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Internet and Technology Law	Micalyn S. Harris 625 North Monroe Street Ridgewood, NJ 07450 (201) 447-0561
Securities Regulation	Michael J. Holliday 327 Jefferson Avenue Westfield, NJ 07090 (908) 654-9038

Editor's Message

As I write this in early November, the mutual fund industry is receiving intense attention. Investors have withdrawn billions of dollars from Putnam; Putnam's CEO has resigned; Attorney General Spitzer is again leading the charge, and investigations of other mutual fund families appear to be imminent. Earlier this week Vanguard, one of the largest and most respected of all mutual fund companies, released a report that lambasted companies generally for a half-hearted response to calls for improved corporate governance.

As a result of the recent dramatic growth of self-directed 401(k) plans, more Americans are investors than ever before, and they receive conflicting advice from the financial experts. Will the uncertainty affect the flow of funds into the mutual fund industry? Will employees begin to clamor (as they probably should) for employers again to assume responsibility for the investment of pension plan assets?

We begin this issue with reports from the Committees on Corporations and Other Business Entities, Internet and Technology Law and Securities Regulation. As the reports indicate, the Committees have been very active in preparing comments and holding meetings.

In our first article, Grace Sterrett explores the complexities of the New York State and New York City laws governing "high cost home loans" and their relationship to, and possible preemption by, federal law.

The second article, by Vincent Amato, discusses predatory lending and mortgage fraud, and outlines various types of sophisticated frauds perpetrated by groups of individuals, covering multiple properties in elaborate schemes to defraud lenders.

The third article reflects the changed environment resulting from the Enron debacle and the claims brought by the U.S. Department of Labor and individual plan participants for alleged fiduciary violations relating to employee benefit plans. Richard Nelson points out that corporate board members, senior executives, and administrative committee members may be liable under ERISA even though they are not themselves named as plan fiduciaries.

Our final article is the paper that was awarded second prize in the Section's student writing competition. David Lampman argues that The Digital Millennium Copyright Act of 1998 upsets the traditional balance of copyright law by providing copyright owners with a monopoly while preventing society from benefiting from fair use access.

I would like to thank the authors and the Section's officers, notably Grace Sterrett and Stuart Newman, for all their help. Publication of this *Journal* would be impossible without the unfailing support of our friends at the New York State Bar Association, particularly Richard Martin, Wendy Pike and Lyn Curtis.

Finally, I encourage you to enhance the benefits of Section membership by attending meetings sponsored by the Section and its Committees. In September, the Section put on an excellent program at its meeting in Cooperstown, and later this month the Section's Committee on Securities Regulation is sponsoring a program on Private Offering Exemptions and Exclusions Under the New York State Martin Act and section 18 of the Securities Act of 1933. The Section's presentation at the NYSBA annual meeting will take place on the morning of Wednesday, January 28, 2004, at the Marriott Marquis in New York City. To those of you who are unable to attend, I commend the excellent written program materials available from NYSBA.

David Pratt
Professor of Law
Albany Law School

Committee Reports

Committee on Corporations and Other Business Entities

The Committee has been focusing on two major efforts and a number of smaller ones. The major efforts are a complete revision and updating of the New York Not-for-Profit Corporation Law and a proposal to adopt a Business Trust Law.

The work on the Not-for-Profit Corporation Law is headed by Fred Attea and Greg Blasi and has involved very significant help from Professor Peter Pitegoff, Vice Dean for Academic Affairs and Professor at the University at Buffalo Law School, and Ms. Lauren Breen, Clinical Instructor at the University at Buffalo Law School. The major effort on the business trust legislation has been made by Greg Blasi.

Other matters which the Committee has been working on include legislation which would eliminate various publication requirements for New York entities, an effort which is being headed by Bruce Rich, and amendments to section 803 of the Business Corporation Law and certain provisions of the Limited Liability Company and Limited Partnership Laws.

Edward H. Cohen
Chair

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Committee on Internet and Technology Law

The Internet and Technology Law Committee, formerly The Computer Law Committee, was formed about 20 years ago to examine "cutting edge" issues raised by the increasing use of computers, especially desktop computers, and the computer software and services they require. Our members include practitioners, corporate counsel and government lawyers whose practices focus on or frequently involve the uses and abuses of computer hardware and software.

Over the years, we have exchanged information on Internet research and examined issues such as: whether software licenses are enforceable; the appropriate use of e-mail for attorney-client communications; the need for and likely impact of the proposed Uniform Computer Information Transactions Act; what kinds of expectations are reasonable regarding employees' use of employer's computers for personal e-mail and other activities; the scope of discovery of e-mail and other "electronic" documents (documents maintained in digital form); e-commerce and contracting; and protection of trademarks and other intellectual property on the Internet, both when being sent and being used on or accessed from Internet Web sites.

Over time, some of these issues have been resolved. *ProCD, Inc. v. Zeidenberg*[1] put to rest most if not all of the questions as to whether software licenses are enforceable. (They are if the contract was validly formed—offer, acceptance, consideration, absence of fraud, etc.) Courts have also found that in appropriate circumstances, corporations must produce electronic records in response to discovery requests and requests for electronic records are now routine. Courts continue to flesh out what constitutes a "reasonable expectation of privacy" regarding employee e-mail, but increasingly, the answer is that company e-mails, at least if backed up and stored as part of a company's routine corporate back up procedures, are corporate records and neither the corporation nor individual employees can rely on claims of a right to privacy regarding such records.

Challenges remain. Software development contracts continue to produce drafting challenges. Protection of intellectual property in digital form continues to produce practical challenges. (For example, the record companies' attempts to stem alleged lost revenues due to file-swapping have been widely publicized, and the movie industry shares similar concerns.) Preventing and prosecuting trademark infringement on the Internet produces both jurisdictional and substantive challenges. Articulating corporate e-mail and Web-surfing policies governing employee use of desktop computers and handling of information on or accessible via employee laptop computers continues to produce challenges.

Notwithstanding these challenges, e-commerce is burgeoning. Online stock-trading by individuals, retail purchases of all kinds—from books to clothing to appliances to sending money and flowers, continues to expand.

In the coming year, the Committee expects to focus on articulating techniques for assuring that online contracts are valid, binding and enforceable, techniques for avoiding fraud and charges of fraud, available techniques for protecting digital content accessed via and intellectual property such as trademarks displayed on the Internet, and the emerging definitions of the scope of electronic discovery and production of both digital documents and internal mechanisms for sorting, searching and retrieving them. In these connections, methods to assure that privacy obligations to clients, customers are met, that systems are secure, and therefore that contracts and information reliable are also likely subjects for examination.

We encourage informal exchanges among our committee members and warmly welcome new members. Our next meeting is scheduled for April, 2004, in conjunction with the Section's Spring Meeting.

Micalyn S. Harris
Chair

Endnote

1. 908 F. Supp. 640 (WD Wis. 1996)

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Committee on Securities Regulation

The Committee on Securities Regulation presented a CLE program on "Practical Implementation of the New Governance, Compliance & Disclosure Requirements After Sarbanes-Oxley" at the Section's Fall Meeting in conjunction with the Young Lawyers Section in September. Earlier in the year, the Committee presented two CLE programs—on "Corporate Governance Issues as Affected by Sarbanes-Oxley" at the Annual Meeting in January in conjunction with the Corporate Counsel and Young Lawyers Sections, and the Section and Association's regularly scheduled program on "Basic Securities Law for the Business Practitioner" in April.

In addition, during the year through September, the Committee has filed comments on seven proposed regulatory and legislative changes and requests for public views. The subjects included SEC rules regarding the proxy process and shareholder nomination of directors, shareholder communications with boards of directors, New York Stock Exchange (NYSE) corporate governance standards for listed companies, standards of professional conduct for attorneys (in conjunction with the Section), standards for audit committees, electronic filing of insider ownership reports, and proposed changes to the Martin Act and certain other sections of the General Business Law.

The Committee also had a full schedule of monthly meetings with presentations by Committee members and outside speakers. Topics included SEC, NYSE and NASD rule proposals to implement Sarbanes-Oxley, shareholder nomination of directors, internal financial controls, management certifications of financial statements and disclosure reports, audit committee standards and member qualifications, financial reporting and other disclosures, professional standards of attorney conduct, equity compensation plans, corporate governance proposals, insider short-term trading liabilities, and issuer share repurchases and disclosures. The Committee presentations also covered regulation of securities analysts, reporting of proxy voting by investment advisers and funds, regulation of the IPO distribution process, Federal Reserve Board interpretations on tying credit to underwriting and investment banking services, director liability for corporate compensation arrangements, pension plan funding and disclosures, and mutual fund and hedge fund issues.

Michael J. Holliday
Chair

Crackdown on "Predatory Lending": New York's Approach and the Impact of Federal Preemption and Parity

By Grace Sterrett

"Predatory lending"—the very term conjures up an image of inequities: unscrupulous mortgage brokers and lenders preying upon consumers who out of ignorance or financial desperation pledge their homes, typically in a refinancing, as security for a loan on terms (interest rate plus fees) that, in reality, they lack the ability to repay, making default and foreclosure almost a certainty. In contrast, consider "subprime lending": risk-based credit pricing lending programs that allow consumers with less then perfect credit histories (often due to circumstances other than "fault" such as a period of unemployment caused by a decline in the economy) to qualify for a loan. Granted, the "price" of credit on a subprime transaction is greater than for a loan to a person with a good credit rating, but then the risk of default is greater. Surely a lender, like any other business, should be *permitted* to price the loan of its inventory (essentially money) based on risk of default?

Part of the growing concern over "predatory lending" has been fueled by growth in the availability of credit—starting in the mid-'90s—for those with less than ideal credit; the increase in the number of willing lenders—enhanced by the growth of non-bank home finance lenders; and the relative ease of obtaining a junior lien loan/line secured by one's home.[1] Basically there are more willing lenders, lots of interested borrowers, and the growing concern that many people are borrowing above their means, leading to the ultimate loss of their homes when they can't repay the loan.

Although the federal and state laws typically do not outright prohibit the making of so-called "high-cost home loans," there are so many open questions as to whether such loans can be sold into the secondary market (and at what price), or ultimately enforced in a foreclosure action if there is a default, that there is a concern that such laws may result in the reduction of subprime credit programs, making credit less available for those with a blemished credit record.[2]

One question facing state and municipal legislatures and governmental agencies today seems to be *where* to draw the line: assuming a willing borrower, is there some interest rate or some amount of related fees that is just too much, so that the government is justified in "capping" the fees a borrower can pay and in actively discouraging the borrower from accepting the loan? Some legislators and regulators seem to be saying, in effect, that consumers ought not to be allowed to obtain mortgage financing if the interest rate or fees exceed a specified level—even if the consumer is a willing borrower. This type of "prohibition" is akin to state usury laws where a state has declared that a loan, with an interest rate above a stated percentage, is so excessive that it is criminal. For example, although there are numerous exceptions to New York's general civil usury ceiling of 16%, interest rates charged to natural persons in excess of 25% per annum generally constitute a violation of the Penal Law.[3] How does any government protect its citizens from "predators" and at the same time not scare off legitimate risk-based credit lenders who are willing to extend credit to those with poor credit histories?

Numerous states and municipalities,[4] including New York State[5] and New York City,[6] have wrestled with this question and have enacted *their* version of an anti-predatory lending residential mortgage law. Congress first attempted to address this issue by the passage of the Home Equity Ownership Protection Act (HOEPA) in 1994.[7] The federal law is implemented by the Federal Reserve Board in the form of Regulation Z, which was recently revised effective October 1, 2002, to make the HOEPA rules more protective of consumers.[8] Still, many states and municipalities determined that HOEPA, even as revised, did not go far enough and so continued to enact their own protective lending laws with different criteria, different disclosure requirements and different penalty provisions for brokers, lenders and assignees who violate their laws.

A second question is *who* gets to draw "the line." Is it the right of a state or a local municipality to draw the line for loans made within their communities? Should there be one national standard, particularly for federally chartered financial institutions who are regulated by a federal agency, like federal savings banks and national banks, so that lenders doing business in several states will not have to prepare multiple state or municipal lending programs? This question of "who" has the right to regulate "predatory lending" is now part of the classic debate over states' rights versus federal preemption or the right of all or only select entities to override state and municipal laws when acting pursuant to a federal law or a national lending standard.

New York's Approach

The approach in New York State has been to *proactively* enact laws and regulations that are more protective of consumers seeking credit to be secured by their principal residence than the federal standards established by HOEPA. In October of 2002, New York enacted its own "High-cost Home Law" in the form of Banking Law § 6-l which became effective April 1, 2003.[9] This statute followed a pre-existing banking regulation, "Part 41," which went into effect on October 1, 2000. Part 41 was one of the first state regulations to adopt more protective standards than those set by HOEPA. The Banking Board has since revised Part 41 (effective May 5, 2003) in order to comply with the terms of the new *state* High-cost Home Law.[10]

Just prior to this action on the state level, seemingly uncertain that the state legislature would adopt legislation to curb predatory lending practices, the New York City Council overwhelmingly (44-5-0) passed a strong anti-predatory lending bill (Int. 67-A) on September 25, 2002, basically barring those engaged in what the bill defined as predatory lending practices, directly or through affiliates, from doing business with New York City. Noting that there was now a state law that arguably preempted the field, and alleging that the City Council had assumed rights reserved to the Mayor's Office regarding the designation of those eligible to do business with the city, the Mayor vetoed the resolution on October 24. The City Council overrode the Mayor's veto on November 20, 2002, and Local Law 2002/036 went into effect 90 days thereafter, on or about February 18, 2003.[11] Shortly after its effective date, the Mayor commenced an action to prevent the ordinance from being enforced. The parties initially agreed to a temporary restraining order pending the outcome of a preliminary hearing and pursuant to a subsequent court ruling, the effectiveness of the law is stayed until the court makes a decision on the Mayor's demand for the city's law to be deemed to be preempted and unenforceable.[12]

New York State's High-cost Home Law follows the two-prong test established under HOEPA to determine whether a residential mortgage loan is a "high-cost home loan."[13] The first test is whether the "Annual Percentage Rate," or APR (basically the interest rate and fees deemed to be finance charges described at an annual rate), exceeds a set margin over the yield on U.S. Treasury securities having comparable periods of maturity to the loan. This is sometimes referred to as the APR trigger. The second test or "trigger" is whether the total "points and fees," or P&Fs, paid by the borrower at or prior to closing exceed the thresholds set by the statute. (The P&Fs are defined by each law or regulation and may include different items, but typically they include things like points, broker fees and certain third party closing costs (such as title insurance or an appraisal) if the lender or an affiliate of the lender receives compensation from the charge.) If the loan (or line of credit) exceeds one or both of these two thresholds, then the loan/line is a "high-cost loan" and the mortgage broker and lender are obligated to issue additional disclosures (such as a notice recommending counseling before financing),[14] and the loan terms may not contain certain features deemed to be anti-consumer such as short-term balloon provisions, negative amortization, an increased interest rate upon default, etc.[15]

The New York State APR trigger to determine whether a residential mortgage loan is a "high-cost home loan" is where the APR exceeds the yield on Treasury securities having comparable periods of maturity to the loan term by 8 percentage points or more for a first lien and if it equals or exceeds the yield by 9 percentage points or more for junior liens.[16] In contrast, the New York City APR trigger is a rate that equals or exceeds the Treasury securities yield by 6 percentage points for first liens and equals or exceeds that yield by 8 percentage points for junior liens.[17] HOEPA, as implemented by Regulation Z, sets the APR triggers at 8% for first liens (reduced from 10% to 8% in 2002) and a notably higher threshold of 10% for junior lien loans.[18]

The P&F trigger for New York State ranges from 5% to 6% of the "total loan amount" or "TLA": 5% where the TLA is $50,000 or more; 6% where the TLA is $50,000 or more and the loan is a purchase money mortgage insured or guaranteed by the Federal Housing Administration or the Department of Veterans Affairs; and the greater of 6% or $1,500 where the TLA is less than $50,000.[19] The New York City P&F triggers range from 4% if the TLA is $50,000 or more to the greater of 5% or $1,500 where the TLA is less than $50,000.[20] HOEPA sets the trigger at the greater of 8% of TLA or $488 (effective January 1, 2003).[21]

Lest one conclude that compliance is a simple matter of keeping a chart of percentages, note that the definition of TLA varies with each statute so that the P&F trigger is applied to a different base number depending upon the statute. For example, in the New York State law the TLA is not the principal amount of the loan but rather the principal of the loan minus those P&Fs (as defined in the statute) that are included in the principal amount of the loan.[22] HOEPA and Regulation Z define the TLA as the "amount financed," a defined term in that regulation, minus the P&Fs financed by the creditor.[23] While these two formulas seem similar, a further problem is that what is considered to be a P&F also varies by statute. Under HOEPA, for example, yield spread premiums paid to brokers out of the interest rate on the loan are not included in the P&F calculation, as presumably they are already included in the APR calculation.[24] In contrast, the New York State law expressly includes all fees paid to mortgage brokers as a P&F.[25]

Assuming the loan is a "high-cost home loan" the lender is then required to issue additional disclosures (typically notices suggesting that the borrower seek counseling before entering into the loan transaction, advising the consumer that this is an expensive loan, etc.). The lender also faces operational constraints and severe penalties for even unintentional or technical errors. Using New York State's Banking Law § 6-l as an example—here's what a lender faces in the way of operational constraints and potential penalties:

- **No lending without due regard to repayment ability.** A lender or a mortgage broker is prohibited from making or arranging a high-cost home loan without due regard to repayment ability. Factors to consider include the borrower's current and expected income, current obligations, employment status, and other financial sources. (Lenders and brokers may *not* consider the borrower's equity in the home which will secure the loan.) Such information must be *". . . verified by detailed documentation of all sources of income, as and corroborated by independent verification*." Rebuttable Presumption: There is a "rebuttable presumption" that a loan was made with due regard to repayment ability provided the lender can demonstrate that, at the time the loan was made, the borrower's total monthly debts, including amounts owed under the loan, *did not exceed 50% of the borrower's monthly gross income*, provided the lender also followed the residual income guidelines established by the Veterans' Administration.[26]

- **No Financing of "points and fees" in excess of 3% of the principal amount of the loan.** "Points and fees" are as defined in the Banking Law. Note: This 3% limit is of the *principal loan amount*, not the "Total Loan Amount," a term defined above.[27]

