Second Circuit Holds Financial Firms' Claim for "Hot News" Misappropriation Preempted By Federal Copyright Law

On June 20, 2011, the Second Circuit in *Barclays Capital Inc. v. theflyonthewall.com, Inc.*,[1] ruled that plaintiff financial firms' claim against an online news aggregator for "hot news" misappropriation under New York law was preempted by federal copyright law.[2] In reversing the District Court for the Southern District of New York's holding that the aggregator had committed "hot news" misappropriation by early morning reporting of that day's stock recommendations, the panel made a key distinction between makers and breakers of news:

> "[A] Firm's ability to make news—by issuing a Recommendation that is likely to affect the market price of a security—does not give rise to a right for it to control who breaks that news and how."[3]

The decision could have broad implications for financial firms, traditional media companies, and news aggregators, many of whom filed amici briefs on appeal.[4] Though the Second Circuit did not address the viability of the "hot news" misappropriation tort, its analysis suggests it exists, but in a circumscribed form.

I. Facts and Procedural History

The plaintiffs-appellees in *Barclays Capital* were three major financial institutions—Barclays Capital Inc.; Merrill Lynch, Pierce, Fenner & Smith Inc.; and Morgan Stanley & Co. Inc. —which, among other services, provided research and recommendations about publicly traded companies and their securities to the public ("Recommendations").[5] The Recommendations usually provided advice on purchasing, holding, or selling securities.[6] The Recommendations were distributed each morning before the markets opened to clients and prospective clients in the hope that the recipients would execute a trade through the firm, earning the firm a commission.[7]

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1 Barclays Capital Inc. v. theflyonthewall.com, Inc., No. 10-1372-cv, slip op. (2d Cir. June 20, 2011), available at http://www.ca2.uscourts.gov/decisions/isysquery/3f6fcc52-6049-4ab7-8314-3ac30e9b85a7/3/doc/10-1372_both.pdf#xml=http://www.ca2.uscourts.gov/decisions/isysquery/3f6fcc52-6049-4ab7-8314-3ac30e9b85a7/3/hilite/.

2 *Id.* at 71.

3 *Id.*

4 Amici included, for the plaintiff, the Securities Industry and the Financial Markets Association, Reed Elsevier, and The Investorside Research Association; and for the defendant, Google and Twitter, and StreetAccount. A group of media companies including the Associated Press, Scripps, Gannett, McClatchy, The New York Times Company, Time, and the Washington Post filed a brief supporting neither party but arguing that the "hot news" doctrine is an important protection for the press and should not be limited. Dow Jones also filed a brief in support of neither party, arguing that the doctrine should be limited to instances of free-riding and systematic misappropriation. The Media Law Project, Electronic Frontier Foundation, and Public Citizen filed a brief not supporting either party, arguing that First Amendment jurisprudence must guide application of the doctrine, and that the doctrine must not be allowed to impede the growth of online communication. *Id.* at 2–3.

5 *Id.* at 9–10.

6 *Id.* at 5.

7 *Id.* at 11–12.

The defendant-appellant, theflyonthewall.com, Inc. ("Fly"), is a news aggregator that distributes news electronically to subscribers.[8] The defendant had gained access in recent years to the Recommendations before they had been made available to the public.[9] It distributed them to its subscribers through an online news feed, which was updated between 5 a.m. and 7 p.m.[10] Fly said that until 2005, it got Recommendations from employees of recommending firms.[11] It maintained that it now gets Recommendations through a combination of other news outlets, chat rooms, IMs, and conversations with traders, money managers, and others.[12]

The plaintiffs argued that defendant's unauthorized distribution of their Recommendations would destroy their business model, as recipients would have less incentive to come to the recommending firms for trades.[13] The plaintiffs filed suit against Fly in 2006 in the Southern District of New York for federal copyright infringement and "hot news" misappropriation under New York state tort law.[14] Fly effectively conceded liability on the copyright claim, which focused on direct quotation of the reports, and the district court entered an injunction that restrained Fly from further infringing any copyrighted portion of the firms' reports (but not the fact of the firms' making the Recommendations).[15] That injunction was not appealed.

