



SECOND CIRCUIT REVIEW

Expert Analysis

Analyzing 'Hot-News' Misappropriation Claim

This month, we discuss *Barclays Capital Inc. v. Flyonthewall.com*,¹ a closely watched case in which the U.S. Court of Appeals for the Second Circuit held that the federal Copyright Act preempted a state-law "hot-news" misappropriation claim. The majority opinion, written by Circuit Judge Robert Sack and joined by Circuit Judge Rosemary Pooler, rejected as dictum a frequently cited test from an earlier Second Circuit opinion. Circuit Judge Reena Raggi concurred in the result, agreeing that the "hot-news" claim was preempted, but disagreeing with the panel majority's decision to abandon the court's previously articulated test.

Background

Plaintiffs are three financial services firms: Barclays Capital, Merrill Lynch, and Morgan Stanley. The firms regularly prepare research reports on publicly traded companies. The reports sometimes make a stock recommendation that is the subject of the report.

Each trading day, before the stock market opens, the firms disseminate these research reports and recommendations to their clients and potential clients, but not to the general public. The firms' stock recommendations usually result in increased trading activity in that stock. The firms benefited from this increased trading activity because they received commissions when clients placed trades through them. The firms contended that clients were much more likely to place their trades through one of the firms if they learned about a recommendation directly from that firm.

Through various means, defendant Flyonthewall.com (Fly) would obtain the recommendations before they were available to the general public and before the market opened. Fly would provide the recommendations to its own subscribers. As a result, the firms' clients and others would learn about the recommendations from Fly and, according to the firms, were less likely to place their trades through the firms, which in turn resulted in lost commissions.

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In July 2006, the firms sued Fly in the Southern District of New York, asserting two sets of claims. First, the firms alleged that Fly violated the federal Copyright Act by verbatim copying from 17 research reports. Second, the firms alleged that Fly committed the New York common-law tort of "hot-news" misappropriation through its on-going publication of the recommendations. The "hot-news" tort originated in *International News Service v. Associated*

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Press, 248 U.S. 215 (1918) (hereinafter *INS*). There, the Supreme Court held that defendant, a rival of the Associated Press, violated the AP's property rights in news that it had gathered by taking news from the AP wire and selling it (sometimes, but not always, after re-writing it) to newspapers as its own. New York State courts subsequently adopted the tort into state common law.²

In *Barclays Capital*, the firms prevailed on their claims following a bench trial, and the district court issued, on the misappropriation claim, a broad permanent injunction against Fly.³ Fly appealed the judgment on the misappropriation claim, but not the copyright claim. Numerous amici, including Google, Twitter, and several major news organizations, weighed in on all sides of the appeal. Although Fly asserted a number of grounds for reversal, the Second Circuit ruled in favor of Fly's argument that the "hot-news" claim was preempted and did not reach the other issues.

The Majority's Analysis

Copyright Preemption. In 1976, Congress amended the Copyright Act to include an express preemption provision. Under that provision, codified at 17 U.S.C. § 301, the Copyright Act preempts state-law claims when two requirements are met. First, the state-law claim must "seek[] to vindicate legal or equitable rights that are equivalent to one of the bundle of exclusive rights already protected by copyright law," which courts term "general scope requirement." Second, the work in question must be one "of the type of works protected by the Copyright Act"—termed the "subject matter requirement."⁴

Discussion of 'NBA v. Motorola.' The majority noted that only one previous binding decision—*National Basketball Association v. Motorola Inc.*, 105 F.3d 841 (2d Cir. 1997)—directly addressed whether the Copyright Act preempted the type of "hot-news" misappropriation claim first recognized by *INS*. In *NBA*, defendants sold a pager that displayed real-time information about professional basketball games, such as the score and the time remaining. Defendants' employees obtained this information by watching the games on television or listening to them on the radio. They then transmitted the information to the pagers via modems and satellites. The NBA sued defendants, alleging hot-news misappropriation.