- **Insertion of "Bad" Loan Features Prohibited, *including*:** no call provisions; no balloon payments prior to 15 years; no negative amortization; no increased interest rate triggered by default; no more than two advance payments can be taken from loan proceeds at time of consummation; no oppressive mandatory arbitration clauses; no financing of insurance (premiums and debt cancellation payments calculated and paid on a monthly basis are not considered to be financed); no loan flipping; no encouragement of default on an existing loan to persuade borrower to enter into high-cost home loan transaction; etc.[28]

- **Limitations of Refinancing.** A lender may not charge *any* P&Fs when lender refinances its own or an affiliate's high-cost home loan with a new high-cost home loan.[29] A lender, who is not the original lender or an affiliate of the original lender, cannot charge any fees to modify, renew, extend or defer maturity date or payment of a high-cost home loan, if after such action: a) the loan will still be a high-cost home loan, or b) even if the modified loan is no longer a high-cost home loan, if the APR has *not* been decreased by 2 or more percentage points. Such a lender, however, who advances additional funds on a new loan (for which it and its affiliates were not the original lenders), can charge points/fees which reflect the lender's typical P&F structure for such loans.[30] There are also restrictions on the refinancing of "special mortgages," e.g., a home loan that is originated/financed by a government, tribal or not-for-profit agency which has benefits to the borrower like a below-market rate, where such benefits will be lost on refinancing, unless there is evidence that the borrower has received HUD-certified loan counseling or counseling from the original lender about the impact of refinancing and the loss of these "benefits."[31]

- **Penalties—Much Worse.** With respect to the penalty and related enforcement provisions, this state law is *much tougher* than "old" Part 41, which was only enforced by the Banking Department: there was no private right of action. The new state law provides for a private right of action and also authorizes the Superintendent of Banking and the Attorney General to take enforcement actions.[32] New Banking Law § 6-1 provides for actual damages, statutory damages—including forfeiture of all interest (earned and unearned), fees and closing costs; complete rescission may be ordered by a court for *any* violation—*without any time limitation*—regardless of whether the issue of a violation is raised affirmatively or as a defense; and for *intentional* violations the court may declare the entire transaction void and mandate a complete refund to the borrower.[33]

- **Foreclosure Uncertain.** Assignees who seek to foreclose a New York high-cost home loan, or to take some enforcement action after the loan has been in default for 60 or more days, may be subject to any claim in recoupment or defense to payment under the provisions of this law with respect to such a loan, *without time limitations*, that the borrower could have asserted against the original lender.[34]

A companion amendment to Banking Law § 6-l amended the New York foreclosure laws to provide that it shall be a defense to a foreclosure proceeding that there was *any* violation of Banking Law § 6-l. It requires lenders in their foreclosure complaints to affirmatively allege complete compliance with Banking Law § 595-a (a provision which addresses various compliance procedures ranging from advertising to the making, closing, and funding of mortgage loans with various disclosure and substantive obligations) and the new law, Banking Law § 6-1.[35] This may be difficult for any lender to do, and virtually impossible for an assignee, who has no actual knowledge of what was given (or not given) to the borrower in the course of the solicitation, application and closing process.

The Secondary Market Is Nervous

Assuming a lender is able and willing to comply with the above, note that the secondary market has been sufficiently scared off by the New York law so that the two major purchasers, the Federal National Mortgage Association and the Federal Mortgage Home Loan Corporation, have indicated that they will not buy any such loans and are requiring lenders to essentially certify that any New York mortgage loans sold to them do not contain high-cost home loans.[36] The credit agencies are also concerned about the liability of assignees, so that agencies which give credit ratings to pools of mortgage loans sold to investors in the secondary market have either refused to rate New York high-cost loans or, if they do agree to rate them, will do so on the condition of additional due diligence and representations from the lenders, together with payment of an additional credit enhancement to cover the increased risk.[37]

Is Federal Preemption the Salvation for Federally Chartered Lenders?

Lenders, even those who do not make high-cost home loans, want the New York law (and similar laws in other states and municipalities) to simply *go away.* In part that's because lenders have to be aware of a multitude of APR and P&F "triggers" in each jurisdiction where they make loans, in order to either avoid making a high-cost loan, or to make a high-cost loan properly. As shown above, were the New York City law in effect today, lenders making loans in New York City would have to "chart" both the state and municipal laws to determine their compliance obligations. Currently there are some 21 state and municipal "predatory lending" laws/regulations in effect.[38] The burden of keeping abreast of all of the state and municipal requirements and then fashioning mortgage programs with state or municipal specific disclosures and terms is a costly one for lenders who make loans in more than one state. The fact that municipalities within a state are enacting their own unique laws makes compliance increasingly difficult. Most lenders would be pleased to have one national standard. Lenders who are federally chartered currently have the best opportunity to avoid being subject to the unique requirements of any state or municipal law, including those of New York.

The OTS Declares Its Members Exempt from the New York Law

In January 2003, the Office of Thrift Supervision (OTS) declared that the federal law which governs the operations of federal savings associations preempts the New York law, thereby exempting federal thrifts from any obligation to comply with New York Banking Law § 6-l.[39] In her letter, OTS Chief Counsel Carolyn Buck noted that:

> The NY law would thwart the more general congressional objective that OTS have exclusive responsibility for regulating the operations of federal savings associations "giving primary consideration of the best practices of thrift institutions in the United States." Congress gave OTS, not the States, the task of determining the best practices for thrift institutions and creating nationally uniform rules.[40]

The OCC Takes Preemptive Actions Which Could Impact New York

On July 30, 2003, the Office of the Comptroller of the Currency (OCC) issued a Determination and Order exempting National City Bank and its operating subsidiaries from compliance with the Georgia Fair Lending Act, an anti-predatory lending law similar to New York Banking Law § 6-l. The OCC found that the state law conflicted with several federal laws governing the lending operations of national banks, including national banks' powers to make real estate loans. Moreover the OCC concluded that "national bank's authority to engage in real estate lending activities derives exclusively from Federal law."[41] Use of the term "exclusively" sends the strong message that states or municipalities have no authority to regulate the real estate lending activities of a national bank—even when the loans are to residents of those states and municipalities.

The OCC simultaneously issued proposed regulations which, if adopted, would essentially preempt all national banks from compliance with state (and presumably municipal) high-cost home loan laws, provided the national bank adhered to OCC lending requirements. In fact, the proposed regulations would give national banks preemptive powers in more than just the predatory lending arena as the proposal addresses all real estate secured loans and non-real estate loans as well.[42]

In issuing their orders of preemption and exemption from compliance with a state's unique lending law, both federal bank agencies declared their opposition to predatory lending practices.[43] The motivation behind the rulings is to free their member banks from the cost of compliance with multiple state (not to mention municipal) laws and to preserve the power of a federal charter.

Operating Subsidiaries?

There is also an open issue as to whether an order of federal preemption would apply not only to the federally chartered "bank," but also to its operating subsidiary. Note that in the Preemptive Determination and Order issued by the OCC in connection with the Georgia law, the exemption applied not only to the national bank, National City Bank of Indiana, NA, but also to its operating subsidiaries.[44] The idea that the operating subsidiary of a national bank should be entitled to the same level of exemption from a state's lending laws is currently the subject of a challenge in the state of Connecticut. Wachovia Bank, NA is challenging the authority of the state to license and regulate its mortgage lending subsidiary. Attorneys General in some 35 states, supported by 43 state bank commissioners (including New York's), have filed an *amicus* brief in support of Connecticut Banking Commissioner John Burke. New York State's Attorney General, Elliott Spitzer, was quoted as saying: "This case is another illustration of the unrelenting efforts by federal regulators to undermine the states' ability to protect citizens from fraudulent and deceptive corporate practices."[45]

National Credit Union Association Provides Exemption for Its Members

Federal credit unions are primarily governed by the National Credit Union Administration (NCUA), pursuant to the Federal Credit Union Act.[46] The NCUA recently issued an opinion exempting its members from compliance with the D.C. Home Loan Protection Act of 2002, an anti-predatory lending law. NCUA declared that the D.C. statute was preempted as it contained provisions which would limit or affect the rates and terms of repayment that a federal credit union could offer to its members, and noted that the NCUA has *exclusive* authority to regulate interest rates, terms of repayment, and other terms and conditions of consumer loans for its members.[47]

Although the NCUA has not issued an opinion with respect to the application of Banking Law § 6-l to its members, it would seem that to the extent the D.C. and the New York statutes impact the rates and terms of repayment of a loan or line, the NCUA would declare its members to be exempt from compliance under the right of federal preemption. As noted above, prior to the enactment of Banking Law § 6-l, the New York State Banking Board had adopted the original anti-predatory lending regulation known as Part 41. In response to a letter from one its members, the NCUA in 2001 took a less aggressive position by issuing an opinion to the effect that its members could ignore Part 41—but only to the extent it was inconsistent with HOEPA:

> Reviewing the New York regulation in light of HOEPA, we believe that FCUs [Federal Credit Unions] are subject to provisions such as the state regulation's prohibitions regarding negative amortizations, increased interest rates, advance payments and certain lending practices. 3 NYCRR §§ 41.2(c). 2(d). 2(f),. 3(b), .3e. These provisions track HOEPA and its implementing regulation, Regulation Z, issued by the Federal Reserve Board (FRB).[48]

In its opinion preempting the D.C. law, the NCUA expressly disavowed this prior view, noting that the courts had recently expanded their interpretation of the preemptive authority of the Federal Credit Union Act, concluding that the savings clause of the Truth in Lending Act (TILA), by which a lender would have to comply with any state law governing HOEPA type loans which was not inconsistent with HOEPA, did *not* control the federal preemption analysis. Therefore NCUA has now opined: "NCUA's lending regulation preempts any state law, including one affecting aspects of lending primarily regulated by TILA, that regulates rates, term of repayment and other conditions of loans and lines of credit [citing 12 CFR § 701.21(b)(1)]."[49]

The Battle for Control Continues

As states and municipalities continue to enact lending laws protective of their residents it would appear that the federal regulatory agencies are becoming increasingly strident in their interpretation of the "right" of their members to ignore state and municipal legislation under an expanding claim of federal preemption. Therefore the question of federal vs. states' rights—regarding *"who"* gets to regulate lending activities affecting consumers—continues to be a controversial and combative one.

Who's Left to Regulate?

If the OCC declares all national banks to be exempt from state high-cost home laws, then in New York, Banking Law § 6-l (and presumably the New York City law, if it survives the current court challenge) would only apply to New York State-chartered financial institutions, licensed mortgage bankers and mortgage brokers.

Impact of Wild Card—"Parity" Statutes?

Such a result—declaration of exemption of national banks from compliance with Banking Law § 6-l—could lead to a request for "parity" by state-chartered commercial banks under New York's "Wild Card" legislation, which allows the New York Banking Board to provide state-chartered commercial banks with the same banking powers and benefits that are granted to national banks at the federal level.[50]

Initially enacted in 1997, primarily to grant state banks insurance powers equivalent to those granted to national banks, the statute provides that the Banking Board can adopt regulations to enable state commercial banks to "exercise any right, power, privilege or benefit, to engage in any activity, or to enter into any loan, investment or transaction" which a national bank or its subsidiary can enter into or engage in. Before enacting such parity regulations, the Banking Board is required to make a finding that the new regulation is not only necessary to achieve parity with national banks but is also consistent with the declared policy of New York to operate a safe and sound banking system and to protect the public interest, *including the interests of consumers*. Lenders and consumer groups will be watching New York closely to see how the Banking Board will respond to any request for "parity"—should the OCC exempt national banks from compliance with the New York high-cost home loan law, as they did with the Georgia statute.

As the 2003 Wild Card amendments also granted state savings banks similar parity rights to those enjoyed by federal savings banks, the Banking Board could be asked to exempt state thrifts from compliance with the New York high-cost home loan law on the ground that federal thrifts are not required to comply with this state law, thereby enjoying a "benefit" denied to state thrifts.[51]

Such requests will help to define the scope and application of the Wild Card parity statutes, as initially they were enacted to grant state financial entities *powers* similar to their federal counterparts—such as the right to offer insurance products. The purpose was to provide a level playing field between state and federally chartered banking institutions and to "preserve and enhance"[52] the value of the state banking charter. Although state-chartered institutions would want to enjoy the "benefit" of making loans under a single national lending standard, it is unlikely that the Wild Card statutes were intended to be a vehicle by which state-chartered financial institutions could seek to avoid compliance with state consumer protective laws. The issue of whether the "parity" statutes will be interpreted to apply the "benefits" (as opposed to "powers," e.g., insurance powers) bestowed on federally chartered financial institutions to state chartered banks on an equal basis, despite state laws to the contrary, will be an interesting one to follow.

Endnotes

1. *See* Supplementary Information Section of the Board of Governors of the Federal Reserve System's implementation of the final rules revising the HOEPA regulations in 12 C.F.R. Part 226, 66 Fed. Reg. 65604 *et seq*., (Dec. 20, 2001), and "A Prudent Approach To Preventing 'Predatory' Lending," by Robert E. Litan, VP and Director, Economic Studies Program at the Brookings Institution, Report prepared on behalf of the American Bankers Association (2001).
2. *See* Supplementary Information Section of the Board of Governors of the Federal Reserve System's implementation of the final rules revising the HOEPA regulations in 12 C.F.R. Part 226; *see also* discussion of section 31(a) "coverage" in 66 Fed. Reg. 65604 *et seq*., (Dec. 20, 2001); OCC Working Paper, Economic Issues in Predatory Lending, July 30, 2003 (Office of the Comptroller of the Currency discusses, in part, various studies which attempt to calculate the impact of protective laws on credit availability); and also "Unintended Consequences: The Risks Of Premature State Regulation of Predatory Lending" (2003) by Robert E. Litan, report prepared on behalf of the American Bankers Association.
3. *See, e.g.,* N.Y. Penal Law §§ 190.40, 190.42, prohibiting rates in excess of 25%.
4. Currently 18 states and Washington, D.C., have some type of high-cost home loan law or anti-predatory lending law in effect: Arkansas, California, Colorado, Connecticut, Florida, Georgia, Illinois, Kentucky, Maine, Maryland, Massachusetts, Michigan, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, and Texas. Five more states have passed such a law but the effective date is still pending: Illinois, Nevada, New Jersey, New Mexico and South Carolina. The effectiveness of other municipal laws has been stayed by litigation, including: Los Angeles, Oakland, Atlanta, Dayton, New York City and Toledo. Source: *Predatory Lending Update*, HouseLaw, Oct. 2003. (*See Counselor Library, TM* at http://www.creditcompliance.com.)
5. N.Y. Banking Law § 6-l (L. 2002, ch. 626, eff. Apr. 1, 2003) (hereinafter "Banking Law").
6. Local Law 2002/036 (Int. 0067-2002 A), available on Web site: http://www.council.nyc.ny.us. (Amends title 6 N.Y.C. Adm. Code by adding § 6-128; amends section 20-393 of title 20 of N.Y.C. Adm. Code by adding subdivisions 17, 18; amends § 1544(a)(2) of the City Charter.).
7. Pub L.103-325, 109 Stat. 2160, enacted in 1994 as an amendment to the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*
8. 12 C.F.R. 226.32, 66 Fed. Reg. 65604 (Dec. 20, 2001).

9. Banking Law § 6-l (L. 2002, ch. 626, eff. Apr. 1, 2003).
10. 3 N.Y.C.R.R. part 41; *see also* N.Y. Banking Dep't's Web site http://www.banking.state.ny.us: "high-cost home loans."
11. Local Law 2002/036 (Int. 0067-2002 A), available on Web site: http://www.council.nyc.ny.us, which shows history of enactment.
12. *The Mayor of The City of New York v. The Council of the City of New York and The Comptroller of the City of New York*, N.Y. Sup. Ct., Index No. 400583, Feb. 20, 2003.
13. Banking Law § 6-l (1)(d),(e) & (g).
14. Banking Law § 6-l(2)(l).
15. Banking Law § 6-l (2).
16. Banking Law § 6-l (1) (i).
17. N.Y.C. Admin. Code § 6-128 (a)(8)(b).
18. 12 C.F.R. § 226.32(a)(1)(i).
19. Banking Law § 6-l(1)((g)(ii).
20. N.Y.C. Admin. Code § 6-128(a)(8)(a).
21. 12 C.F.R. § 226.32(a)(1)(ii).
22. Banking Law § 6-l (1)(h).
23. Official Comment #1 to 12 C.F.R. § 226.32 (Official Commentary of Regulation Z).
24. Official Comment #1 to 12 C.F.R. § 226.32(b)(1)(ii).
25. Banking Law § 6-l (1)(f)(iii). See also warning of New York Banking Dep't to this different standard of calculation from what lenders may be accustomed to following under federal law: http://www.banking.state.ny.us/41overv.htm.
26. Banking Law § 6-l (2)(k).
27. Banking Law § 6-1(1)(f)—defines P&Fs, *and see* § 6-l(2) (m) for cap.
28. Banking Law § 6-l (2).
29. Banking Law § 6-l (2)(q).
30. Banking Law § 6-l(2)(f).
31. Banking Law § 6-l(2)(j).
32. Banking Law § 6-l(5).
33. Banking Law § 6-l (7)-(12).
34. Banking Law § 6-l (13).
35. N.Y. Real Property Actions and Proceedings Law § 1302 (added by L. 2002, ch. 626, eff. Apr. 1, 2003).
36. Federal National Mortgage Association, Announcement 03-02, Mar. 31, 2003; Federal Home Loan Mortgage Corporation, Industry Letter, Mar. 31, 2003.
37. *See, e.g.*, N.Y. Times, Mar. 26, 2003, reporting on Moody's Investors Service and Fitch Ratings; *see also* Fitch Ratings press release on New York issued Apr. 30, 2003.
38. *See* note 4 *supra*.
39. Office of Thrift Supervision, Letter from Chief Counsel Carolyn J. Buck, Jan. 30, 2003 (P-2003-2), *available at* http://www.ots.treas.gov.
40. *Id.* at 4, citing 12 U.S.C.A. § 1464(a).
41. OCC Preemption Determination and Order re National City Bank and Georgia Fair Lending Act (Docket No. 03-17) July 30, 2003, 68 Fed. Reg. 46264, Aug. 5, 2003; http://www.occ.treas.gov/georgiapreorder.pdf.
42. OCC Proposed Rule re: Bank Activities and Operations; Real Estate Lending and Appraisals, dated July 30, 2003, 68 Fed. Reg. 46119, Aug. 5, 2003 (comments due Oct. 6, 2003), *available at* http://www.occ.treas.gov/nprm.pdf.
43. *See, e.g.*, OCC Press Release, July 31, 2003, describing its anti-predatory lending policy. The OCC has also published other efforts on its Web site at: http://www.occ.treas.gov/combat.htm.
44. OCC Preemption Determination and Order re National City Bank and Georgia Fair Lending Act [Docket No. 03-17] July 30, 2003, 68 Fed. Reg. 46264, Aug. 5, 2003; http://www.occ.treas.gov/georgiapreorder.pdf.
45. *Wachovia Bank N.A., and Wachovia Mortgage Corp. v. John P. Burke*, (Civil Action No. 303 CV 07073 pending in the U.S. District Court for the District of Connecticut), as reported by MBA today, Mortgage Bankers Association, Aug. 28, 2003.
46. 12 C.F.R. § 201.21(b), 12 U.S.C. § 1751-1795.
47. NCUA Gen. Counsel Opinion Ltr. 03-0165 (May 23, 2003).
48. NCUA Gen. Counsel Opinion Ltr 00-0827 (Mar. 2, 2001).
49. NCUA Gen. Counsel Opinion Ltr. 03-0165 (May 23, 2003).
50. Banking Law § 14-g, as amended by L. 2003, ch. 241, extending expiration date until Sept. 10, 2007.
51. Banking Law § 14-h, as amended by L. 2003, ch. 241, to grant state savings banks parity with federal savings banks.
52. Banking Law § 14-g (1).