The district court also ruled in favor of the plaintiffs on the "hot news" misappropriation claim. It entered an injunction that barred Fly from reporting on the plaintiffs' Recommendations for half an hour after the market opens, if the report containing the Recommendation was released before 9:30 a.m., or two hours after release, if the report was released after 9:30 a.m.[16]

II. The 'Hot News' Misappropriation Tort

The "hot news" misappropriation tort at the heart of the case was first articulated in the 1918 Supreme Court case *International News Service v. Associated Press*.[17] In that case, the AP accused INS of taking the news AP had gathered and selling it to AP's customers.[18] In ruling for the AP as a matter of federal common law, the Court noted that the "hot news" tort amounted to "taking material that has been acquired by complainant as the result of organization and the expenditure of labor, skill, and money, and which is salable by complainant for money, and . . . appropriating it and selling it as [the defendant's] own."[19] Though *INS* is no longer good law since

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8 *Id.* at 13. The Second Circuit defines a news aggregator as "a website that collects headlines and snippets of news stories from other websites. Examples include Google News and the Huffington Post." *Id.*

9 *Id.* at 6.

10 *Id.* at 15.

11 *Id.*at 16.

12 *Id.*

13 *Id.* at 12–13.

14 *Id.* at 21. Other news companies, such as Bloomberg, Dow Jones, and Thomson Reuters, also publish the Recommendations without permission, but the plaintiffs focused on Fly. *Id.* at 20.

15 *Id.* at 23.

16 *Id.* at 29.

17 248 U.S. 215 (1918).

18 *Id.* at 231.

19 *Id.* at 239.

federal common law disappeared with the *Erie* decision[20], an earlier Second Circuit panel noted that the legislative history of the 1976 Copyright Act amendments implies that a "hot news" claim survives preemption.[21]

Under the Copyright Act, 17 U.S.C. § 301, a state-law claim is preempted "(i) if it seeks to vindicate 'legal or equitable rights that are equivalent' to one of the bundle of exclusive rights already protected by copyright law under 17 U.S.C. § 106—the 'general scope requirement'; *and* (ii) if the work in question is of the type of works protected by the Copyright Act under 17 U.S.C. §§ 102 and 103—the 'subject matter requirement.'"[22]

Claims that meet the statutory two-part test may still survive preemption. A Second Circuit panel in 1997 laid out the "extra element" test under which "hot news" misappropriation claims may survive preemption in *National Basketball Association v. Motorola*:

> (i) a plaintiff generates or gathers information at a cost;
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> (ii) the information is time-sensitive;
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> (iii) a defendant's use of the information constitutes free-riding on the plaintiff's efforts;
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> (iv) the defendant is in direct competition with a product or service offered by the plaintiffs; and
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> (v) the ability of other parties to free-ride on the efforts of the plaintiff or others would so reduce the incentive to produce the product or service that its existence or quality would be substantially threatened.[23]

III. The Second Circuit's Decision

The Second Circuit's decision in *Barclays Capital* hinged on its interpretation of *NBA* and the "free-rider" requirement in connection with the "hot news" tort. At the outset, it refused to consider the viability of the "hot news" misappropriation tort itself, as amici Google and Twitter had urged.[24] It noted that because of its preemption holding it did not have to reach the issue, but were it called on to consider the continued viability of the tort under New York law, "perhaps we would certify that issue to the New York Court of Appeals."[25]

The court then proceeded with the *NBA* and copyright preemption analysis. It concluded that the claim met the statutory two-part test for preemption because the subject matter was the type covered by the statute, i.e. "original works of authorship fixed in a[] tangible medium of expression," and the Recommendations fulfilled the "general scope" requirement.

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20 *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938).

21 *National Basketball Association v. Motorola, Inc.*, 105 F.3d 841, 845 (2d Cir. 1997) ("*NBA*").

22 *Barclays Capital* at 36–37.

23 *NBA* at 845 (2d Cir. 1997).

24 *Barclays Capital* at 32.

25 *Id.* at 33.

The Second Circuit differed from the Southern District of New York in applying the *NBA* "extra element" test. The panel rejected the test altogether, noting that the *NBA* panel put forth two differently stated five-part tests, as well as a three-part test.[26] It determined that the tests were dicta and thus not binding on subsequent courts:[27] "In our view, the several *NBA* statements were sophisticated observations in aid of the Court's analysis of the difficult preemption issues presented to it."[28]

Although the court rejected *NBA*'s five-factor test, it went on to analyze whether Fly could be considered a free-rider, since that factor was dispositive in *NBA*.[29] In finding that Fly was not a free-rider, it drew a key distinction between those who make the news and those who break it: "The Firms are making the news; Fly, despite the Firms' understandable desire to protect their business model, is breaking it."[30] It observed that Fly was "collecting, collating and disseminating factual information—the *facts* that Firms and others in the securities business have made recommendations with respect to the value of and the wisdom of purchasing or selling securities—and attributing the information to its source."[31] In drawing the critical distinction between the gathering of facts and the creation of news, the court quoted *INS*: "[T]he news element—the information respecting current events contained in the literary production—is not the creation of the writer, but is a report of matters that ordinarily are *publici juris*; it is the history of the day."[32] Rather than seeking to protect the product of news gathering efforts, "the Firms seek only to protect their Recommendations, something they *create* using their expertise and experience rather than *acquire* through efforts akin to reporting."[33] Moreover, unlike in *INS*, Fly did not try to pass the Recommendations off as its own; it attributed them to the firms.[34] Fly's own recommendations would have no value; rather, it was the fact that the firms were making the recommendations that mattered.[35]

