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# Intellectual Property

## Patent Law

### Hot News

## "Hot News" and Preemption

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In *Barclays Capital Inc. v. Theflyonthewall.com, Inc.*, the Southern District of New York ruled that Theflyonthewall's use of stock recommendations developed by a number of financial institutions constituted "hot news" misappropriation under New York Law and issued an injunction against Theflyonthewall. The Second Circuit Court of Appeals, on June 20, 2011, reversed the district court, ruling that the claim for hot news misappropriation is preempted by the Copyright Act.[1] On August 8, 2011, the Second Circuit denied the plaintiff's petition for a rehearing *en banc*. Here is the case in a nutshell, with the question remaining as to whether a petition for *certiorari* will be filed.

Theflyonthewall ("TheFly") is a subscription service that gathers current stock research from public sources and reports the information, including headlines of brokerage research reports as well as their upgrades and downgrades, before the New York Stock Exchange opens so that its subscribers have an opportunity to follow the advice of many of the large financial institutions such as Barclays, Merrill Lynch and Morgan Stanley. TheFly does not provide any brokerage services. It does not provide investment advice. It only reports the news with 80 percent of its recommendation headlines posted before the financial markets open.

"Emphasizing the timeliness of its reporting, [TheFly] asserts that, as the 'fastest news feed on the web,' it delivers to its customers 'actionable, equity news in a concise & timely manner.' In the words of TheFly's website, '[o]ur quick to the point news is a valuable resource for any investment decision.'"[2] In marketing its services, TheFly points out "its quick and comprehensive access to Recommendations made by Wall Street research analysts. . . . Fly asserts that '[h]aving a membership with TheFly is like having a seat at Wall Street's best houses and learning what they know when they know it' . . . . it allows its subscribers to be a 'fly on the wall' inside the investment firms' research departments."[3]

Barclays is a major financial institution. It provides wealth and asset management services, brokerage services and investment advice. It spends hundreds of millions of dollars a year in stock research to develop stock reports. It does not sell its reports in the traditional sense; rather, it provides them as a service to its clients in order to encourage them to invest with Barclays. It employs sophisticated password protected internet platforms to minimize the chances that the common investor will gain access to its recommendations before the N.Y.S.E. opens. Barclays regularly monitors the list of recipients entitled to receive its reports. The reports also include prohibitions on redistribution. Although Barclays' customers include businesses of every size, families and individuals, among its clients of particular importance are private equity firms, money managers and wealthy individual investors. Barclays markets its brokerage services to provide its highest commission paying customers-typically large institutional and wealthy individual investors-an edge in equity buying.

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The development and marketing of equity research is a "critical component" of Barclays' business model.[4] Barclays uses its equity research to enhance its reputation for "creating reliable and valuable advisory reports" and recommendations that, if followed, are more likely to enable their customers to reap significant monetary benefits from timely trades in the financial markets.[5]

TheFly, after extensive internet and other public record searching, might find a Barclays equity research report on the near term (in terms of hours) projection for a stock price. Such reports typically "range from a single page to hundreds of pages in length."[6] They "may include projections of future stock prices, judgments about how a company will perform relative to its peers, and conclusions about whether investors should buy, sell, or hold stock in a given company."[7] A Barclays report may "indicate whether analysts believe the price of a stock is likely to increase, decrease, or remain relatively steady."[8]

The majority of key "actionable" reports are "issued between midnight and 7:00 a.m. [They] may move the market price of a stock significantly, particularly when a well-respected analyst makes a strong Recommendation. Such market movement usually happens quickly, often within hours of the market opening following the Recommendation's release to clients. Thus, timely access to Recommendations is a valuable benefit to each [of Barclays'] clients, because the Recommendations can provide them an early informational advantage."[9] Barclays provides personalized service to its keys customers, known as "short horizon" investors, to discuss its exclusive Recommendations and solicit business before the financial markets open and when the Recommendations are most timely and valuable.

Notwithstanding its knowledge that Barclays reports were confidentially generated, were issued before the N.Y.S.E. opened, could materially impact stock price and were intended for its most private clients, TheFly was allegedly able to locate some of Barclays' equity reports without breaching any confidentiality agreements or web security employed by Barclays (although proof of "its actual source of any particular Recommendations was limited."[10])

Even though other news services provided "hot" news about the recommendations of traditional brokerage houses like Barclays, Barclays decided to sue TheFly in the Southern District of New York in *Barclays Capital Inc. v. Theflyonthewall.com, Inc.*[11] Barclays sued on a variety of theories, the most significant being for "hot news" misappropriation.

This tort is based upon the seminal U.S. Supreme Court decision in *International News Service v. Associated Press*.[12] In the *INS* case, INS, an entity associated with the infamous William Randolf Hearst, had taken news reports from the Associated Press about military and political developments during WWI without having to spend the time and effort employing reporters in the war fields of Europe. Just when the news was hot, and the AP reports were posted on the East Coast on bulletin boards and early editions of newspapers, INS would paraphrase information in the AP reports, formulate their own copy, and telegraph the paraphrased information to the West Coast where the copy was published in Hearst newspapers. There was no issue as to copyright infringement. The Supreme Court found that such "hot news" was quasi-property. Justice Pitney, writing for the majority, said infamously that "the defendant has reaped where it has not sown."[13] Thus INS was permanently enjoined from engaging in this conduct.