Grace Sterrett is a Partner in the New York office of Hudson Cook, LLP. She is current Chair of the Business Law Section of the New York State Bar Association and immediate Past Chair of its Consumer Financial Services Committee. She is a frequent speaker and author of articles on matters concerning consumer financial services and banking.

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Predatory Lending and Mortgage Fraud

By Vincent N. Amato

The mortgage industry has long had to live with loan fraud as a risk of doing business. We are all probably aware of the situations where a borrower misrepresents income or falsely states he will occupy the mortgaged premises as his principal dwelling to avoid paying the higher interest rate associated with loans to investors. Today, we are seeing the growth of a different type of fraud, one perpetrated by groups of individuals covering multiple properties in elaborate schemes to defraud lenders.

What makes these schemes more insidious is their reliance on unsophisticated borrowers who, more often than not, are as much victims of the schemes as the lenders. The perpetrators of the fraud represent all the disciplines involved in a mortgage transaction, including real estate agents, mortgage brokers, appraisers, closing agents, sellers and occasionally buyers. Since these schemes rely on unsophisticated borrowers, some of the most notorious schemes have involved properties in low- to moderate-income (LMI) neighborhoods that leave the victimized borrowers accusing the victimized lender of predatory lending, usually as a result of the lender's relationship with the participants in the fraud scheme. Community groups have already focused on fraudulent and deceptive loan origination processes as an element of predatory lending.[1] This focus has been incorporated into regulators' views of what practices constitute predatory lending.[2]

Fraud Scheme Examples

One of the more notorious schemes involved Baltimore row houses, and required the collusion of the mortgage broker, appraiser, and closing agents. In this scenario, individuals engaged in a series of transactions whereby they purchased properties (often run-down) at a minimal cost. These individuals purported to make some repairs and re-sold the properties at four or five times the amounts paid for them. Once one property was sold (at an inflated price), a "comparable" value was set for the appraisers to use in valuing the other properties. The mortgage brokers found prospective purchasers for the over-valued properties, or used Realtors for that purpose. These purchasers paid the inflated prices for the properties after being told that they could own the homes for "no money down." Many purchasers were misled about the terms of the mortgage as well. The closing agents then falsified the amounts of the down payments on the HUD-1 forms. The mortgage brokers, as their contribution to the scheme, falsified the amounts of the borrowers' income, and represented to the borrowers that the amounts of the mortgage payments to be made were less than the actual payment amounts. After the loans funded, the fraud participants walked off with a 500 percent profit, leaving the unsuspecting purchasers with buildings in need of substantial repair and loans they could not afford, and leaving the lenders with loans that were doomed to go into early payment default—as well as the blame for allowing the whole scheme to take place because of their lending practices through their brokers.

The Baltimore row house scam resulted in tens of millions of dollars in losses to lenders, who became the only entities available to compensate the borrowers for their damages.[3] Several lenders attempted to pursue the individuals behind the fraud on a variety of legal theories, and at least one lender brought civil RICO[4] claims against the fraud participants. The fraud schemes were so insidious that the claims withstood motions to dismiss, much to the surprise of many seasoned RICO litigators.[5]

The Baltimore row house scenario has been played out in Indianapolis, Cleveland, areas of North Carolina and other major cities with old housing stock in LMI areas and with lenders eager to increase their LMI lending. This scenario is merely illustrative of the shape these schemes can take. The aftermath is always the same: the victimized borrowers blame the lenders for allowing the scheme to happen and for the borrowers finding themselves with loans they cannot afford which will result in the eventual loss of their homes. Often the schemes involve identity theft, which eliminates the need to obtain an unsophisticated borrower's cooperation. The collaborators merely steal the borrower's identity, which makes the process of perpetrating a mortgage fraud that much easier.[6]

Schemes in New York

New York has witnessed its own fraudulent loan schemes in many neighborhoods that feature predominantly older houses. On May 8, 2003, the Queens County District Attorney, Richard A. Brown, announced the indictment of seventeen individuals for allegedly masterminding a scheme that targeted LMI areas of Jamaica, N.Y., and Ozone Park, N.Y. The seventeen defendants included three lawyers, a title closer and an unlicensed real estate broker. These individuals are accused of targeting property in particular neighborhoods and then falsifying all documentation, including a straw buyer and seller. The only thing real was the lender's money.[7] The actual homeowners were not even aware that mortgages had been placed on their properties until the lenders tried to collect payments.

Several schemes in Brooklyn also have left lenders with substantial financial exposure. These schemes, generally involving falsification of information by mortgage brokers, have victimized buyers who never understood the underlying financial transactions, who are unable to make the mortgage payments, and who do not have the resources to make the substantial repairs required to make the buildings habitable. In one scenario, participants in the fraud invited prospective buyers to come to a "meeting" at the participants' homes, so they could convince the buyers of the "financial benefits" of particular mortgages. These individuals were paid a "bounty" of $10,000 for every prospective buyer brought into the fraud scheme as long as the buyer had a credit history sufficient to support the granting of a mortgage. This modern version of the "Tupperware party" is an ongoing risk to lenders as unsophisticated buyers obtain loans on properties in LMI areas and subsequently discover that they cannot afford the loan or the repairs on the house.

Lender Responses

As can be seen, mortgage fraud is a real concern to lenders, not only for the loan losses it causes, but also because the victimized LMI borrowers leave the lenders on the dark side of the predatory lending debate. The question will always be, "How could the lender have let it happen?" The accusations that the lender should have known the facts before making a loan to the borrower that the borrower could not afford are routinely raised. The need for heightened lender awareness and protective action was highlighted recently by the Office of the Comptroller of the Currency. In several recent pronouncements,[8] the OCC discussed the processes required of lenders to avoid engaging in predatory and abusive lending practices. One of these processes involved procedures to avoid mortgage fraud, especially in the context of loans originated through third parties.

What, then, can lenders do to mitigate fraud risk and its accompanying predatory lending risk? An unintended benefit of the imminent requirement that financial institutions comply with section 326 of the USA Patriot Act[9] is the rise of an all-new industry to provide tools to detect fraud and identity theft. Various service providers will flag a loan for possible fraud based on information in the provider's database, which may concentrate on tracking the real property, the participants to real estate transactions, Social Security numbers, or any combination of these factors. New valuation services also are being made available to insure the valuation of the real property.

At the end of the day, the most effective loss mitigation strategy lies in the strength of a lender's pre-funding quality control. Careful reviews of HUD-1s prior to funding, specific closing instructions to closing agents and stringent verification of various types of borrower information are some of the most effective processes a lender can utilize, but they are difficult to advocate in an era of ever-more compressed timelines between loan application and funding. Lenders who are willing to take on this task can even obtain insurance against various types of fraud, which will allow a shifting of the risk and a financial benefit to the lenders in the area of loss reserves and capital requirements. In addition, the chance of moving the loan from its portfolio eliminates the servicing and public relations nightmares that are possible. Undertaking this task will also assist banks in meeting the expectations of their regulators. As stated by the OCC in the questions and answers to the pronouncements on predatory and abusive lending, the procedures will help address another significant risk of consumer abuse involving fraud.

Endnotes

1. ACORN, ACORN Hous. Corp., ACORN Fair Hous., Separate and Unequal: Predatory Lending In America, at 2, Nov. 2002.
2. OCC, Economic Issues in Predatory Lending, at 6 (Working Paper July 30, 2003).
3. The Baltimore row house scams became so pervasive that the Maryland legislature enacted legislation requiring appraisers to file a quarterly report with the State Commission of Real Estate Appraisers and Home Inspectors, listing the address and appraised value of all residential real estate in Baltimore on which the appraiser performed an appraisal. Act effective Oct. 1, 2003, ch. 435 (to be codified at Md. Code Ann. Bus. Occ. & Prof. § 16-212.1). Lenders utilizing their own in-house licensed and certified appraisers will need to ascertain the impact on their compliance. The law is effective Oct. 1, 2003.
4. Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961, *et seq.*
5. *Superior Bank FSB v. Tandem Nat'l Mortgage, Inc.*, 197 F. Supp. 2d 298 (D. Md. 2000) (denying motions to dismiss). The opinion sets forth the fraud scheme in detail and provides new authority for lenders to pursue third-party vendors. Of particular interest is the fact that the plaintiff was not the original lender, but a purchaser of closed loans. The court, during the course of the case, ruled favorably on the issues of privity and the duty owing to third-party purchasers.
6. One recent report shows that more than 3 percent of the adult population in the United States (seven million people) have been victimized by identity theft, and that complaints to the Federal Trade Commission of identity theft doubled in 2002 to 161,819. Kathy M. Kristof, *Survey Sounds the Alarm on Identity Theft's Scope; The Number of Victims Soared to 7 Million Last Year, Poll Says, Far Higher Than Previous Estimates*, L.A. Times, July 22, 2003, at Cl. Another report conducted by Columbia University has found that 33 million United States residents have had their identity stolen. *ID Theft Up Sharply; 33 mil Victims*, Investor's Bus. Daily, July 31, 2003, at A2.
7. Robert F. Worth, *17 Are Charged in Scheme to Steal Mortgage Money*, N.Y. Times, May 9, 2003, at B3.
8. OCC Advisory Letter 2003-2, Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices (Feb. 21, 2003); OCC Advisory Letter 2003-3, Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans (Feb. 21, 2003).
9. The USA Patriot Act of 2001, Pub. L. No. 107-56, § 326, 31 U.S.C. 5318(l).

Vincent N. Amato is the principal of Law Offices of Vincent N. Amato in Pearl River, N.Y. He also chairs the Section's Consumer Financial Services Committee.

Overseeing the Overseers: The Recent *Enron* Decision and the Fiduciary Responsibilities of Persons Who Appoint Benefit Plan Fiduciaries

By Richard A. Nelson

Many companies are (or should be) in the process of re-examining corporate governance issues relating to their employee benefit and executive compensation programs, and more clearly defining the roles to be played by the Board, senior executives, and administrative committee members. When allocating these responsibilities, one critical issue that must be kept in mind is the fiduciary responsibility (and potential liability) of the persons who have the authority to appoint plan decision-makers.

A recent court decision involving Enron's Board of Directors illustrates this issue and is discussed below. The issue, however, is much broader than the facts in *Enron,* and should be considered by *any* company that sponsors an employee benefit plan governed by ERISA. A number of cases currently pending against other companies raise the same issue, and the U.S. Department of Labor has filed "friend of the court" briefs supporting the plaintiffs in those cases, as it did in *Enron.* We discuss the *Enron* decision in detail only because it provides a real-life example of how this issue can play out in litigation.

***Enron's* Facts.** The Enron 401(k) plan and ESOP held large amounts of Enron stock which became worthless when the company filed for bankruptcy. Participants in those plans filed a class action lawsuit in an attempt to recover the losses. Among other things, the plaintiffs alleged that at some point it became imprudent to continue the plans' investments in Enron stock. The plan documents gave the Administrative Committee responsibility for investments in Enron stock, so plaintiffs sued the individual members of the Committee.

Claims against the Board members for failure to monitor. The plaintiffs did not stop there, however. They also sued the individual members of Enron's Board of Directors for breach of fiduciary duty. The Board had no direct responsibility for the plans' investments in Enron stock, so the plaintiffs had to come up with a different theory of liability against the Board. Citing cases holding that the appointment of a fiduciary is itself a fiduciary act, the plaintiffs argued that the Board members had become fiduciaries by appointing the members of the Administrative Committee. The plaintiffs also alleged that the power to appoint includes an ongoing duty to monitor, and that the Board members had breached their fiduciary duties because they had never done anything to monitor the performance of the Administrative Committee.

Claims against the Board members for failure to disclose information. The plaintiffs also alleged that, as an ERISA fiduciary, the Board had a fiduciary duty to disclose to the Administrative Committee the information that it knew the Committee did not have and that the Committee needed to properly perform its job, including information regarding the accounting concerns that ultimately led to Enron's demise.

Court allows lawsuit to go forward. In a recent ruling, the court held that the plaintiffs had stated viable legal theories against the Board members, and that the plaintiffs should be allowed to try to prove their allegations.

What to do? Many companies will want to review their current plan structures with an eye toward attempting to minimize fiduciary exposure. The possible steps in such a review include:

- Determine the decision-making structure that is right for your plans and your company. Decide who should be responsible for what, and who will appoint the plan decision makers.
- Document that structure in plan documents, summary plan descriptions and ancillary documents.
- Educate the appropriate individuals on their roles and their fiduciary responsibilities under your plans and ERISA.
- Establish formal monitoring and review processes.
- Follow the processes that you establish.

Remember: *It may be best not to bother with the first four steps unless you are willing to do the last step.*

Richard A. Nelson is a partner in the Minneapolis office of Faegre & Benson LLP. We thank that firm for permission to print this article.

"A Prologue to a Farce or a Tragedy"? A Paradox, a Potential Clash: Digital Pirates, The Digital Millennium Copyright Act, The First Amendment & Fair Use*

By David V. Lampman, II

I. Introduction

Since the dawn of man, technology has been shaping the way people live.[1] It was technological developments in tools that allowed civilizations to evolve. Technology has influenced all aspects of human culture—from the development of crude stone scraping and cutting tools used by early humans,[2] to the developments of farming technologies,[3] to the printing press that spawned the expression of humanism during the Renaissance, to the creation of machines that drove the Industrial Revolution and changed the landscape of our planet. Indeed, technology has been a guiding force of our social structure, our belief system, and our laws.[4] Today, technology's influence on our lives is obvious.[5] Technology has shifted the focus of our economy from manufacturing to service and information.[6] The rapid growth of the Internet is a catalyst to this change and has created a global marketplace.[7]

> Instant access to virtually limitless raw information is at the heart of today's service economy. Economic value resides increasingly in the creation, distribution, interpretation and transformation of information. This information may take many forms, including text, sound, images, and video. Representation of information by ones and zeros, the binary language of the computer, permits the development of standardized formats for storage, distribution, manipulation, and display. This standardization lowers costs so that the ideal of universal access to information by all members of society is within reach, spawning the digitally-driven Information Age.[8]

These technological developments create the challenge of allowing access to information while providing an incentive to copyright owners by protecting their rights. In the past, technology was merely a means to an end, providing a more efficient way to produce a tangible commodity. Today, technology meshed with information is the end, it is the commodity that our world demands.

In this new paradigm, maintaining a balance in the law of copyright is essential to create economic growth while fostering positive social change. During the Industrial Revolution, when technological developments changed American society, Congress passed antitrust laws that made it illegal to create unfair competition.[9] This ensured that America's metamorphosis from an agrarian society to a manufacturing society would be a positive change. In contrast, at the inception of the current Information Revolution, Congress passed two laws that strongly favor those who control information.[10]

In 1998, Congress passed the Sonny Bono Copyright Term Extension Act[11] ("CTEA"), a law that extended the copyright term by twenty years.[12] This law applies retroactively; it extends the term of current and future copyrights.[13] Although this is not the first time the term of copyright protection has been expanded and applied to existing copyrights,[14] it is important to realize that a copyright's original term, fourteen years with a renewal term of fourteen years, has now been extended to the author's life plus seventy years.[15] While a full study of the CTEA is not within the scope of this Comment, it is important to consider the flaws of this law and its effect on copyright law. This is especially true since commentators have "contended that an extension of an existing copyright term constitutes precisely one of those instances in which copyright law may unconstitutionally abridge speech."[16] It is also important to review the arguments that were heard by the United States Supreme Court in *Eldred v. Ashcroft*.[17]

Eldred involved a challenge of the constitutionality of the CTEA by individuals and entities that rely on works that are in the public domain.[18] The petitioners unsuccessfully argued that the CTEA violates both the Copyright Clause and the First Amendment.[19] Specifically, they claimed that the "limited Times" provision of the Copyright Clause does not allow Congress to extend the term of years like they did in passing the CTEA.[20] The First Amendment argument was based on the concept that the CTEA is a content neutral regulation of speech that fails the heightened constitutional scrutiny that such a law demands.[21] Petitioners further argued that the CTEA violates the Copyright Clause because it fails to "promote the Progress of Science."[22]

Another obvious, and "perhaps the most troub[ling],"[23] flaw of the CTEA is that new authors do not benefit from its retroactive feature.[24] Instead, the CTEA's primary beneficiaries are those who already held copyrights when the Act was created.[25] Thus, some copyright owners are receiving a benefit without creating a new work that could benefit all of society.[26] This would seem to contradict the goal stated in the Copyright Clause.[27] The beneficiary class of the CTEA "include[s] motion picture studios, record studios, and music publishers."[28]

In 1998, Congress passed another law that extended the scope of copyright protection and further tilted the balance of copyright in the favor of copyright owners. The Digital Millennium Copyright Act ("DMCA"),[29] the focus of this Comment, is a law that permits copyright owners to utilize technologies that create a shield that protects against any unauthorized use of their work.[30] This law upsets the balance of copyright law by providing copyright owners with a monopoly while preventing society from benefiting from fair use access.[31] The great fear associated with the DMCA is that with the advent of digital technologies, especially the Internet, and with society's growing reliance on them,[32] copyright owners will only publish their works in a digital format where, because of the DMCA, there is no opportunity for fair use. This form of selective publishing will enable copyright owners to self-regulate or prevent access, thus legally violating both the Copyright Clause and the First Amendment. Therefore, the implications of the DMCA are far reaching;[33] this law, along with the CTEA, has made copyright law increasingly unjust,[34] which may harness the full potential of this new Information Revolution by preventing the free flow of information.[35]

Part II of this Comment will briefly examine the landscape of American copyright law. Part III will argue that the doctrine of Fair Use is an essential tool in ensuring that there is a balanced transition into the Information Age by providing access to information and by buttressing the copyright law with the guarantees of First Amendment expression. Part III provides examples of the importance of the fair use defense through case law. Part IV will review the developments in technology that may eliminate the fair use defense, the right to access, and the right to make use of works that have entered the public domain. Part V will examine the DMCA, specifically section 1201, its effect on fair use, and its potential effect on the development of America's Information Revolution. Part V will also examine cases that have interpreted the DMCA. Part VI will discuss proposals to save fair use which will ensure a balance in both copyright law and in the Information Revolution.