Finally, the court analyzed the potential profit flow. *INS* referred to the tort as "amount[ing] to an unauthorized interference with the normal operation of complainant's legitimate business precisely at the point where the profit is to be reaped, in order to divert a material portion of the profit from those who have earned it to those who have not."[36] In distinguishing Fly's actions, the court noted that the profit was diverted to brokers, not Fly, and that, in any case, the Firms' clients were never under any obligation to execute trades with them upon

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26 *Id.* at 54.

27 *Id.* at 53.

28 *Id.* at 56–57.

29 *Id.* at 60.

30 *Id.*

31 *Id.*

32 *Id.* at 60–61 (quoting *INS*, 248 U.S. at 234).

33 *Id.* at 62.

34 *Id.* Judge Sack's description of the tort in *INS* is analogous to the "reverse passing off" trademark infringement prohibited by § 43(a) of the Lanham Act, 15 U.S.C. § 1125(a). The Act prohibits both selling the good or service of one's own creation under the name or mark of another ("passing off") and selling another's good or service under one's own name or mark ("reverse passing off"). *Waldman Publishing Corp. v. Landoll, Inc.*, 43 F.3d 775, 780 (2d Cir. 1994). INS essentially passed off AP's work as its own. Fly, on the other hand, did not claim the Recommendations as its own.

35 It noted that a report of the endorsement of a political candidate by *The New York Times* cast the *Times* as a news maker. *Barclays Capital* at 64 n.38.

36 *INS*, 248 U.S. at 240.

receipt of Recommendations.[37] In other words, the profit was not diverted at the point where the Firms would collect, nor was it diverted to the alleged misappropriator.

Judge Raggi concurred, noting that she did not reject *NBA*'s five-part test in reaching a verdict in favor of Fly.[38] Instead, she applied the test and concluded that the firms failed to establish "direct competition."[39]

IV. Significance of the Decision

The status of the "hot news" misappropriation tort may be uncertain. The fact that the Second Circuit refused to consider the viability of the tort itself means that it survives, in New York at least, until a New York state court considers it. The Second Circuit's analysis appears to limit the availability of the tort, however, and perhaps call into question whether it should survive preemption at all, even assuming that the New York courts affirm its continued existence.

The distinction between "makers" and "breakers" of news may prove pivotal in future "hot news" claims. Both traditional media companies and news aggregators may claim something of a victory from the distinction. Aggregators won a narrowing of the "hot news" misappropriation tort. Yet the tort apparently still survives in its traditional form, applying to situations in which one outlet takes the reporting of another and repackages it as its own for distribution,[40] a desirable outcome for traditional media companies who seek to protect their investment in reporting.

The court was careful to note that financial firms may still resort to self-help to attempt to protect their Recommendations, including through contract.[41] Protective measures that the plaintiffs had employed include working with third-party vendors to limit access to clients; employing internal security programs to detect security breaches; investigating employees, including a review of cell phones, for leaks; internalizing email subscription systems; identifying and blacklisting websites that seek to post content links; and creating unique signature URLs when links to research are sent to clients so that clients' usage can be monitored and tracked.[42]

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Dean Ringel at 212.701.3521 or dringel@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Jon Mark at 212.701.3100 or jmark@cahill.com.

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37 *Barclays Capital* at 65.

38 *Id* at 1 (concurring opinion) (Raggi, J., concurring).

39 *Id.*

40 In fact, the court noted that Fly had brought a "hot news" misappropriation suit against a competitor, tradethenews.com. *Barclays Capital* at 68 fn.39. Although the court emphasized that the suit had no bearing on the case before it, it noted that "Fly could raise a creditable argument that its lawsuit based on the copying of facts from its service by a similar, competing service is closer to the hypothetically valid 'hot news' causes of action referred to in *NBA* . . . than is the Firms' claim against Fly." *Id.*

41 "The contractual terms the Firms impose on their clients are presumably enforceable irrespective of the viability of a 'hot news' cause of action." *Id.* at 19 fn.12.

42 *Id.* at 18.