified" law schools should direct questions to the deans of their respective schools.

The paper should be 12-15 pages in length, including footnotes, double-spaced, in *Bluebook* form. Papers should be submitted to each law school's designated faculty member. Each school will screen its candidates' work and submit no more than three papers to the Scholarship Committee. The committee will select the scholarship recipient(s).

Submission deadlines are the following: October 1st for student submissions to their respective law schools

for initial screening; November 15th for law school submission of up to three papers to the committee. The committee will determine recipient(s) on January 15th. Scholarships will be awarded during the Section's Annual Meeting in late January.

Payment of scholarship funds will be made directly to the recipient's law school and credited to the student's account.

## Law School Scholarships

The committee reserves the right to award only one scholarship, or not to award a scholarship, in any given year.

The scholarship fund is also pleased to accept donations, which are tax-deductible. Donation checks should be made payable to The New York Bar Foundation, designating that the money is to be used for the Phil Cowan Memorial/BMI Scholarship, and sent to Kristin O'Brien, Director of Finance, New York State Bar Foundation, One Elk St., Albany, N.Y. 12207.

Cowan chaired the EASL Section from 1992-94. He earned his law degree from Cornell Law School, and was a frequent lecturer on copyright and entertainment law issues.

## ENTERTAINMENT LAW REPORTER

**The Entertainment Law Reporter has gone online at  
[www.EntertainmentLawReporter.com](http://www.EntertainmentLawReporter.com)**

Technology is revolutionizing the entertainment industry. Its impact on the music business is the most dramatic so far, though the movie business is close behind. Book and periodical publishers are feeling technology's effects too. Even the *Entertainment Law Reporter* has not been immune. So, after more than 27½ years of traditional publishing in print, the *Entertainment Law Reporter* is available online, free-to-the-reader, at [www.EntertainmentLawReporter.com](http://www.EntertainmentLawReporter.com).

Simply navigate your browser to the *Reporter's* website, and that month's articles will be there, waiting for you to read. In fact, new articles will be posted many times each month, just as soon as they are written, to get the information to you more quickly than was possible with a monthly print publication.



## Publication of Articles

The *Journal* welcomes the submission of articles of timely interest to members of the Section. Articles should be submitted with biographical information either via e-mail or on a 3½" diskette (preferably in WordPerfect or Microsoft Word) along with a laser-printed original. Please submit articles to:

Elissa D. Hecker  
90 Quail Close  
Irvington, NY 10533  
eheckeresq@yahoo.com

**WWW.NYSBA.ORG/EASL**

## Entertainment, Arts and Sports Law Journal

### Editor

Elissa D. Hecker  
90 Quail Close  
Irvington, NY 10533

### Section Officers

#### Chair

Alan D. Barson  
853 Broadway, Suite 1001  
New York, NY 10003

#### Vice-Chair

Kenneth N. Swezey  
41 Madison Avenue, 34th Floor  
New York, NY 10010

#### Secretary

Judith B. Prowda  
15 West 75th Street  
New York, NY 10023

#### Assistant Secretary

Michele Christina Cerullo  
100 Park Avenue, 12th Floor  
New York, NY 10017

#### Treasurer

Steven H. Richman  
32 Broadway, 7th Floor  
New York, NY 10004

This *Journal* is published three times a year for members of the Entertainment, Arts and Sports Law Section of the New York State Bar Association. Members of the Section receive the *Journal* without charge. The views expressed in articles published in this *Journal* represent those of the authors only, and not necessarily the views of the Editor, the Entertainment, Arts and Sports Law Section or the New York State Bar Association.

We reserve the right to reject any advertisement. The New York State Bar Association is not responsible for typographical or other errors in advertisements.

©2006 by the New York State Bar Association.  
ISSN 1090-8730



Entertainment, Arts and Sports Law Section  
New York State Bar Association  
One Elk Street  
Albany, NY 12207-1002

**ADDRESS SERVICE REQUESTED**

NON PROFIT ORG.  
U.S. POSTAGE  
**PAID**  
ALBANY, N.Y.  
PERMIT NO. 155