II. The United States Law of Copyright

A. The Intent of the Copyright Clause

"[T]he Framers intended copyright itself to be the engine of free expression."[36] Nearly all Framers of the Constitution believed that some form of copyright protection should be included in the federal sphere of government.[37] In fact, James Madison stated, "The utility of this power will scarcely be questioned."[38] Article I Section 8 of the Constitution allows for the creation of the federal copyright protection that the Framers believed was so important.[39] The Copyright Clause provides that "The Congress shall have Power . . . To promote the Progress of Science and useful Arts, by securing for limited Times, to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."[40] The Supreme Court has held that while this clause grants Congress the power to make copyright laws, it limits congressional power to passing laws that serve the interests of the public and not merely the copyright owner.[41]

Congress has since passed a federal copyright law that grants five basic exclusive rights to copyright owners over the protected work.[42] These rights include: (1) the right to copy the protected work; (2) the right to make derivative works from the protected work; (3) the right to distribute copies of the protected work; (4) the right to perform the protected work; and (5) the right to publicly display the protected work.[43] This limited monopoly is given to the creators of original works under the theory that the public benefits from the work of inventors; it is essential to provide the benefits of the protection to promote new discoveries and creativity.[44]

B. Overview of the First Amendment's Limitations to the Copyright Clause

The protection of copyright law is not absolute. The copyright law restricts free speech in that it prevents others from using the author's expression of a work. Because of this restriction of speech, copyright protection must be limited.[45] The First Amendment guarantees freedom of expression and declares that ideas are freely alienable.[46] Therefore, a constitutional copyright law can protect only an author's expression of an idea, not the idea itself.[47] This distinction between ideas and expressions prevents the occurrence of a serious constitutional clash between the Copyright Clause and the First Amendment.[48] "It cannot be denied that the copyright laws do in some degree abridge freedom of speech, and if the First Amendment were literally construed, copyright would be unconstitutional."[49] Indeed, there are other laws that serve a vital role in our society that also restrain speech and could be considered unconstitutional if the First Amendment was literally construed.[50]

Here, the Copyright Clause's inconsistency with the First Amendment can be rationalized by the important social role that the copyright laws champion. The limited monopoly given to copyright owners serves the important purpose of providing authors with the incentive to create works from which society will benefit, while still allowing the work to be communicated freely.[51] There are other limitations to the protection of copyright. While section 106 of the Federal Copyright Act of 1976 provides that any user of a copyrighted work who uses or authorizes the use trespasses into the exclusive domain of the protected work,[52] section 107 provides that a use may not be a trespass into the exclusive domain of a copyrighted work if the use is considered to be a fair use.[53]

III. The Doctrine of Fair Use

"[T]he issue of fair use . . . is the most troublesome in the whole law of copyright." [54] The concept of fair use has been explained as "a privilege in others than the owner of a copyright to use the copyrighted material in a reasonable manner without his consent, notwithstanding the monopoly granted to the owner."[55] The issue that vexes courts is what constitutes a reasonable, or fair use of a protected work. The four factor test provided in section 107 of the Copyright Act has codified the equitable considerations of the common law that help to focus a court's interpretation.[56]

A. Factor One: The Purpose & Character of the Use

1. The Profit/Nonprofit Distinction

The first factor that most courts consider is the purpose and character of the use.[57] In 17 U.S.C. 107, Congress included that takings for comment or criticism should usually be considered a fair use.[58] However, the court must also determine if the use is commercial in nature, or for an educational or nonprofit reason.[59] "The crux of the profit/nonprofit distinction is not whether the sole motive of the use is monetary gain but whether the user stands to profit from exploitation of the copyrighted material without paying the customary price."[60] This distinction is illustrated by *Princeton University Press v. Michigan Document Service Inc.*[61]

Princeton University Press held that a use that may ultimately have an educational purpose is still an unfair commercial use if the user is to gain a competitive edge or to make a profit.[62] In this case, a copyright owner of college textbooks brought suit against a commercial print shop.[63] The print shop reproduced the copyrighted materials for professors who made coursepacks, which were sold to students as assigned class readings.[64] The Court of Appeals for the Sixth Circuit held that the reproduction of the copyrighted materials and the making of coursepacks was an unfair use.[65] "Like the students who purchased unauthorized coursepacks, the purchasers of *The Nation* did not put the contents of the magazine to commercial use—but that did not stop the Supreme Court from characterizing the defendant's use of the excerpts as 'a publication [that] was commercial as opposed to nonprofit.'"[66] Judge Rosen further explained the *Princeton University Press* holding while writing for the court in *Higgins v. Detroit Education Television Foundation.*[67] Judge Rosen stated:

> Copying copyrighted materials was the express business of the *Princeton University Press* defendant. It was because the defendant was in the business of making copies of copyrighted material for profit that the court refused to find an educational purpose simply because the copies made were ultimately used by university students.[68]

2. The Transformative Value of the Use

The first factor also considers the transformative value of the use.[69] Courts have held that copied works that merely supersede the original creation, but add nothing to transform the value of the original work, do not achieve the goal of fair use, which is to provide access to work so as to further science and to promote creativity.[70] To be considered transformative, a work must change the meaning of the protected work or add new value to it.[71] *Campbell v. Acuff-Rose Music, Inc.*[72] and *Suntrust Bank v. Houghton Mifflin Co.*[73] provide examples of a transformative use.

In the famous *Campbell* case, the Supreme Court found a transformative fair use in a parody.[74] In *Campbell*, the rap group 2 Live Crew, parodied Roy Orbison's classic song *Oh Pretty Woman*.[75] 2 Live Crew copied the opening line of the original and used it as the first line of their song.[76] The rap group then moved to parody the original with their own brand of music and lyrics.[77] Finding a fair use, the Court stated that the use of the first line of the protected song was necessary in establishing the parody.[78] It allowed the listener to comprehend the intended humor by the rap group's reference to the original song.[79] The Court reasoned that the use was transformative because it changed the value and the meaning of the original by adding different music and new lyrics.[80] *Campbell* is an example of a traditional parody that takes a nearly de minimis amount of the original.[81]

However, the defendant's use in *Suntrust Bank* provides an example of a transformative use that takes a large portion of the original to achieve the using author's goal.[82] There, the defendant published a book titled *The Wind Done Gone*, a fictional work based on the popular fictional novel *Gone With the Wind*.[83] The defendant argued that her novel served as commentary of

Gone With the Wind's depiction of slavery.[84] To achieve her artistic goal, the defendant appropriated *Gone With The Wind*.[85] The plaintiff claimed that *The Wind Done Gone* copied famous scenes, elements of the plot, the main characters, the characters' traits, and verbatim dialogue from *Gone With The Wind*.[86] The defendant contended that her work did not infringe upon the protected work because her book was a transformative use.[87] Addressing this factor the court held: "The fact that *TWDG* [*The Wind Done Gone*] was published for profit is the first factor weighing against a finding of fair use. However, *TWDG*'s for-profit status is strongly overshadowed and outweighed in view of its highly transformative use of *GWTW*'s [*Gone With The Wind*] copyrighted elements."[88]

In holding that the defendant's use was a fair use, the court reached the proper conclusion. The defendant clearly gave new meaning to the original in her revisionist approach.[89] The defendant's book did not merely copy from the original, instead it transformed the original in a way that made it more historically accurate and a more truthful version of itself.[90] This is an example of a transformative use that does not merely point to the humor of a work of literature, it also points to the flaws of the society intended to view the protected work of art.[91]

B. Factor Two: The Nature of the Protected Work

Even if a defendant's purpose is held to be a non-transformative commercial use, this does not alone equate to an unfair use. The second factor of the fair use test studies the nature of the protected work.[92] This factor questions whether the protected work is a creative work or a factual work.[93] The distinction between a creative work and a factual work is important due to the copyright law's treatment of facts and ideas as unprotected.[94] The law is slow to protect a fact or an idea alone because society, as a whole, may need full access to the information to advance as a people.[95] Instead, the law is only willing to protect the expression of a fact or the expression of an idea so that others may have access to the core concept for interpretation and further enlightenment.[96] To achieve this end, the scope of fair use is narrowed in situations where the original work is fictional or creative rather than a factual statement, such as a phone book, so as to promote creativity by protecting the expression of an idea while allowing the core idea to be shared and expanded.[97]

C. Factor Three: The Amount & Substantiality of the Use

Factor three of the fair use analysis is a measure of the amount and the substantiality of the use.[98] This third factor is a sensitive scale, measuring the reasonableness of the taking.[99] "[T]he fact that a substantial portion of the infringing work was copied verbatim is evidence of the qualitative value of the copied material, both to the originator and to the plagiarist who seeks to profit from marketing someone else's copyrighted expression."[100] In holding that the amount and substance of the used excerpts were an unfair use, the Supreme Court in *Harper & Row, Publishers, Inc., v. Nation Enterprises* found that "*The Nation* article is structured around the quoted excerpts which serve as its dramatic focal points," the most intriguing and the best portions of the manuscript were used; thus, "the heart" of the book was used, even though the exact quotes only made up thirteen percent of the defendant's article.[101]

However, there are instances where a complete copying can be a fair use.[102] *Haberman v. Hustler Magazine, Inc.*, is a case that permitted a complete copying for the purpose of social commentary.[103] Although *Hustler* copied artistic photographs in full, the court held that this was not enough to be considered an unfair use.[104] The district court reasoned, "The works in question are graphic and unusual"; it was essential to copy them in order to criticize them or to comment on them.[105] The court, therefore, held that "a commentator may fairly reproduce as much of the original, copyrighted work as is necessary to his proper purpose."[106]

In *Sony Corp. of America v. Universal City Studios*,[107] the plaintiffs claimed that the defendant's marketing of VCRs was an infringement on their copyrights.[108] The Supreme Court did not find this argument persuasive because of the potential non-infringing uses associated with VCRs.[109] This reasoning led the Court to hold that the marketing of VCRs was a fair use.[110] The Court noted that two of the obvious non-infringing uses of the VCR were the copying of television shows by private owners of VCRs for the purpose of "time shifting,"[111] or for the purpose of building a video library.[112] These, of course, are also complete takings.

D. Factor Four: The Use's Effect on the Original's Market

The fourth factor of the fair use inquiry has been deemed "undoubtedly the single most important element of fair use."[113] The Supreme Court has held that to negate fair use one need only to show that, if the challenged use "should become widespread, it would adversely affect the potential market for the copyrighted work."[114] "This inquiry must take account not only of harm to the original but also of harm to the market for derivative works."[115] These quotes clearly indicate that courts have focused on whether the use would impede sales of the protected work in deciding this element.[116] Therefore, it is necessary for a copyright owner to offer evidence that the challenged work will replace or supplant the original or derivatives of the original.[117]

In *Suntrust Bank*, the court held that the copyright owner did not establish proof that the defendant's use infringed upon the market or potential market of the original or the original's protected derivatives.[118] This led the court to decide this factor in the defendant's favor and contributed to the court's holding that the defendant's use was a fair use.[119]

E. The Doctrine of Fair Use: Bridging The Gap Between the Copyright Clause & the First Amendment

The doctrine of fair use is a limitation to the copyright law's protections that has the values of the First Amendment ingrained in it.[120] Fair use serves to reconcile the contradiction between the Copyright Clause and the First Amendment by permitting uses that serve as criticism, comment, parody, news reporting, and by other means that may further science and the useful arts.[121]

"The exceptions carved out [in § 107] for these purposes are at the heart of fair use's protection of the First Amendment, as they allow later authors to use a previous author's copyright to introduce new ideas or concepts to the public."[122] Fair use also provides a legal tool that allows the law of copyright to adapt to the application of new technologies.[123] It is important to understand this and to realize that the roots of our Constitution's Copyright Clause can be traced to the Statute of Anne that intended to promote the free exchange of ideas and to end the private censorship of ideas by giving authors the legal ownership of their works.[124] The Copyright Clause has a similar intent: to promote the arts and sciences while preventing private censorship.[125] Thus, for a copyright law to maintain the balance between the important interests of promoting science and the useful arts and providing access to the idea being expressed, it must be limited by the doctrine of fair use.[126] If the interests that fair use protects are ignored, the copyright law's carefully created balance will be upset only to violate the First Amendment.[127] Here, it is important to remember the role of Congress in creating copyright laws compared to the supremacy of the First Amendment:

> A grave danger to copyright may lie in the failure to distinguish between the statutory privilege known as fair use, and an emerging constitutional limitation on copyright contained in the First Amendment. The scope and extent of fair use falls within the discretion of the Congress. The limitations of the First Amendment are imposed upon Congress itself. Fair use, when properly applied, is limited to copying by others that does not materially impair the marketability of the work that is copied. The First Amendment privilege, when appropriate, may be invoked, despite the fact that the marketability of the copied work is thereby impaired.[128]

IV. Technologies that Threaten Fair Use

A. Digital Pirates

The Internet provides an economically efficient means for copyright owners to reach diverse markets and to utilize new distribution tactics.[129] However, when copyright owners use the Internet and digital technologies they also subject themselves to the risk of losing revenue from the work of modern day pirates.[130] Digital technologies allow for a pirate to make perfect copies of a protected work that can be duplicated and reduplicated without compromising the quality of the copies.[131] Here, it is important to identify the problems associated with making copyrighted work available in digital forms and to distinguish the digital pirate from the private user. Pirates are highly skilled and extremely devoted to stealing copyrighted work:

> "Digital files cannot be made uncopyable [sic], any more than water can be made not wet." Although digital content can be scrambled, every known scrambling system has been hacked. . . ." [N]othing works against a dedicated and skilled hacker[,] [including] unlock codes, encryption, serial numbers, hardware devices, on-line verification[,] copy protection, file encryption and watermarking." . . . Almost any protection system will work against the average user, but no protection system will work against the power user, hacker, or professional pirate.[132]

Of course, the loss of revenue caused by digital pirates threatens the copyright industry, which accounts for five percent of the United States gross domestic product and holds strong lobbying power.[133] In response to the risk of piracy and the need to capture markets by using the Internet, the copyright industry has pursued the development of technologies known as technological protection measures ("TPMs") that prevent any unauthorized access.[134]

With the passage of the DMCA, the copyright industry was given the authorization to use TPMs and the support of the federal government, which will penalize anyone that attempts to circumvent TPMs.[135] This allows copyright owners to charge for access both during and after the term of copyright protection by using technology to create a pay-per-use world.[136] This gives the copyright owner an infinite term of protection, which is far more than what the Copyright Clause grants.[137]

B. Development of Technological Protective Measures

The TPMs that have been developed to protect digital copyright material use encryption and digital watermarking[138] (or stegonography) to protect against unauthorized uses.[139] These technologies are based on mathematical processes that use numbers, symbols, or characters to encode the protected information in a seemingly illogical language.[140] By using these systems, the copyright industry believes they can eliminate the threat of most pirating.[141] For example:

> Using encryption technology, . . . major companies believe they can ensure the secure transmission of digital movies and music over computers, high-definition televisions, TV set-top boxes, digital VCRs and digital-video disk players—or at least make it extremely difficult to copy without permission. It would allow digital devices to "talk" to each other and allow only a prescribed number of copies to be made. For example, if somebody downloaded a movie from the Internet onto a digital VCR, the transmitting device would tell the receiving device that the film could be viewed only once.
>
> This process would be invisible to consumers, unless there was an attempt to make illegal copies.[142]

Another TPM, called the public key, uses a mathematical formula called convolution product; it is claimed to be a faster and a more efficient form of encryption.[143] Proponents of the technology maintain that the public key can "encode every second of a data stream with a different encryption key."[144] This means that an average length song would be mixed into 180 distinct codes.[145] If pirates attempted to break this code, their attempts would be in vain; they would only be able to enjoy one second of the music.[146] "Data like songs could be encoded to play on only one specific music player or computer, after which that particular version of the code would be thrown away."[147] This TPM is thirty times smaller than other devices and can be used for any digital device that is connected to the Internet and can be personalized to the user.[148] Therefore, the information can only be downloaded by the specific user whose computer has the key that is customized to the user so "[h]e can't share it with his friends without authorization because it simply won't play on his friend's device."[149]

These are not the only forms of encryption being used by copyright owners.[150] Many companies have developed their own brand of TPM to serve as solutions to the problem of digital piracy.[151] In fact, before the DMCA became law,[152] creators of TPMs were fighting to become the industry's standard TPM.[153]

C. Technological Protective Measures Upsetting the Balance of the Copyright Clause

If these technologies continue to be developed, TPMs will become more efficient and more difficult for the digital pirate and especially private copiers to crack. It seems that the copyright industry will free itself of the inefficiency of lost revenues caused by these pirates. Nevertheless, the benefit received by the copyright industry will be at the cost of society, who may have lost its right of fair use, access, and to make use of works that have entered the public domain. Therefore, society's half of the Copyright Clause's bargain was lost with the birth of the DMCA.