In addressing whether the hot-news claim was preempted, the *NBA* court found that both the "subject matter" and "general scope" requirements were met. As to the subject matter requirement, the *NBA* court explained that the Copyright Act protects only "works of authorship...fixed in a tangible medium of expression" and, because athletic events were not "works of authorship," the games themselves were not protected under the act. The broadcasts of the games, however, were "works of authorship" and therefore protected. Moreover, once the game was broadcast, the players' performances became "fixed in tangible form" and the games, even though uncopyrightable themselves, became inseparable from the copyrightable broadcasts. Therefore, the subject matter requirement was met as to both the broadcasts and the games.⁵

As to the second requirement—whether the state-law claim sought to vindicate rights within the general scope of rights already protected by the copyright laws under 17 U.S.C. § 106—the *NBA* court found that it had been satisfied. Section 106 gives a copyright owner "the exclusive right to,"

inter alia, “reproduce the copyrighted work” and “prepare derivative works,” which plausibly describe what the NBA alleges defendants did.⁶

The NBA court, citing prior Second Circuit case law, then explained that some claims may not be preempted even when both the subject matter and general scope requirements have been met. It explained that state-law causes of action “otherwise within the general scope requirement will survive preemption if” the claim requires an “extra element”...instead of or in addition to the acts of reproduction, performance, distribution or display....⁷

The NBA court concluded that the “extra element” was not present. In reaching this conclusion, the court extensively analyzed *INS* and other prior cases to determine what types of hot-news misappropriation claims survived preemption. In previewing this analysis early in its opinion, the NBA court had stated: “We hold that the surviving ‘hot-news’ *INS*-like claim is limited to cases where: (i) a plaintiff generates or gathers information at a cost; (ii) the information is time-sensitive; (iii) a defendant’s use of the information constitutes free riding on the plaintiff’s efforts; (iv) the defendant is in direct competition with a product or service offered by the plaintiffs; and (v) the ability of other parties to free-ride on the efforts of the plaintiff or others would so reduce the incentive to produce the product or service that its existence or quality would be substantially threatened.”⁸ (“first five-part test”)

Later, in the analysis section of the opinion, the NBA court set out a substantially similar, but not identical, list of factors it said were “the elements central to an *INS* claim.” (“second five-part test”)⁹ And, later in its opinion, the NBA court set out three factors “that allow a ‘hot-news’ claim to survive preemption.” (“three-part test”)¹⁰

The NBA court then concluded that the extra element required to overcome preemption was not present. First, it held that there was little evidence that defendants’ publication of game information had any competitive effect on the NBA’s primary products, which were playing and televising basketball games. Second, the court disagreed that defendants were “free riding” off of the NBA, noting that defendants had expended their own resources to collect, assemble, and transmit the information about the games.¹¹

Precedent vs. Dicta in ‘NBA.’ Before it applied NBA to the facts at issue, the *Barclays* panel majority discussed the precedential effect of the NBA decision’s three- and five-part tests. Although the parties and the district court had agreed that “a five-part analysis” from NBA was determinative of the hot-news claim, as had a number of other courts since NBA was decided,¹² the majority stated that the multi-part analyses from NBA, including the first five-part test, which was prefaced with “we hold,” were dicta. The *Barclays* majority explained that a court can only reach a “holding” on the “specific facts and circumstances” before it.

According to the majority, the NBA court, in setting out the five-part analyses, was “opining about the hypothetical set of circumstances—not present in that case—that might give rise to” a hot-news claim. According to the majority, although the three-part test “focus[ed] on...[the] extra elements” required to avoid preemption, the NBA court needed only to address the “free riding” element to reach its decision. Additionally, the majority discussed the (relatively slight) differences among the various tests, noting “inconsistent as they were, they could not all be equivalent to a statutory command

to which we or the district court are expected to adhere.”¹³

Application of the “Subject Matter” and “General Scope” Tests. Turning to the facts before it, the majority ruled that both the subject matter and general scope tests had been met. As to the subject matter test, the panel majority noted that the recommendations were not themselves copyrightable. Under NBA, however, because they were part of the reports, which were copyrightable, they became “fixed in a tangible medium of expression” and thus within the Copyright Act’s subject matter. The general scope requirement was met because the firms’ rights in the reports and recommendations could be injured by acts that would also constitute copyright infringement, such as the unauthorized reproduction, distribution, or display.¹⁴

Application of the Extra-Element Analysis. The majority also found that the hot-news claim lacked the “extra element” required to overcome preemption. The majority focused on the same factor that was dispositive in NBA: a lack of “free riding” by defendant.

First, extrapolating from the seminal *INS* case, the majority stressed “free riding” occurs when a plaintiff “acquire[s]” news or information and a defendant takes that information and sells it “as [the defendant’s] own.” The firms, however, had not “acquired” the recommendations, and Fly

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did not sell the information as its own. The court explained that, although the firms had “created” the recommendations, they had not “acquired” them in the same way that a news organization, such as the Associated Press in *INS*, gathered news through its reporters. Nor was Fly, in contrast to the defendant in *INS*, selling the recommendations “as its own.” Instead, it was specifically attributing the recommendations to the issuing firm.