V. The Digital Millennium Copyright Act

A. Rationale for the DMCA

1. The White Paper

In 1993, the Clinton Administration established a working group to study the effect of digital technologies on intellectual property.[154] This was a response to the threat that digital pirates would make the Internet an unsafe and inefficient market, thus preventing copyright owners from releasing their work on it.[155] When reviewing the efficiency of digital piracy, the rapid growth of the Internet, and optimism that encompassed the Internet during the mid-1990s, the goal of making the Internet safe for copyright owners in order to promote its use seems valid.[156]

Furthermore, during the 1980s, the uses of TPMs were failing in both the marketplace and in their ability to block unauthorized users.[157] Consumers rejected products that were protected by TPMs because they restricted common product uses, such as making backup copies.[158] More importantly, copyright owners who chose to use TPMs were at a competitive disadvantage compared to those who did not use them.[159] Consumers simply chose not to purchase products that used TPMs.[160] The TPMs did not effectively block unauthorized uses because courts adopted the *Sony Corp. of America* non-infringing use standard when interpreting the products that enabled a user to circumvent TPMs.[161]

The working group's stated goal was to study the status of copyright law in relation to the Internet and to recommend changes that would help maintain the traditional balance of copyright.[162] In September of 1995, the working group released its recommendations in the white paper, the working group's final report.[163] Prior to the white paper's release, the working group published the green paper, an early draft of the white paper, and also solicited public comment and heard testimony.[164] The working group "depict[ed] the changes to copyright law recommended in the white paper as minor clarifications and updates to existing law."[165] The white paper commented:

> Throughout more than 200 years of history, with periodic amendment, United States law has provided the necessary copyright protection for the betterment of our society. The Copyright Act is fundamentally adequate and effective. In a few areas, however, it needs to be amended to take proper account of the current technology. The coat is getting a little tight. There is no need for a new one, but the old one needs a few alterations.[166]

The white paper recommended specific alterations to update the copyright law.[167] When the white paper was written, the copyright law did not specifically address the distribution of electronic transmissions.[168] Thus, it endorsed amending the right to distribution to clarify that digital transmissions are within the exclusive distribution right of the copyright owner.[169] The working group believed that the technological aspects of electronic transmissions jeopardize the reproduction and distribution of a copy in digital format.[170] The white paper encouraged expanding the definition of "transmit" in section 101 that only included a performance or a display to incorporate the transmission of reproductions.[171] The reason for this proposal was to respond to digital technologies' ability to yield simultaneous fixation of a performance at the receiving end of a transmission.[172] The white paper included an amendment clarifying that a digital transmission of a work into the United States violates the copyright owner's exclusive importation rights.[173] The white paper also recommended the elimination of the first sale rule for digital transmissions.[174] Finally, the white paper recommended the creation of a new provision in the Copyright Act to aid copyright owners using TPMs by preventing the use of circumvention technologies.[175] Although the working group did not formulate its own provision concerning criminal offenses,[176] it passively endorsed legislation that intended to impose criminal liability for the copying or distribution of protected work that exceeds $ 5,000.[177] The working group further rationalized the recommendations made in the white paper by stating that "when technology gets too far ahead of the law, and it becomes difficult and awkward to adapt the specific statutory provisions to comport with the law's principles, it is time for reevaluation and change."[178]

Some commentators, however, criticized the recommendations made in the white paper as being too accommodating to the copyright industry.[179] These critics were quick to point out that the working group was led by Bruce Lehman, a former copyright industry lobbyist,[180] and that the alterations proposed are loaded with hidden benefits for copyright owners.[181] They contended that the white paper is a "shockingly careless piece of work" that repeatedly misstates the current law concerning copyright.[182] The critics further contended that the white paper's evaluation of the law was consistently tilted in the favor of creating new laws and that it repeatedly misinterpreted the law in the favor of change.[183] These critics argued that the white paper's actual agenda was to:

> (1) give copyright owners control over every use of copyrighted works in digital form by interpreting existing law as being violated whenever users make even temporary reproductions of works in the random access memories of their computers;
>
> (2) give copyright owners control over every transmission of works in digital form by amending the copyright statute so that digital transmissions will be regarded as distributions of copies to the public;
>
> (3) eliminate fair-use rights whenever a use might be licensed . . . ;
>
> (4) deprive the public of the 'first sale' rights it has long enjoyed in the print world . . . because the White Paper treats electronic forwarding as a violation of both the reproduction and distribution rights of copyright law;
>
> (5) attach copyright management information to digital copies of a work, ensuring that publishers can track every use made of digital copies and trace where each copy resides on the network and what is being done with it at any time;
>
> (6) protect every work technologically (by encryption, for example) and make illegal any attempt to circumvent that protection; [and]

> (7) force online service providers to become copyright police. . . .[184]

2. WIPO Standards

Like the working group that the Clinton Administration established, the World Intellectual Property Organization ("WIPO") attempted to address the dangers associated with publishing copyrighted materials in digital forms.[185] In 1996, WIPO passed two treaties to protect copyrighted information in digital forms.[186] The Performances and Phonograms Treaty created safeguards for releasing sound recordings in digital format.[187] The Copyright Treaty intended to buttress the Berne Convention Copyright Treaty and addressed protections for commerce on the Internet.[188] This Treaty included provisions for coverage of computer programs, robust public distribution rights, and extensive Internet communication rights.[189] On April 12, 1997, the United States signed both WIPO treaties.[190] In doing so, the United States was required by the treaties to:

> provide adequate legal protection and effective legal remedies against the circumvention of effective technological measures that are used by authors in connection with the exercise of their rights under this Treaty or the Berne Convention and that restrict acts, in respect of their works, which are not authorized by the authors concerned or permitted by law.[191]

B. The DMCA

President Clinton signed the Digital Millennium Copyright Act in 1998 [192] with the intent of updating the copyright law to be consistent with the developments of digital technologies and the Internet.[193] The DMCA also brought the United States in compliance with the 1996 WIPO treaties.[194] In drafting the DMCA, Congress created a drastic amendment to the Copyright Act of 1976.[195] Unlike traditional copyright laws, the DMCA does not address the act of infringement, but instead concentrates on the technologies that facilitate infringement.[196] "[I]ts goal is to 'make available via the Internet the movies, music, software, and literary works that are the fruit of American creative genius.'"[197]

While the DMCA consists of five titles,[198] this discussion will focus on Title I that implements WIPO treaties.[199] This title also contains the most significant aspect of the DMCA:[200] section 1201, which introduces anti-circumvention to the law of copyright and has obvious effects on the fair use doctrine.[201] This provision also highlights the tensions between copyright and technology.[202] Section 1201 states, "No person shall circumvent a technological measure that effectively controls access to a work protected under this title."[203] It also bans the creation, marketing, and trafficking of devices that are designed to crack encryption technologies and imposes civil and criminal penalties for violations of the section.[204] In doing so, the DMCA illegitimatizes the fair use defense and stifles researchers' ability to pursue the development of new technologies, thus directly hindering the progress of science.[205]

C. The Flaws of the DMCA

1. The DMCA Goes Beyond the White Paper's Recommendations and the WIPO Requirements

a. The White Paper's Recommendations

The DMCA created protections for copyright owners that exceed the scope of the white paper's recommendations.[206] The white paper proposed a prohibition on the importing, manufacturing, or distributing of devices or services that had the principal purpose of circumventing a TPM, but did not propose the creation of legislation that made the act of circumvention illegal.[207] The effect of the white paper's approach would have protected copyright owners' section 106 of the Copyright Act rights from the perils of Internet piracy.[208] However, the new causes of action created in section 1201 of the DMCA go far beyond the white paper approach by allowing copyright owners to prosecute those who attempt to circumvent their TPMs, even when their section 106 rights have not been violated.[209]

b. WIPO Requirements

Furthermore, section 1201 of the DMCA exceeds WIPO requirements. The WIPO treaties only require member countries to "provide adequate legal protection and effective legal remedies" to protect copyrighted works secured by TPMs against circumvention.[210] Compliance with the treaties could have been accomplished with the adoption of the less restrictive approach laid out in the white paper or by creating greater civil penalties for infringement.[211] The WIPO treaties are devoid of language requiring member nations to implement the criminal penalties that section 1201 creates.[212] More importantly, WIPO does not require member nations to prosecute those who attempt to circumvent a TPM even when the copyright owner's rights have not been violated.[213]

2. A "Back Door" Reversal of *Sony Corp. of America v. Universal City Studios, Inc.*?

In *Sony Corp. of America v. Universal City Studios, Inc.*,[214] the Supreme Court held that those who manufactured devices that had legitimate non-infringing uses could not be sued merely because their devices could also support infringing uses.[215] However, the copyright industry lobbied for Congress to pass a law that would prevent all acts of circumvention.[216] The copyright industry argued that the recognition of legitimate circumvention purposes would make it too laborious for them to litigate all the resulting cases of copyright infringement.[217] The copyright industry's concern may be valid; however, when one weighs it against the prospect of depriving society of circumvention tools that could provide robust fair use opportunities,[218] or the prospect of stifling technological development,[219] it seems that society's interest in permissible circumvention is greater. Furthermore, the risks of litigation and the responsibility of identifying whom to sue seem to be part of the costs associated with conducting business.

3. The Exemptions to Section 1201 of the DMCA Are Too Narrow to Be Effective

The DMCA provides specific exemptions to the anti-circumvention rule with the intent of preserving the doctrine of fair use.[220] These exemptions are designed to allow circumvention for legitimate encryption research, law enforcement activities, security testing, technologies that invade privacy rights, reverse engineering for the intent to enable the inter-operability of computer programs, and certain uses by libraries and educational institutions.[221] These exceptions, however, are too limited to allow for any socially valuable access.[222] For example, the DMCA contains an exemption for the reverse engineering of TPMs, but the exemption has little practical value.[223] The exemption fails to "allow reverse engineering for the production of non-infringing works that are not designed to be interoperative."[224] More importantly, these exemptions are impractical because reverse engineering entails the use of circumvention technologies that the DMCA specifically bans.[225] Furthermore, although the exemption does allow the development of technologies to circumvent TPMs for reverse engineering, the DMCA renders it useless because it specifically bans the distribution of circumvention technologies.[226] Few people possess the requisite knowledge to create their own circumvention tools that would allow them to crack TPMs for reverse engineering or any other fair use access.[227] In short, while the DMCA is purported to support the value of fair use and the necessity of access, none of the exemptions provide a practical means of achieving circumvention for fair use purposes.[228]

4. Congressional Criticism

The creation of the law that came to be the DMCA was criticized by Congressmen Scott Klug and Rick Boucher as failing to provide the proper balance of copyright law that the Constitution demands.[229] The following is an excerpt of the criticism that illustrates some of the inherent flaws of the DMCA:

> In its original version, H.R. 2281 contained a provision that would have made it unlawful to circumvent technological protection measures that effectively control access to a work, for any reason. In other words, the bill, if passed unchanged, would have given copyright owners the legislative muscle to "lock up" their works in perpetuity—unless each and every one of us separately negotiated for access. In short, this provision converted an unobstructed marketplace that tolerates "free" access in some circumstances to a "pay-per-access" system, no exceptions permitted.
>
> In our opinion, this not only stands copyright law on its head, it makes a mockery of our Constitution. . . .
>
> The anti-circumvention language of H.R. 2281, even as amended, bootstraps the limited monopoly into a perpetual right. It also fundamentally alters the balance that has been carefully struck in 200 years of copyright case law, by making the private incentive of content owners the paramount consideration—at the expense of research, scholarship, education, literary or political commentary, indeed, the future viability of information in the public domain. In so doing, this legislation goes well beyond the rights contemplated for copyright owners in the Constitution.
>
> The . . . amendment, representing a compromise between those on the content side and "fair use" proponents, simply delays this constitutional problem for a period of two years. Delegating authority to develop anti-circumvention regulations to the Secretary of Commerce was a means to eliminate the stalemate that existed, but it is not, by itself a comment on the need for limitations on this [sic] anti-circumvention rights. . . .
>
> What we set out to do was to restore some balance in the discussion and to place private incentive in its proper context. We had proposed to do this by

legislating an equivalent fair use defense for the new right to control access. For reasons not clear to us, and despite . . . WIPO Treaty language "recognizing the need to maintain a balance between the rights of authors and the larger public interest, particularly education, research and access to information . . .," our proposal was met with strenuous objection. It continued to be criticized even after it had been redrafted, and extensively tailored, in response to the myriad of piracy concerns that were raised.

> In the end, this legislation purports to protect creators. It may well be that additional protections are necessary, though we think the 1976 Copyright Act is sufficiently flexible to deal with changing technology. Whatever protections Congress grants should not be wielded as a club to thwart consumer demand for innovative products, consumer demand for access to information, consumer demand for tools to exercise their lawful rights, and consumer expectations that the people and expertise will exist to service these products.[230]

5. The DMCA Frustrates the Justifications of the Copyright Clause & the Balance of the Copyright Clause with the First Amendment

The DMCA, and specifically section 1201, represents a severe deviation from the established notions and rationalizations for the privileges of copyright protection.[231] In fact, the DMCA frustrates both the justifications for the Copyright Clause and the balance between the Copyright Clause and the First Amendment.[232] The Copyright Clause justifies the granting of a limited monopoly to promote the progress of science and the useful arts.[233] While the DMCA may provide additional incentives for authors who intend to post their work on the Internet or through other digital means, it contradicts the goal of promoting scientific discovery by preventing the research and publication of encryption technologies.[234] "In chilling publication, the DMCA wreaks havoc in the marketplace of ideas, not only the right to speak, but the right to receive information—the right to learn."[235] In preventing circumvention, the DMCA restricts the valuable practice of reverse analysis that has long been recognized as legal[236] and also promotes "follow-on innovation."[237] Moreover, these techniques may have little to do with copyright infringement.[238] There are numerous practical uses of reverse analysis that have become casualties of the DMCA.[239] Examples of these are: fixing flaws in computer programs, analyzing programs to learn how to improve them, and making a back up copy of a program.[240] These practices also aid understanding the technology of a product to develop a more advanced competing product, and taking excerpts of a digital movie to criticize it or to make other fair uses of it.[241] Therefore, the DMCA provides ultimate protection for copyright owners at the expense of society's access to and opportunities for making fair use of works.[242]

Furthermore, the DMCA's grand protection of copyrighted work may hinder the development of TPMs and prevent related technological innovations.[243] The DMCA does this by over-protecting copyright owners without encouraging them to research, develop, and implement exceptionally effective TPMs.[244] Thus, the DMCA rules do not provide incentives to copyright owners for using better TPMs than the ones currently being used, which lessens the market for TPMs.[245] The logical conclusion to this argument is that copyright owners would be most willing to invest in the development of more efficient TPMs if the DMCA did not prohibit all circumvention.[246] The market for TPMs would also be better served by this approach:

> The super-strong protection of the DMCA not only erodes incentives to use [TPMs], it also erects barriers to entering the market to supply them.
>
> . . . The DMCA inhibits research and hence follow-on innovation in [TPMs] because it limits the ability of researchers to learn from their predecessors.[247]

The new protections the DMCA grants to copyright owners have also upset the balance of the Copyright Clause and the First Amendment's guaranties of access to ideas, use of ideas to build upon old works and to engage in a social dialogue, and its restriction against censorship.[248] With the addition of the DMCA, copyright law is now allowing TPMs to protect the expression of an idea and shielding the idea from fair use access.[249] Using the protections made available by the DMCA, a copyright owner can supersede the restraints of traditional copyright law by using TPMs to protect their work from all access in perpetuity, thus creating a pay-per-use world.[250] Therefore, the DMCA permits a form of private censorship of speech[251] because the copyright owner has complete control over whom, if anyone, will be given access to the ideas expressed in their work.[252] "[T]his result—allowing every copyright owner to custom-design its own version of copyright law—[by deciding the term of protection and who will be given access] cannot conceivably have been what Congress intended."[253]

6. The DMCA Does Not Stop Digital Pirates

The greatest flaw of the DMCA is that it obstructs legitimate access and fair use rights while failing to prevent the hard core digital pirate from accessing circumvention technologies.[254] This is evident when evaluating the widespread pirating of satellite television.[255] Although the DMCA has had limited success in stopping Americans who traffic circumvention technologies in the United States and in shutting down their websites,[256] it has had relatively no effect on the practice of pirating satellite television.[257] This is due to Canadian courts' interpretation of a "culture law" that made it illegal for its citizens to own an American satellite dish system.[258] The law also resulted in the practice of Canadians giving phony American addresses to satellite providers to gain access to their service.[259] Additionally, the law gave birth to a robust industry of pirating satellite signals.[260] A judge recently held that Canadians could receive American satellite signals legally, and critics argue satellite piracy is not a crime because the American satellite businesses are not authorized to conduct business in Canada.[261]

This odd holding has resulted in Americans having access to the tools to circumvent TPMs that protect copyrighted work released over satellite systems.[262] By conducting a basic America Online Internet search, one can easily find Canadian websites that are in the business of selling circumvention tools to Canadians and Americans.[263] These sites also provide instructions on how to use the tools, tips on the best tools, chat rooms for discussing the various acts of piracy, and a colorful narrative history of satellite piracy.[264] This problem illustrates both the stubbornness of the digital pirate and the inability of the DMCA to completely stop the theft of copyrighted material.

D. The Cases Challenging the DMCA Have Failed

In spite of the DMCA's flaws, the cases that have challenged its constitutionality have failed.[265] While these cases illustrate some of the negative effects that the DMCA can have on research and publication, they did not reach the court with a full arsenal of ripe arguments to be asserted against the DMCA.[266] Only one of these cases had its First Amendment argument analyzed by the court.[267] Moreover, neither case was able to combine a First Amendment argument with a ripe and compelling fair use defense.[268]

1. *Felten v. RIAA*[269]

The dispute in *Felten v. RIAA*[270] is illustrative of one of the ways the DMCA stifles scientific research.[271] In this case, the DMCA was challenged on the basis that it violates the First Amendment by restricting the scientific community from publishing its research.[272] On September 6, 2000, Secure Digital Music Initiative Foundation ("SDMI"),[273] a developer of TPMs,[274] published an online letter to the scientific community entitled, *An Open Letter to the Digital Community*.[275] This letter was an invitation for researchers to "show off [their] skills, make some money, and help shape the future of the online digital music economy" by attacking TPMs that SDMI was developing and reporting the findings to SDMI.[276] The letter went on to place a $10,000 award for those who could crack the TPM if they assigned the intellectual property rights of their findings to SDMI.[277] However, the letter stated that the winner did not have to claim the prize or assign the rights of their findings.[278]

In fact, the winners of the challenge, Professor Edward Felten, a computer science professor at Princeton, and his research team chose not accept the prize money so that they could publish a paper describing their findings.[279] Felten was then informed by the Recording Industry Association of America ("RIAA") that the TPM he and his team cracked was being used to protect copyrighted information, and that if Felten and his team published the paper they would be liable under the DMCA.[280] Felten and his team decided to publish the paper arguing that they did not violate the DMCA,[281] that "the DMCA has chilled, and will continue to chill, the [p]laintiffs and others from engaging in activities protected by the First Amendment."[282] Felten and his team also contended that the DMCA violates the First Amendment:

> By imposing civil and criminal liability for publishing speech (including computer code) about technologies of access and copy control measures and copyright management information systems, the challenged DMCA provisions impermissibly restrict freedom of speech and of the press, academic freedom and other rights secured by the First Amendment to the United States Constitution.[283]

Still, Felten's case was dismissed before the First Amendment claim was heard.[284] Felten and his team decided not to appeal the case.[285]

2. *Universal Studios, Inc. v. Corley*[286]

Like *Felten, Universal Studios, Inc. v. Corley*[287] involved First Amendment challenges to the DMCA. Like *Felten*, these challenges failed; however, in *Corley* the Second Circuit held that the DMCA did not violate the First Amendment.[288] In *Corley* the defendant published an article concerning a decryption program that could enable a user to circumvent the TPM protecting DVDs.[289] The defendant's article contained a copy of DeCSS, the code for the decryption program.[290] As a result of the publication of this code, the defendant was sued for violating the DMCA.[291] The district court granted the plaintiff an injunction that forbade the defendant from posting his article on the Internet or from using Internet linking to connect to websites that posted the article.[292] The Second Circuit held that the computer code was protected by the First Amendment.[293] Nonetheless, the court refused to apply strict scrutiny when evaluating the constitutionality of the injunction.[294] Instead, the court applied intermediate scrutiny reasoning that the restriction only touched upon the nonspeech aspects of the code.[295] The court went on to hold that the injunction did not impede the defendant's First Amendment right because the restriction was content neutral.[296] *Corley* affirmed the district court holding that there is not enough human interaction in computer code for it to be protected as pure speech, it is too functional.[297] Humans do not have to follow an instruction or comprehend language for the code to accomplish its task; the computer instantly comprehends the language and does the work with the slightest human undertaking—"a single click of a mouse."[298]

The court also heard the defendant's claims that the DMCA is unconstitutional because it does not provide opportunities for fair use.[299] The defendant claimed that section 1201 extends protection in perpetuity to copyright owners in spite of the Constitution specifically limiting Congress to granting the protection for a limited time.[300] This claim was raised by an amicus brief, but only appeared in a footnote.[301] The court dismissed the claim and noted that it was not ripe for consideration.[302] Furthermore, the court refused to address the defendant's claim that the DMCA unconstitutionally eliminates fair use because the defendant did not raise the fair use defense.[303]

The courts that heard the *Corley* case have been criticized for missing an opportunity to correct some of the DMCA's flaws.[304] They have also been criticized for misinterpreting the legislative history of the DMCA and for relying on the DMCA's statutory provisions addressing circumvention instead of the trafficking provision that were relevant to the case.[305] Moreover, it has also been noted that the court ignored the DMCA's assurance that fair use would still exist in the digital millennium, and for not addressing the DMCA's effect on *Sony Corp. of America*.[306] In spite of the court's blunders, it seems that as in *Felten*, the facts of *Corley* sealed its fate.[307]

VI. Potential Solutions to the DMCA Dilemma

A. Copyright Law Must Permit Access

The lack of fair use access to copyrighted materials using TPMs can be analogized to the unauthorized fencing of public land; it hoards the benefits of a commodity in which all members of society have an interest.[308] Although the DMCA does not intentionally kill the Doctrine of Fair Use, it makes the doctrine inoperative since the use of TPMs prevent all legal access.[309] However, for a copyright law to meet and achieve the balance of the Copyright Clause, it must allow society to access the work that it protects.[310] Therefore, the potential for TPMs to allow copyright owners to create their unique forms of copyright law and self regulation must be avoided.[311] Although it should be mindful of the First Amendment, Congress should have a firm grasp of the regulation of copyright law.[312]

B. A Proposal: Congressional Regulation

1. Technology Safeguarding Access

There are ways that Congress can regulate the use of TPMs under the DMCA while staying within the boundaries of the International Treaties that it was designed to comply with.[313] A rather inexpensive regulation of TPMs use is to require that the technology allow for a standard number of bits of a work to be available for free access.[314] This would ensure that society would have access to the ideas being expressed. Nonetheless, for this approach to work, further regulation would be required to ensure that copyright owners were using the proper TPMs that permit access.

2. The Trusted Third Party Observer

Another way that Congress can promote the use of TPMs while maintaining access values is to establish a trusted third party observer. Congress may be able to do this by delegating its power to regulate to a public organization, such as the Library of Congress.[315] Under this system the trusted third party would take requests for fair use access and would decide if the access should be permitted.[316] However, this approach forces the trusted third party to function as the Judiciary in that it is determining the value of the inquiring party's fair use. Consequently, the constitutionality of Congress's delegation might be challenged since it could be interpreted as delegating a power that is vested in a separate branch of government. Another use of the trusted third party would have it grant access to a potential fair user without identifying the party or judging the potential value of its use.[317] This would mirror the traditional or real world concept of fair use; it would also likely be rejected by the copyright industry because of the threat of piracy.[318] Perhaps the best use of a trusted third party would have it issue access, but keep a record of the user.[319] This would allow the copyright owner to obtain the identity of pirates.[320] It has been suggested that the identity of the user should only be unveiled on a court order when the copyright owner can show the existence of piracy, so that Doctrine of Fair Use and privacy interests are promoted.[321]

C. Other Suggestions

It seems that Congress would better serve the digital and the analog world if they forced the copyright industry to pursue self-help remedies.[322] If required to explore the digital world at its own risk, the copyright industry will be pressured to research and develop the strongest TPMs.[323] Stronger TPMs will stop the common user from copying as well as make the act of circumvention too expensive for more skilled and daring pirates.[324] The pirates who possess the ability to crack TPMs are most likely still pirating in spite of the DMCA.[325] Further, the traditional section 106 rights provide an adequate system for copyright owners to bring litigation against accused infringers. This more natural approach would better serve society, and perhaps the copyright industry.[326] Following the *Sony Corp. of America* holding one of the plaintiff's lawyers stated, "Unless Congress acts to compensate copyright owners for the home taping of their intellectual property, the audiovisual marketplace will become a barren wasteland of programming that does not edify, nor inspire nor entertain."[327] However, Congress did not act and the copyright industry is now thriving because of the VCR. This example indicates that the copyright industry could thrive when it is forced to adapt. More importantly, this approach would maintain the balance and preserve the justifications for the Copyright Clause.

VII. Conclusion

Today, at the beginning of the Information Revolution, maintaining the intended balance of the Copyright Clause is essential so information is accessible to all elements of society and so the integrity of our Constitution is protected. The success of the Information Revolution depends on such a balance. Ironically, the same technologies that are fueling the Information Revolution are also providing ways for copyright owners to protect the value of their works from all uses, even fair use after the statutory term of protection expires.[328] This suggests that copyright will be a pay-per-use world and that the Information Revolution will only breathe on one side of the digital divide and will only benefit the segment of society that can afford the access fee set by the copyright owner. However, the irony does not end with this restriction. These technologies are also protecting copyrighted information while preventing the study and potential development of other technologies, which may stifle the potential of the Information Revolution.[329] These developments, set into motion by the drastic changes in the law of copyright instituted by the DMCA, seem to frustrate the very purpose of the Copyright Clause and suggest that the First Amendment limitations on copyright law have been ignored.[330] The suggestions made in Part VI of this note may serve as a means of alleviating the contradictions in the law that the DMCA has created. However, it may be that the DMCA can only achieve the purposes of the Copyright Clause if it is amended.[331]

Furthermore, it is important to recall that the DMCA was created in part to harmonize America's copyright law with the standards of the International Treaties.[332] No doubt, America's rationale for granting copyright protection is much different than other member nations. An obvious example of this is America's value of free speech, which is at the heart of our concept of government. For the past 227 years, America has reconciled the potential clash of the interests of the Copyright Clause with the interests of the First Amendment by promoting the Doctrine of Fair Use.[333] Congress must ensure that this balance is once again achieved, even at the expense of breaching the standards of these International Treaties, so that our copyright law is in compliance with our Constitution.

Nonetheless, in spite of its glaring flaws, the DMCA seems to provide insight about our copyright law and about our society. The DMCA is a law that highlights Congress's willingness to give additional economic incentives to copyright owners at the expense of restricting access to information. This is also apparent when one evaluates the CTEA and the DMCA because both seem to indicate that our capitalistic values have trumped our ideals of individualism, as well as academic freedom and artistic liberty. These laws also bring to light the value of economic power and that the voice of lobbyists is greater than the voice of the people. One explanation for the passing of this unjust law "is a simple one: campaign contributions."[334] However cynical, this notion may provide an explanation for a law that seems to contradict so much settled law. In fact, the flaws of the DMCA point to this. It was created under the pressure of lobbyists, and Congress gave the industry what they wanted, not what the white papers or WIPO treaties demanded.[335] Perhaps the perils that have arisen with the passing of the CTEA and the DMCA have been best identified by James Madison, one of the fathers of the Copyright Clause, in a letter to W.T. Barry 190 years ago:

> A popular Government, without popular information, or the means of acquiring it, is but a prologue to a farce or a tragedy; or, perhaps, both. Knowledge will forever govern ignorance; and a people who mean to be their own gov-

ernors must arm themselves with the
power which knowledge gives.[336]

At the beginning of an age that promises to revolutionize the diffusion of information, it is important that our lawmakers consider Madison's words as well as their role in our democratic system of government. It is equally important that they create exemptions to the DMCA that will ensure access to information, and the existence of the fair use defense. These staples of our copyright law will ensure that America does not evolve into a society where information is hoarded by the elite and a pay-per-use world keeps segments of our society in the darkness of ignorance.

Endnotes

* Letter from James Madison to W. T. Barry (Aug. 4, 1822), in 3 Letters and Other Writings of James Madison 276, 276 (New York, R. Worthington 1884).

1. *See* Colin B. Picker, *A View From 40,000 Feet: International Law and the Invisible Hand of Technology*, 23 CARDOZO L. REV. 149, 151 (2001); *see also* Brian Paul Menard, *And the Shirt Off Your Back: Universal City Studios, DECSS, and the Digital Millennium Copyright Act*, 27 RUTGERS COMPUTER & TECH. L. J. 371, 373 (2001).
2. *See* DANIEL R. GROSS, DISCOVERING ANTHROPOLOGY 169 (1992) (noting that anthropologists have discovered tools used by early humans that are about 2.6 million years old).
3. *See id.* at 310.
4. *See* Picker, *supra* note 1, at 151; *see also* CRAIG JOYCE ET AL., COPYRIGHT LAW 49 (5th ed. 2001).
5. *See* Anthony Townsend, *Technology in the Workplace: Employment and Employees in the Information Age*, 21 JOURNAL OF LABOR RESEARCH 377 (2000) (reporting that the technologically driven Information Age has shifted the geographic focus of our economy, forced a change in what America's major corporations produce, and has dramatically modified the role of the worker and the workplace).
6. *See* JOYCE ET AL., *supra* note 4, at 1.
7. *See id.* at 51-52.
8. W. Wayt King, Jr., *The Soul of the Virtual Machine*: *In Re Alappat*, 2 J. INTELL. PROP. L. 575, 575-76 (1995).
9. *See* 15 U.S.C. § 1 (2000).
10. *See* 17 U.S.C. § 1201(2000); *see also* 17 U.S.C. §§ 302-304 (2000).
11. 17 U.S.C. § 101, 302-304 (2000).
12. *Eldred v. Ashcroft*, 123 S. Ct. 769, 774 (2003).
13. *See id.* at 775; *see also* Sue Ann Mota, Eldred v. Reno—*Is the Copyright Term Extension Act Constitutional?*, 12 ALB. L. J. SCI. & TECH. 167, 175 (2001).
14. *See Eldred*, 123 S. Ct. at 775. In 1831, Congress made the first alteration to the term of a copyright by increasing it to forty-two years. *Id.* Congress next extended the term to fifty-six years in 1909 and in 1976, they changed the method of computing the term by increasing it to the life of the author plus fifty years. *Id.*
15. *Id.*; Mota, *supra* note 13, at 170.
16. Neil Weinstock Netanel, *Locating Copyright Within the First Amendment Skein*, 54 STAN. L. REV. 1, 71 (2001) (referencing Melville B. Nimmer, *Does Copyright Abridge the First Amendment Guarantees of Free Speech and Press*?, 17 UCLA L. REV. 1180, 1186-1204 (1970)).
17. *See generally Eldred*, 123 S. Ct. 769.
18. *See id.* at 775; *see also Eldred v. Ashcroft*, 255 F.3d 849, 850 (D.C. Cir. 2001), *aff'd*, 123 S. Ct. 769 (2003).
19. *Eldred*, 123 S. Ct. at 775.
20. *Id.* It is important to note that the petitioners did not contend that the Copyright Clause was offended by the CTEA's twenty year addition to the copyright term. *See id.* In fact, they conceded that since the term the CTEA implemented—life of the author plus seventy years—was a limited time. *See id.* Instead, they only challenged Congress's authority to apply the new term to existing copyrights. *Id.* They urged that "a time prescription, once set, becomes forever 'fixed' or 'inalterable.'" *Id.* at 778 (emphasis added). Nevertheless, the Court disagreed and held that "[t]he word 'limited' . . . does not convey a meaning so constricted" and that there is a long history of Congress applying additional time to existing copyrights. *Id.* at 778; *see also supra* note 16 and accompanying text. Writing for the Court, Justice Ginsburg reasoned that the CTEA was a rational exercise of legislative authority that the Copyright Clause gives to Congress and that they acted in response to "demographic, economic, and technological changes." *Id.* at 782. The Court went on to note that "we are not at liberty to second-guess congressional determinations and policy judgments of this order, however debatable or arguably unwise they may be." *Id.* at 782-83. *But see id.* at 801 (Stevens, J., dissenting) ("It is emphatically the province and duty of the judicial department to say what the law is.") (quoting *Marbury v. Madison*, 1 Cranch 137, 177 (1803)).
21. *See id.* at 788. Again, the Court disagreed and held that it would be improper to impose strict scrutiny to the CTEA since the copyright system has built-in First Amendment protections. *Id.* at 788-89. The Court noted that the doctrine of fair use and only the expression of ideas are protected by the First Amendment. *Id.* 788-89. However, Justice Breyer notes:

    > This statute will cause serious expression-related harm. It will likely restrict traditional dissemination of copyrighted works. It will likely inhibit new forms of dissemination through the use of new technology. It threatens to interfere with efforts to preserve our Nation's historical and cultural heritage and efforts to use that heritage, say, to educate our Nation's children. It is easy to understand how the statute might benefit the private financial interests of corporations or heirs who own existing copyrights. But I cannot find any constitutionally legitimate, copyright-related way in which the statute will benefit the public. Indeed, in respect to existing works, the serious public harm and the virtually nonexistent public benefit could not be more clear.

    Id. at 813 (Breyer, J., dissenting).
22. *Id.* at 784.
23. *See* Mota, *supra* note 13, at 175.
24. Netanel, *supra* note 16, at 70. *But see Eldred*, 123 S. Ct. at 775 (noting that the previous extensions of the copyright term have been applied to existing copyrights). *See generally supra* note 14 and accompanying text.
25. Netanel, *supra* note 16, at 70.
26. *See Eldred*, 123 S. Ct. at 801 (Breyer, J., dissenting). Justice Breyer argues:

> The economic effect of this 20-year extension—the longest blanket extension since the Nation's founding—is to make the copyright term not limited, but virtually perpetual. Its primary legal effect is to grant the extended term not to authors, but to their heirs, estates, or corporate successors. And most importantly, its practical effect is not to promote, but to inhibit, the progress of "Science"—by which word the Framers meant learning or knowledge.

Id. (citing E. Walterscheid, The Nature of the Intellectual Property Clause: A Study in Historical Perspective 125-126 (2002)).