The majority also found another difference with *INS* “noteworthy, if not determinative”: very little of the firms’ profit was being diverted to Fly. Although the firms alleged that Fly’s publication of the recommendations made it less likely that investors would place trades through them, Fly had no significant brokerage operation. So, few, if any, of the firms’ lost customers placed trades through Fly.

Finally, the majority noted that Fly, like the defendant in NBA, employed approximately a dozen people to collect and disseminate the recommendations. This “substantial organizational effort” further undercut any claim of free riding. Accordingly, the majority found the “hot-news” claim preempted and reversed the decision below.

The Concurrence

In her concurring opinion, Judge Raggi agreed that the firms’ hot-news claim was preempted, but disagreed with the majority’s rejection of the NBA

five-part framework. Judge Raggi noted that she too had “reservations” about the NBA framework. Those reservations were different from the majority’s though. Judge Raggi’s concern was that a claim could pass the NBA five-part analysis, but still be “qualitatively” the same as a copyright claim, and thus preempted.¹⁵

Nonetheless, Judge Raggi disagreed that the analyses were dicta. She explained that the majority overstated the differences among the different tests. She believed that the five-part analysis was necessary to the opinion because the NBA court “was required to determine the ‘breadth of the ‘hot-news’ claim that survives preemption.” and the five-part analysis was intended to do just that.

Judge Raggi then explained that, in any event, both five-part tests and the three-part test in NBA required that the parties be in direct competition. She reasoned, however, that the firms did not directly compete with Fly because the firms distributed only their own recommendations and did so only to clients or potential clients that were likely to place trades with them. “By contrast,” she explained, “Fly does not produce any of its own recommendations or seek trading commissions,” and it distributed its products broadly.¹⁶ Thus, Judge Raggi agreed the “hot-news” claim was preempted, but found the lack of direct competition between the parties dispositive on the extra-element issue.

Conclusion

After *Barclays Capital*, it appears that only a narrow set of “hot-news” claims will survive preemption. The case may hamper the efforts of traditional news media organizations to bring actions against, for example, websites that publish factual content derived from traditional media. More generally, the majority’s discussion of dicta may provide grist for parties to argue that unfavorable language in earlier opinions is not entitled to precedential weight.

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1. *Barclays Capital Inc. v. Flyonthewall.com*, No. 10-1372-cv, 2011 WL 2437554 (2d Cir. June 20, 2011).

2. *Barclays Capital Inc. v. Flyonthewall.com*, 700 F. Supp. 2d 310, 332 (S.D.N.Y. 2010) (noting that “*INS* was adopted into state common law by several states, including most enthusiastically in New York”). *INS* itself is no longer good law. The case was decided as a matter of federal common law, which was “largely abandoned” by *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938). *Barclays Capital*, 2011 WL 2437554 at *14. The *Barclays Capital* majority nonetheless believed *INS* relevant “as a description of [the hot-news] tort theory, not as a precedential establishment of a tort cause of action.” Id. at *15.

3. *Barclays Capital Inc. v. Flyonthewall.com*, 700 F. Supp. 2d 310, 343-48 (S.D.N.Y. 2010).

4. *Barclays Capital*, 2011 WL 2437554 at *13.

5. NBA, 105 F.3d at 848-50.

6. Id. at 850; *Barclays Capital*, 2011 WL 2437554, at *13.

7. NBA, 105 F.3d at 850 (quotation omitted); see also *Barclays Capital*, 2011 WL 2437554, at *14; id. at *27 (J. Raggi concurring) (noting that “claims based on breaches of fiduciary duty, contractual promises of confidentiality, or trade secrets often survive preemption because the underlying right they seek to vindicate is the right to redress violations of a particular duty or promise different from an exclusive right protected by copyright” (quotation omitted)).

8. 105 F.3d at 845.

9. Id. at 852.

10. Id. at 853.

11. Id. at 853-54; see also *Barclays Capital*, 2011 WL 2437554, at *20-21.

12. See *Barclays Capital*, 700 F. Supp. 2d at 335.

13. *Barclays Capital*, 2011 WL 2437554, at *18-20 & nn. 32-34.

14. Id. at *21.

15. Id. at 29.

16. Id. at *31-32.