27. *See supra* note 22 and accompanying text. *Cf. Eldred*, 123 S. Ct. at 785 (holding that it is in the discretion of Congress to determine the Copyright Clause's objectives).
28. Netanel, *supra* note 16, at 70.
29. 17 U.S.C. § 1201 (2000).
30. Stephen M. Kramarsky, *Copyright Enforcement in the Internet Age: The Law and Technology of Digital Rights Management*, 11 DePaul-LCA J. Art & Ent. L. & Pol'y, 1, 42 (2001).
31. *See infra* notes 214-30 and accompanying text.
32. Pamela Samuelson, *The U.S. Digital Agenda at WIPO*, 37 Va. J. Int'l L. 369, 439 (1997) (providing that "[t]he market for copyrighted works in digital form is already very substantial, and it will continue to grow.") (hereinafter "Samuelson, WIPO").
33. *See infra* Part V.
34. Glynn S. Lunney, Jr., *The Death of Copyright: Digital Technology, Private Copying, and the Digital Millennium Copyright Act*, 87 Va. L. Rev. 813, 821 (2001) (arguing that "in the face of unjust laws, individual citizens have no choice but to disobey and thereby force society to enforce the law in a way that makes its injustice palpable.").
35. *See infra* Part V and Conclusion.
36. *Harper & Row, Publishers, Inc. v. Nation Enters.*, 471 U.S. 539, 558 (1985).
37. *See* 1 Melville B. Nimmer & David Nimmer, Nimmer on Copyright 1.01 (2002) [hereinafter "Nimmer on Copyright"].
38. *Id.* (quoting James Madison).
39. *See* U.S. Const. art. I, § 8, cl. 8.
40. *Id.*
41. *See, e.g., Graham v. John Deere Co.*, 383 U.S. 1, 5-6 (1966).
42. 17 U.S.C. § 106 (2000).
43. *Id.*
44. *See* Nimmer on Copyright, *supra* note 37, § 1.03[A].
45. *See* Dan L. Burk & Julie E. Cohen, *Fair Use Infrastructure for Rights Management Systems*, 15 Harv. J. L. & Tech, 41, 43 (2001).
46. *See* Nimmer on Copyright, *supra* note 37, § 1.10[A] (noting the fact that the First Amendment trumps the Copyright Clause that appears in the central body of the constitution).
47. *See id.* § 1.10[B][2].
48. *See id.* Recognizing the problem presented by the copyright law's clash with the First Amendment Nimmer quotes Justice Cardozo: "'The reconciliation of the irreconcilable, the merger of antitheses, the syntheses of opposites, these are the great problems of law.'" *Id.* 1.10[A]. Nimmer states that the law often deals with these contradictions by ignoring the opposite's relationship, and by keeping the ideas separate in "logic-tight compartments." *Id.* Nimmer adds that this dichotomy is most evident in the law's attempt to protect all copyrighted works and to championing the values of the First Amendment while failing to realize that the law of copyright and the First Amendment may be contradictory. Nimmer on Copyright, *supra* note 37, § 1.10[A].
49. *Id.*
50. *Id.* (stating that the punishment of perjury, fraudulent statements, and antitrust laws are examples of laws that properly restrict speech). Nimmer *also* notes that the absolutist approach of considering any law involving speech to violate the First Amendment would yield an undesirable result. *Id.*
51. *See id.* at 37, § 1.10[B][1].
52. *See* 17 U.S.C. § 106 (2000).
53. *See* 17 U.S.C. § 107 (2000).
54. *Dellar v. Samuel Goldwyn, Inc.*, 104 F.2d 661, 662 (2d Cir. 1939) (capturing the complexity of fair use analysis, Judge Learned Hand's statement is frequently quoted in fair use cases, and in other materials on copyright law).
55. *Rosemont Enters., Inc. v. Random House Inc.*, 366 F.2d 303, 306 (2d Cir. 1966) (quotation marks omitted).
56. *See generally Folsom v. Marsh*, 9 F. Cas. 342 (C.C.D. Mass. 1841). In this opinion Justice Story introduced the doctrine of fair use to American law. *See id.*
57. *See, e.g., Harper & Row Publishers, Inc. v. Nation Enters.*, 471 U.S. 539 (1985) (serving as a prototypical copyright case on literature and first publication, *Harper* involved the defendant publishing an article, which contained detailed excerpts, including verbatim quotes from President Ford's unpublished memoirs concerning his pardon of President Nixon).
58. 17 U.S.C. § 107.
59. *See id.*
60. *Harper*, 471 U.S. at 562; *see also Princeton Univ. Press v. Mich. Document Servs., Inc.*, 99 F.3d 1381, 1386 (6th Cir. 1996).
61. 99 F.3d at 1385-87.
62. *Id.* at 1386.
63. *Id.* at 1383.
64. *Id.*
65. *Id.*
66. *Princeton Univ. Press*, 99 F.3d at 1386 (citing *Harper*, 471 U.S. at 562) (providing reasons for their decision that the use was not educational) (alterations in original).
67. 4 F. Supp. 2d 701 (E.D. Mich. 1998) (involving the use of plaintiff's song by the defendant in the production of the defendant's film).
68. *Id.* at 705.
69. *See Ringgold v. Black Entm't Television, Inc.*, 126 F.3d 70, 78-79 (2d Cir. 1997) (noting Justice Souter's explanation of a transformative use). Serving as an example of a transformative analysis, Ringgold involved a defendant who used a poster of the plaintiff's "story quilt," a decorative piece of art as a prop for a sitcom set. *See id.* at 72. The poster depicting the plaintiff's work could be seen in certain segments of the program, but the defendant did not give credit to the plaintiff. *Id.* at 73. The Court held that because the defendant used the plaintiff's work for the same reason it was created, to be a decorative piece of art, the defendant merely superseded, the original since it added nothing to transform the original's value. *See id.* at 79.

70. *See Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 579 (1994); *see also Castle Rock Entm't, Inc. v. Carol Publ'g Group, Inc.*, 150 F.3d 132 (2d Cir. 1998) (involving the use of characters and plots from the television show *Seinfeld* in the defendant's quiz book). The Court held that the defendant's use contained no transformative value. *See Castle Rock Entm't, Inc.*, 150 F.3d at 142-43.

71. *See Ringgold*, 126 F.3d at 78-79.

72. 510 U.S. 569 (1994).

73. 268 F.3d 1257 (11th Cir. 2001).

74. *Campbell*, 510 U.S. at 594.

75. *See id.* at 571-72.

76. *See id.* at 582.

77. *See id.*

78. *See id.* at 588-89.

79. *Campbell*, 510 U.S. at 588-89.

80. *See id.* at 583.

81. *See id.* at 582 (noting that only the first line of the original was copied).

82. *See generally* 268 F.3d 1257, 1239 (11th Cir. 2001).

83. *Id.*

84. *See id.*

85. *Id.*

86. *Id.*

87. *See Suntrust Bank*, 268 F.3d at 1259.

88. *Id.* at 1269.

89. *See id.* at 1270.

90. *See id.* at 1269-71.

91. *See id.* at 1271.

92. *See* 17 U.S.C. § 107 (2000).

93. *See Hustler Magazine, Inc. vs. Moral Majority, Inc.*, 606 F. Supp. 1526, 1536 (C.D. Cal. 1985).

94. *See Suntrust Bank*, 268 F.3d at 1271 (noting the "hierarchy of copyright protection"); *see also Harper & Row, Publishers, Inc. v. Nation Enters.*, 471 U.S. 539 at 563 (stating that "[t]he law generally recognizes a greater need to disseminate factual works than works of fiction or fantasy.").

95. *See Harper & Row, Publishers, Inc*., 471 U.S. at 582-83 (Brennan, J., dissenting).

96. *See id.* at 558-59.

97. *See id.* at 563.

98. *See* 17 U.S.C. § 107 (2000).

99. *See MCA, Inc. v. Wilson*, 677 F.2d 180, 183 (2d Cir. 1981).

100. *See Harper & Row, Publishers, Inc.*, 471 U.S. at 565.

101. *Id.* at 548, 566.

102. *See Suntrust Bank v. Houghton Mifflin Co.*, 268 F.3d 1257, 1272-73 (2001) (describing the Supreme Court's findings of fair use in *Sony Corp. of America v. Universal City Studios*, 464 U.S. 417 (1984), and the finding of fair use in *Haberman v. Hustler Magazine, Inc.*, 626 F. Supp. 201 (D. Mass. 1986)).

103. *See* 626 F. Supp. 201, 212 (D. Mass. 1986).

104. *Id.*

105. *Id.*

106. *Id.*

107. 464 U.S. 417 (1984).

108. *Id.* at 420.

109. *Id.* at 442; *see also Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255, 258, 270 (5th Cir. 1988) (holding that copies made during the process of reverse engineering was not copyright infringement). This case supports the *Sony* holding that if a use has valid purposes that do not infringe on a copyright they be considered a fair use. *Vault Corp.*, 847 F.2d at 267.

110. *Sony Corp. of Am*., 464 U.S. at 454-55.

111. *Id.* at 423 (meaning to record and to watch at a later time).

112. It is important to note that the challenged use was a VCR that by itself contained none of the plaintiffs' protected work. *See id.* at 420-423.

113. *Harper & Row Publishers, Inc. v. Nation Enters.*, 471 U.S. 539, 566, 568-69 (1985) (analyzing this element the Supreme Court held the defendant's use was not fair because it "directly competed for a share of the market for pre-publication excerpts" and, therefore, infringed on the plaintiff's market since readers of the defendant's article would have no need to buy the plaintiff's book).

114. *Sony Corp. of Am*., 464 U.S. at 451 (emphasis added).

115. *Harper & Row Publishers, Inc*., 471 U.S. at 568 (emphasis added).

116. *See Suntrust Bank v. Houghton Mifflen Co.*, 268 F.3d 1257, 1275 (2001) (citing *Campbell v. Acuff-Rose Music, Inc.*, 510, 569, 590 (1994)) ("[E]vidence of substantial harm to [a derivative market] would weigh against a finding of fair use.") (alteration in original). *But cf. Campbell*, 510 U.S. at 584 (noting that in the most recent Supreme Court fair use decision, the court declined to give this factor more weight than the other factors).

117. *See Suntrust Bank*, 268 F.3d at 1275.

118. *See id.* at 1275-76 (noting that the use would have little or no appeal to the fans of the original, or to the fans of the original's derivatives).

119. *See id.*

120. *See id.* at 1264.

121. Burk & Cohen, *supra* note 45, at 43.

122. *Suntrust Bank*, 268 F.3d at 1274.

123. *See* Burk & Cohen, *supra* note 45, at 46; *see also Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 430-31 (1984).

124. *See Suntrust Bank*, 268 F.3d. at 1260.

125. *See id.* at 1263.

126. *See id.* at 1264.

127. *See id.* at 1264-65.

128. NIMMER ON COPYRIGHT, *supra* note 37, at § 1.10.

129. *See* Jennifer Burke Sylva, *Digital Delivery and Distribution of Music and Other Media: Recent Trends in Copyright Law; Relevant Technologies; and Emerging Business Models,* 20 LOY. L.A. ENT. L. REV. 217, 218-19 (2000); *see also* Menard, *supra* note 1, at 372.

130. *See* Sylva, *supra* note 129, at 219.

131. *See* Menard, *supra* note 1, at 374.

132. Pamela Samuelson & Suzanne Scotchmer, *The Law and Economics of Reverse Engineering,* 111 YALE L. J. 1575, 1636-37 (2002).

133. Menard, *supra* note 1, at 374; *see also* Burk & Cohen, *supra* note 45, at 49 (reporting that the industry spent nearly three years lobbying for the protection of anti-circumvention that the DMCA provided).

134. *See also* JOYCE ET AL., *supra* note 4, at 899.

135. *See infra* Part V.B. (discussing the DMCA).

136. *See infra* note 250 and accompanying text (discussing the DMCA's creation of a pay-per-use world).

137. *See* Burk & Cohen, *supra* note 45, at 48-49.

138. *See* David L. Clark, *Digital Millennium Copyright Act: Can It Take Down Internet Infringers?*, 6 COMPUTER L. REV. & TECH. J. 193, 200-201 (2002). Describing digital watermarks the author states:

> One of the less expensive techniques is a digital watermark. The watermark signifies authenticity to compatible players, and cannot be removed from a digital recording without causing a dramatic deterioration in its quality. The watermark's disadvantage is that it does not limit access to the work but only provides a "trail" that can be traced to determine the distribution of unauthorized copies on the Internet. Other types of TPMs actually prevent copyright infringement from being physically possible. Some make an unauthorized use impossible. Others track and report uses: if an unauthorized use is detected, the system can disable the product altogether or charge for the use.

Id. at 201.

139. *See* JOYCE ET AL., *supra* note 4, at 899.

140. *See* Sabra Chartrand, *A New Encryption System Would Protect a Coveted Digital Data Stream—Music on the Web,* N.Y. TIMES, July 3, 2000, at C8.

141. *See id.*

142. Jon Bigness, *Taking Aim at Digital Piracy; Intel Leads Group Designing Standard*, CHI. TRIB., Feb. 20, 1998, at C1 (quoted in JOYCE ET AL., *supra* note 6, at 899 n.10).

143. Chartrand, *supra* note 140, at C8.

144. *Id.*

145. *Id.*

146. *Id.*

147. *Id.*

148. *See* Chartrand, *supra* note 140, at C8.

149. *Id.* (quoting chief executive of the company that owns the patent of the TPM, Scott Crenshaw).

150. *See id.*

151. *Id.*

152. *See infra* notes 242-244 and accompanying text (discussing how the DMCA prevents the market from demanding new TPMs).

153. *See* JOYCE ET AL., *supra* note 4, at 899.

154. *See* Gary W. Glisson, *A Practitioner's Defense of the White Paper*, 75 OR. L. REV. 277, 277-78 (1996) (noting that the working group began its study believing that digital technologies upset the traditional balance of copyright holders in the favor of non-copyright owners).

155. Samuelson & Scotchmer, *supra* note 132, at 1634.

156. *See supra* notes 123-127 and accompanying text.

157. *See* Samuelson & Scotchmer, *supra* note 132, at 1631.

158. *See id.*

159. *See id.*

160. *See id.*

161. *See, e.g., Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255, 257, 262, 270 (5th Cir. 1988) (holding that copies made while reverse engineering a product was not infringement).

162. *See* Glisson, *supra* note 154, at 278.

163. James V. Mahon, Note, *A Commentary on Proposals for Copyright Protection on the National Information Infrastructure*, 22 RUTGERS COMPUTER & TECH. L. J. 233, 234 (1996).

164. *Id.*

165. Pamela Samuelson, *The Copyright Grab*, 29 UWLA L. REV. 165, 167 (1998) (citing Bruce Lehman) [hereinafter "Samuelson, Grab"]; *see also* Info. Infrastructure Task Force, *Intellectual Property and the National Information Infrastructure*, 2 (Sept. 1995), *available at* http://www.uspto.gov/web/offices/com/doc/ipnii (last visited Mar. 9, 2003) [hereinafter "White Paper"].

166. *See* White Paper, *supra* note 165, at 212 (citations omitted).

167. *See id.*

168. *Id.* at 213.

169. *Id.*

170. *See id.*

171. White Paper, *supra* note 165, at 217.

172. *See id.* at 217-18.

173. *Id.* at 221.

174. *See id.* at 95.

175. *See id.* at 230-31.

176. *See infra* notes 206-10 and accompanying text (discussing how the DMCA went beyond the white paper's recommendations).

177. White Paper, *supra* note 165, at 229.

178. *Id.* at 211.

179. *See* Samuelson, Grab, *supra* note 165, at 166 (proclaiming "ALERT[:] Stop the Clinton Copyright Grab! The Administration's White Paper on Intellectual Property in the Digital Era Is a Wholesale Giveaway of the Public's Rights"); *see also* Matt Jackson, *The Digital Millennium Copyright Act of 1998: A Proposed Amendment to Accommodate Free Speech*, 5 COMM. L. & POL'Y 61, 73 (2000) (stating that "it was clear from the tone of the report that copyright owners had been very persuasive in articulating their view that strong copyright enforcement measures were needed to ensure the success of the [National Information Infrastructure].").

180. Samuelson, Grab, *supra* note 165, at 167; *see also* Teresa Riordan, *The Commissioner Quits, After Focusing Attention on Intellectual Property and Making Enemies*, N.Y. TIMES, Oct. 26, 1998, at C2 (quoting Jamie Love, director of the Consumer Project on Technology, "whatever Hollywood or the biotechnology industry wanted, [Lehman] would do. His responsibility should have been to the public.").

181. *See* Samuelson, Grab, *supra* note 165, at 167.

182. James Boyle, *Intellectual Property Policy Online: A Young Person's Guide*, 10 HARV. J. L. & TECH. 47, 52 (1996).

183. *See id.*

184. Samuelson, WIPO, *supra* note 32, at 380-81.

185. See, e.g., Carolyn Andrepont, *Digital Millennium Copyright Act: Copyright Protections for the Digital Age*, 9 J. ART & ENT. L. 397, 401 (1999).

186. *Id.* at 401-02.

187. *Id.* at 402.

188. *Id.* at 401.

189. *See id.* at 401-02.

190. World Intellectual Property Organization (WIPO) Copyright Treaty, Apr. 12, 1997, art. II, S. TREATY DOC. No. 105-17, 36 I. L. M. 65 (1997), *available at* 1997 WL 447232.

191. Harry Mihet, Universal City Studios, Inc. V. Corley: *The Constitutional Underpinnings of Fair Use Remain an Open Question*, 2002 DUKE L. & TECH. REV. 3, 4 (quoting article II of WIPO Treaty of 1997, *supra* note 190).

192. Clinton Statement on the Digital Millennium Copyright Act, U.S. Newswire Oct. 28, 1998, *available at* 1998 WL 13606936. After signing the DMCA President Clinton stated:

> These treaties will become effective at a time when technological innovations present us with great opportunities for the global distribution of copyrighted works. These same technologies, however, make it possible to pirate copyrighted works on a global scale with a single keystroke. The WIPO treaties set clear and firm standards—obligating signatory countries to provide "adequate legal protection" and "effective legal remedies" against circumvention of certain technologies that copyright owners use to protect their works, and against violation of the integrity of copyright management information. This Act implements those standards, carefully balancing the interests of both copyright owners and users. . . .
>
> Through enactment of the Digital Millennium Copyright Act, we have done our best to protect from digital piracy the copyright industries that comprise the leading export of the United States.

Id.

193. *See* Menard, *supra* note 1, at 377.

194. David Nimmer, *A Riff on Fair Use in the Digital Millennium Copyright Act*, 148 U. PA. L. REV. 673, 681 (2000) [hereinafter "Nimmer, A Riff"].

195. *See id.* at 674-75; *see also* Menard, *supra* note 1, at 377.

196. *See* Clark, *supra* note 138, at 202-03; *see also infra* notes 214-219 and accompanying text (discussing how the DMCA contradicts Sony).

197. Nimmer, A Riff, *supra* note 194, at 681.

198. *See* Jo Dale Carothers, *Note, Protection of Intellectual Property on the World Wide Web: Is the Digital Millennium Copyright Act Sufficient?*, 41 ARIZ. L. REV. 937, 944 (1999) (providing a brief explanation of the five titles).

199. *Id.* at 944-45.

200. *See, e.g.,* Shandra J. Kotzun, *The Digital Millennium Copyright Act: Anticircumvention Ban Gives More Rights to Copyright Owners*, 3 TUL. J. TECH. & INTELL. PROP. 117, 120 (2001) (noting that § 1201 is "the heart" of the DMCA).

201. *See* Nimmer, A Riff, *supra* note 194, at 675; *see also* Menard, *supra* note 1, at 378 (noting that § 1201(a)(1)(A) became law in October 2000 after being reviewed by the Library of Congress).

202. *See* Menard, *supra* note 1, at 378.

203. 17 U.S.C. § 1201(a)(1)(A).

204. *See* Nimmer, A Riff, *supra* note 194, at 684-85; *see also* JOYCE ET AL., *supra* note 4, at 901.

205. Cassandra Imfield, *Playing Fair with Fair Use? The Digital Millennium Copyright Act's Impact on Encryption Researchers and Academics,* 8 COMM. L. POL'Y 111, 125-26 (2003).

206. *See* Shahram A. Shayesteh, *Comment, High-Speed Chase on the Information Superhighway: The Evolution of Criminal Liability for Internet Piracy*, 33 LOY. L.A. L. REV. 183, 225 (1999).

207. *See id.* at 225-26.

208. *Id.* at 225.

209. *Id.* at 225-26 (noting that "[s]uch an added level of protection is wholly unnecessary and runs counter to the fundamental purposes of copyright law.").

210. *See supra* note 191 and accompanying text.

211. *See supra* notes 191, 206-09 and accompanying text.

212. *See* Pamela Samuelson, *Intellectual Property and the Digital Economy: Why the Anticircumvention Regulations Need to Be Revised*, 14 BERKELEY TECH. L.J. 519, 531-32 (1999).

213. *See supra* note 191 and accompanying text.

214. 464 U.S. 417 (1984); *see also* discussion *supra* notes 107-112 and accompanying text.

215. *See Sony Corp. of Am.*, 446 U.S. at 442-56.

216. *See* Shayesteh, *supra* note 206, at 215.

217. *Id.*

218. *See infra* notes 220-28 and accompanying text for a discussion on how the exemptions of § 1201 do not provide a realistic opportunity for fair use.

219. *See infra* notes 233-46 and accompanying text for a discussion on how § 1201 stifles research.

220. *See* Shayesteh, *supra* note 206, at 211.

221. *See* Clark, *supra* note 138, at 204-05.

222. *See* Jason Sheets, *Copyright Misused: The Impact of the DMCA Anti-Circumvention Measures on Fair & Innovative Markets*, 23 Hastings COMM. & ENT. L. J. 1, 18-19 (2000).

223. *Id.*

224. *Id.* at 18.

225. *Id.*

226. *Id.*

227. Benton J. Gaffney, *Copyright Statutes that Regulate Technology: A Comparative Analysis of the Audio Home Recording Act and the Digital Millennium Copyright Act*, 75 WASH. L. REV. 611, 636 (2000).

228. *See* Sheets, *supra* note 222, at 18-19.

229. Nimmer, A Riff, *supra* note 194, at 720.

230. *Id.* at 720-21 & n.255. (quoting the dissenting views of Congressmen Klug and Boucher). Both Klug and Boucher later retracted their statements and supported the law that became the DMCA. Nimmer, A Riff, *supra* note 194, at 723-24.

231. *See* Burk & Cohen, *supra* note 45, at 51.

232. *See supra* Part II and notes 120-28 and accompanying text.

233. *See* U.S. Const. art. I, § 8, cl. 8.

234. *See generally* Thomas Pack, *Legit Hack Creates Legal Controversy*, ECONTENT NEWS, Oct. 2001, *available at* http://www.econtentmag.com/r8/2001/ecnes10b.html (last visited Feb. 5, 2003) (reporting the legal developments regarding Professor Edward Felten of Princeton University who cracked encryption technologies and published his research).

235. *See* EFF Complaint, *Felten v. RIAA* at ¶ 68 (June 6, 2001), *available at* http://www.eff.org/IP/DMCA/Felten_v_RIAA/20010606_eff_fetten_complaint.html (last visited Jan. 15, 2003) [hereinafter "EFF Complaint"].

236. *See* Samuelson & Scotchmer, *supra* note 132, at 1577. The authors contend that reverse engineering conveys knowledge and seldom has substantial negative effects on markets. *Id.* at 1650-51.

237. *Id.* at 1642.

238. *Id.*

239. *See id.* at 1642-43.

240. *Id.* at 1642-43.

241. Samuelson & Scotchmer, *supra* note 132, at 1642-43.

242. *See* Sheets, *supra* note 222, at 18.

243. Samuelson & Scotchmer, *supra* note 132, at 1641.

244. *Id.*

245. *Id.* at 1639, 1646.

246. *Id.* at 1641 (remarking that the DMCA protects copyright owners by creating harsh penalties against infringement, not by encouraging the use of TPMs).

247. *Id.* at 1646.

248. *See supra* Part II and notes 120-28 and accompanying text.

249. *See supra* note 134 and accompanying text.

250. *See* Nimmer, A Riff, *supra* note 194, at 726; *see also* Burk & Cohen, *supra* note 45, at 50.

251. *See supra* notes 120-28 and accompanying text.

252. *See* Burk & Cohen, *supra* note 45, at 50.

253. *Id.* at 51.

254. *See supra* notes 129-37 and accompanying text discussing the stubborn will of digital pirates.

255. *See* Jay Lyman, *DirecTV Raids Satellite Pirates, Web Sites, NewsFactor Network*, June 28, 2001, *available at* http://www.newsfactor.com/perl/story/11603.html (last visited Jan. 15, 2003).

256. *See id.*

257. *See id.* (reporting that to prosecute these user pirates under the DMCA the copyright industry would have to "catch them red handed"); *see also* Robert Brehl, *DirecTV Blasts B.C. Judge*, TORONTO STAR BUSINESS REPORTER, Nov. 28, 1996, *available at* http://www. canadians.freeservers.com/4.html (last visited June 24, 2002) (quoting DirecTv's chief of security, Larry Rissler who stated that the Canadian "[piracy] is a direct assault at our core market, the United States.").

258. *See Gray/Black Legal Now in Canada? Judge Rules Watching U.S. Satellite-TV Signals Legal*, OTTAWA CITIZEN, May 25, 1997, *available at* http://www.canadians.freeservers.com/3.html (last visited Jan 15, 2003).

259. *See* Brehl, *supra* note 257.

260. *See id.*

261. *See id.*

262. *See DSS Tester*, *at* http://www.dsstester.com/resources.asp (last visited Jan. 15, 2003); *see also DSS Underground*, *at* http://www .dssunderground.com/ (last visited Jan. 15, 2003).

263. *See DSS Tester*, *supra* note 262.

264. *See, e.g., DSS Underground*, *supra* note 262.

265. *See infra* notes 269-307 and accompanying text.

266. *See infra* notes 269-307 and accompanying text.

267. *Universal City Studios, Inc. v. Corley*, 273 F.3d 429, 445-58 (2d Cir. 2001).

268. *See infra* notes 269-307 and accompanying text.

269. EFF Complaint, *supra* note 235.

270. *See id.* RIAA "represents entities which manufacture and distribute sound recordings, including the five major labels and many of their subsidiary labels." *Id.* ¶ 13.

271. *See id.* ¶¶ 1-3.

272. *See id.* ¶¶ 67-69.

273. SDMI is a multi-industry business established to create TPMs for digital music. EFF Complaint, *supra* note 243, ¶ 14.

274. *See* An Open Letter to the Digital Community, *available at* http://www.sdmi.org/pr/OL_Sept_6_2000.htm. (last visited Jan. 15, 2003). This TPM was designed to protect digital music. *Id.*

275. *Id.*

276. *Id.*

277. *Id.*

278. *See* EFF Complaint, *supra* note 235, ¶ 32.

279. *See id.* ¶ 37.

280. *Id.* ¶ 43.

281. *See id.* ¶ 59.

282. *Id.* ¶ 67.

283. EFF Complaint, *supra* note 235, ¶ 69.

284. Declan McCullagh, *Copyright Law Foes Lose Big*, WIRED NEWS, Nov. 29, 2001, http://www.wired.com/news/politics/0,1283,48726,00.html (last visited Jan. 30, 2003) (noting that RIAA claimed that they never intended to sue Felten); *see also* Media Release, "Electronic Frontier Found., Judge Denies Scientists' Free Speech Rights" (Nov. 28, 2001), http://www.eff.org/effector/HTML/effect14.37.html (last visited Jan. 30, 2003).

285. *See* Media Release Electronic Frontier Found., *Security Researchers Drop Scientific Censorship Case* (Feb. 6, 2002), http://www.eff.org/IP/DMCA/Felten_v_RIAA/20020206_eff_felten_pr.html (last visited Jan. 30, 2003).

286. 273 F.3d 429 (2d Cir. 2001).

287. Id.; *see also United States v. Elcom*, 203 F. Supp. 2d 1111, 1118-19, 1141-42 (N.D. Cal. 2002) (noting that the defendant was held to have violated the DMCA for writing a program to circumvent Adobe's e-book software).

288. *Corley*, 273 F.3d at 448-50.

289. *See id.* at 437-39 (noting that this program enabled users to play a DVD on an unauthorized player and make copies of DVDs).

290. *See id.* at 439.

291. *Id.* at 435-36.

292. *Universal Studios, Inc. v. Reimerdes*, 111 F. Supp. 2d 294, 343-45 (S.D.N.Y. 2000); *see also* Tricia J. Sadd, Note, *Fair Use as a Defense Under the Digital Millennium Copyright Act's Anti-Circumvention Provisions*, 10 GEO. MASON L. REV. 321, 334 (2001) (noting the Court commented that "'the fact that Congress elected to leave technologically unsophisticated persons who wish to make fair use of encrypted copyrighted works without the technological means of doing so is a matter for Congress,' not the courts.").

293. *See* Reimerdes, 111 F. Supp. 2d at 333.

294. *See id.* at 332-33.

295. *See id.* at 327-33.

296. *See id.* at 332. It is important to note that the Court used a stricter test to evaluate the linking issue. *Id.* at 341. The test considered if the link was posted with knowledge of providing decryption information. *Id.*

297. *Universal City Studios, Inc. v. Corley*, 273 F.3d 429, 451 (2001).

298. *Id.*

299. *Id.* at 443.

300. *Id.* at 444-45.; *see also* U.S. Const. art. I, § 8, cl. 8.

301. *Corley*, 273 F.3d at 444-45.

302. *Id.* at 445.

303. *See id.*

304. Sadd, *supra* note 292, at 334-35.

305. *Id.* at 334.

306. *Id.* at 334-35.

307. *See supra* note 302 and accompanying text (noting that the fair use issues were dismissed by the court for not being ripe).

308. Burk & Cohen, *supra* note 45, at 53-54.

309. *See id.* at 54.

310. *See supra* Part II and notes 120-128 and accompanying text.

311. *See supra* note 136 and accompanying text.

312. *See supra* note 128 and accompanying text.

313. *See* Burk & Cohen, *supra* note 45, at 55.

314. *Id.*

315. *See* Burk & Cohen, *supra* note 45, at 66; *see also* Samuelson & Scotchmer, *supra* note 132, at 1636 n.296 (noting that 17 U.S.C. 1201 (a)(1)(C) limits the Library of Congress's power to develop exceptions to the anticircumvention rule).

316. *See* Burk & Cohen, *supra* note 45, at 63.

317. *See id.* at 64.

318. *See id.* at 64.

319. *See id.*

320. *Id.*

321. *See* Burk & Cohen, *supra* note 45, at 64.

322. *See* Samuelson & Scotchmor, *supra* note 132, at 1640.

323. *See id.* at 1641.

324. *See id.* at 1640.

325. *See supra* note 264 and accompanying text.

326. *See supra* note 242-46 and accompanying text.

327. Lunney, *supra* note 34, at 919 (quoting JAMES LARDNER, FAST FORWARD: HOLLYWOOD, THE JAPANESE, AND THE ONSLAUGHT OF THE VCR 229 (1987)).

328. *See* Burk & Cohen, *supra* note 45, at 52.

329. *See, e.g.,* Pack, *supra* note 234.

330. *See supra* notes 29-33 and accompanying text.

331. *See* Sheets, *supra* note 222, at 21-22.

> The DMCA stifles innovation by creating an incentive to engage in the monopolistic practices of misuse. The DMCA creates an incentive to engage in copyright misuse regardless of whether the use of a technological protection system to prevent access to public domain material is considered a misuse. Prior to the DMCA, the availability of the copyright misuse defense and fair use defense provided the copyright owner reasons to avoid engaging in a misuse; protection by the copyright law was conditioned upon not engaging in misuses. . . . The owner loses nothing by engaging in behavior that contravenes public policy.

Id.

332. *See supra* note 193 and accompanying text.

333. *See supra* note 121 and accompanying text.

334. *See* Samuelson, Grab, *supra* note 165, at 166.

335. *See supra* notes 205-08 and accompanying text.

336. Letter from James Madison to W. T. Barry (Aug. 4, 1822), in 3 Letters and Other Writings of James Madison 276, 276 (New York, R. Worthington 1884).

David V. Lampman, II was Editor-in-Chief of the *Albany Law Journal of Science & Technology*, has a J.D. from Albany Law School, Union University, May 2003, and a B.A. in History, cum laude, from Kings College, May 2000. An earlier version of this Comment won first prize in the 2002 ASCAP Nathan Burkan Memorial Competition, first prize in the 2003 Conner Writing Competition sponsored by the New York Intellectual Property Law Association, and second prize in the 2003 New York State Bar Intellectual Property Writing Contest. **I would also like to thank Professor Provorny for his helpful suggestions. I would also like to thank the members of *Gonzaga Law Review*, especially Audrey Nutt and Chad Nicholson for their editorial work. Additionally, I would like to thank my friends at the *Albany Law Journal of Science & Technology* for their dedication and for their kind encouragement. Finally, I dedicate this Comment to my family and thank them for everything.**

The New York Bar Foundation Can Help Business Lawyers

By Robert L. Haig

The New York Bar Foundation is uniquely qualified to help business lawyers and their corporate clients make charitable contributions for law-related purposes. In particular, a corporation may establish a restricted fund in the name of the corporation within The Foundation to be used for particular purposes defined by the corporation. A fund established recently by CT Corporation is discussed in this article as an example; the same principles may apply to any law-related charitable contribution by a corporation.

The CT Corporation Legal Scholarship Fund

CT Corporation has established the CT Corporation Legal Scholarship Fund to promote the advancement of technology to improve the practice of corporate law.

CT Corporation will award four scholarships of $2,500 each to four second-year law students at New York City law schools. The scholarships will be awarded by selecting essays written by the law students about how technology can change the practice of law for general counsel and other attorneys who represent corporations. The selection panel will consist of representatives of The New York Bar Foundation, three New York State Bar Association entities (including the Business Law Section), and CT Corporation. The Foundation will disburse the funds provided by CT Corporation to the winning students' law schools for application to their tuition.

Other Restricted Funds in The Foundation

The Foundation administers other restricted funds which may be of interest to business lawyers and their corporate clients. For example, the Business Law Pro Bono Service Fund was established within The Foundation at the recommendation of the Business Law Section for projects that promote pro bono service by business lawyers outside New York City. The Foundation also administers a fund which provides annual fellowships for employment of minority law students with public interest organizations and agencies. In addition, The Foundation administers restricted funds which make contributions for the purposes of: improving legal services for indigent clients; assisting in the profession's disaster relief efforts; sponsoring contests for law students to write original research papers; preparing reports on improvements in certain statutes; and presenting public information and preparing written materials for the public.

The Foundation

We want you to know that The New York Bar Foundation welcomes the establishment by corporations of appropriate restricted funds within The Foundation. A corporation may include its corporate name in the title of the restricted fund (for example, the "CT Corporation Legal Scholarship Fund") and may specify the particular purpose for which the fund will be used (for example, tuition scholarships for law students). All contributions to such funds will be recognized in The Foundation's Annual Report and in the *State Bar News*. The Foundation will work with your corporate client on additional publicity for its contribution.

Let me tell you a little about The New York Bar Foundation and why your corporate clients should select The Foundation as the vehicle for a restricted fund of this nature.

The New York Bar Foundation is the charitable and philanthropic arm of the New York State Bar Association. Founded in 1950, The Foundation is dedicated to aiding educational, direct legal services, and charitable projects aimed at meeting the law-related needs of the public and the profession. The work of The Foundation is made possible through the contributions of lawyers, other individuals, corporations, and other organizations. The Foundation is a not-for-profit corporation organized for charitable and educational purposes and is classified as tax-exempt under section 501(c)(3) of the Internal Revenue Code. Contributions to The Foundation are tax-deductible to the extent provided by law.

Why This Foundation?

The New York Bar Foundation is uniquely qualified to administer a restricted fund established by a corporation for a law-related purpose.

The Foundation makes grants after careful review by The Foundation's Board of Directors. The Foundation's Board has extensive knowledge and experience with law-related organizations and programs throughout New York State. The grant review process reflects the quality and sophistication of our Board's judgment as to which organizations deserve funding and which do not; which programs are meritorious and which are not; and the Board's ability to add value to the grants by suggestions and, sometimes, conditions which make programs more cost-effective.

In that connection, our Board has adopted guidelines over the past year to improve our grant review process. One of the criteria we have adopted is the bang-for-your-buck test, that is, whether a grant recipient can leverage the funds it receives from The Foundation to achieve results which could not be obtained if The Foundation merely subsidized the grant recipient's operating budget.

Another reason for a corporation to consider The New York Bar Foundation when establishing a restricted fund for a law-related purpose is the cost-effectiveness of The Foundation. As its Annual Report readily demonstrates, The Foundation's expenses are minimal in relation to its revenues and assets. The result of this frugality is that contributions to The Foundation are used almost entirely for grants to benefit worthy recipients, not for overhead or administrative expenses.

Finally, earnings on restricted funds held by The Foundation are exempt from federal income taxes under section 501(a) of the Internal Revenue Code to the extent provided by law. Accordingly, creating a restricted fund with The Foundation may enable your corporate client to facilitate tax-exempt growth of its charitable contributions and to thereby increase the impact of the money it allocates for charitable purposes.

How to Obtain Further Information

We are happy to work with business lawyers to help their corporate clients establish restricted funds within The Foundation. We also welcome contributions to The Foundation from business lawyers and their clients. If you would like further information, please call me at (212) 808-7715.

Robert L. Haig is the President of The New York Bar Foundation.

This article was inserted at the request of The New York Bar Foundation (TNYBF), which is the charitable and philanthropic arm of the New York State Bar Association (NYSBA). The Foundation, established in 1950, is dedicated to aiding educational, direct legal service and charitable projects aimed at meeting the law-related needs of the public and the profession. The work of TNYBF is made possible through contributions of lawyers, other individuals and organizations.

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Manuscripts intended for publication in the fall and spring issues must be received by the preceding June 15 and December 15, respectively. Manuscripts are to be submitted to: *NY Business Law Journal*, c/o Professor James D. Redwood, Editor-in-Chief, Albany Law School, 80 New Scotland Avenue, Albany, N.Y. 12208, telephone (518) 472-5839, fax (518) 445-2315.

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Business Law Section Committees are a valuable way for you to network with other attorneys from across the state and research issues and influence the laws that can affect your practice. Committees are also an outstanding way to achieve professional development and recognition. Your involvement is very much welcomed.

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