As expected, INS relied on the First Amendment for its argument that once the news was made public, the news - the information therein - is free for anyone to use, report and publish. INS argued that even though it was "hot news" developed at great expense by the AP, it could be freely used by another. Justice Brandeis, writing for the dissent, was clearly not enamored by the position of Justice Pitney as he wrote: "[t]he general rule of law is, that the noblest of human productions-knowledge, truths ascertained, conceptions, and ideas-become, after voluntary communication to others, free as the air to common use."[14] Thus to Justice Brandeis, the means by which the INS obtained the news, from public sources or the open market, was unobjectionable. While Justice Brandeis did not feel INS's conduct was absolutely pure and that some remedy might be in order, he felt that the courts were ill-equipped to make such decisions and that Congress should step in. Notwithstanding this sensible approach, Congress has not. Other courts, however, have.

Recently, in *National Basketball Association v. Motorola, Inc.*,[15] the NBA sued Motorola, the maker of a handheld pager which displayed real-time information about professional basketball games while they were in progress. Although it declined to find Motorola liable, the Second Circuit did articulate the now fairly well established elements of a "hot news" claim: (1) a plaintiff generates or gathers information at a cost; (2) the information is time-sensitive; (3) a defendant's use of the information constitutes free riding on the plaintiff's efforts; (4) the defendant is in direct competition with a product or service offered by the plaintiff; and (5) 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. The *NBA* court emphasized that a "hot news" claim "is about the protection of property rights in time-sensitive information."[16]

The Ninth Circuit recognizes the tort of "hot news" misappropriation and applies the *NBA* test. In *X17, Inc. v. Lavandeira*,[17] for example, the District Court for the Central District of California stated that "California law recognizes the misappropriation tort in the broad sense, of which the 'hot news' tort is a subset, and acknowledges that it survives preemption when accompanied by additional elements distinguishing it from a copyright infringement cause of action."[18]

One of the defenses urged by defendants in "hot news" cases is that the federal Copyright Act preempts state law based "hot news" claims. TheFly put forth this defense, citing the *NBA* case in the Second Circuit where the Court stated: "only a narrow 'hot-news' misappropriation claim survives preemption . . . ."[19] More recently, in *Agora Financial, LLC v. Samler*,[20] the District Court for the District of Maryland further refined the preemption conclusion in the *NBA* case by holding that if the alleged misappropriated information is not mere facts but is copyrightable, then the "hot news" tort is preempted by the Copyright Act.[21] A review of the information misappropriated by TheFly suggests that some of it may be copyrightable and the District Court may have held that Barclays' claims with respect to this information were preempted but it did not.

In another recent application of "hot news" misappropriation theory, on July 14, 2010, the District Court for the Southern District of New York in *Banxcorp v. Costco Wholesale Corporation*,[22] issued its decision denying Costco's motion to dismiss Banxcorp's "hot news" claim for failure to state a claim under Federal Rule of Civil Procedure 12(b). There, Banxcorp sued Costco based upon its allegations that Costco obtained from Banxcorp database compilations and market research performance indices which are systematic compilations of selected banking, mortgage, and loan data that "are frequently used as original benchmarks to measure the rates and performance of the U.S. banking and mortgage markets," known as "BanxQuote Indices."[23] Banxcorp alleged that Costco distributed the BanxQuote Indices in "direct mail, print advertisements, newspaper advertisements, websites, and marketing presentations."[24] BanxQuote alleged that the BanxQuote Indices published by Costco contained information that was highly time-sensitive and subject to change by plaintiffs at any time, since they are intricately intertwined with, and based on, thousands of variable interest rates subject to change at any time, and that at least in one example, Costco misappropriated continuously updated information that was "hot." Thus, BanxQuote was able to sufficiently allege not only that the news was time-sensitive when it was gathered, but that it was time-sensitive when it was misappropriated.

The *Barclays* case was tried to the district court on March 8-11, 2010, after both sides waived their claims for damages to the extent that such claims entitled either party to a jury trial, and after the district court denied summary judgment motions by both parties.

In applying New York law, the district court readily found that Barclays generated its investment reports at great expense and that the stock recommendation information was very time-sensitive. Moreover, even though TheFly used significant efforts to gather the "hot" information from public records and that others used such public information just like TheFly did, the court still found TheFly to be free-riding. The fact that TheFly may have obtained some of its information from the public domain was not significant to the court: "Similarly, even if true, it is not a defense to misappropriation that a Recommendation is already in the public domain by the time Fly reports it."[25]

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The district court found that TheFly was in direct competition with Barclays even though Barclays did not sell its reports. The court reasoned that TheFly aligned itself with discount brokers who were in competition with Barclays. Finally, the court found that even though TheFly was a tiny competitor, the subscription services provided by TheFly "substantially threatened" the economic viability of Barclays' research reports. The court notably did not consider any proof by Barclays of this substantial harm, nor did it comment on whether Barclays factored into its brokerage fees the risk of information leaked impacting market price.

The district court thereupon issued an order enjoining TheFly from distributing reports released by Barclays when the market closes, until one-half hour after the New York financial markets opened the next day or 10:00 a.m., whichever is later, and for reports that issue when the markets open, TheFly must delay two hours after the Recommendations are released by the financial firms before distributing headlines from the Recommendations.

In formulating the terms of the injunction the district court tried to balance the incentive for financial institutions to create equity research and spread the benefits of that research against the "ordinary presumption in favor of the free flow of information."[26] The court pointed out the Supreme Court's admonition in the *INS* case, namely, that the injunction against dissemination of the "hot news" should only last "until its commercial value as news to the complainant and all of its members has passed away."[27] On the other hand, the court did make clear that TheFly would not be held in contempt of the injunction if it engaged in the actual analysis of market movements and referred occasionally

to a Recommendation in the context of its own independent analytical reporting on significant market movement that had already occurred.

It should be noted that the district court found that TheFly violated some copyrights of the Plaintiffs but awarded little in the way of statutory damages, and other than impacting credibility, this judgment did not guide the "hot news" ruling. However the Court did subsequently award Plaintiff's reasonable attorneys' fees in the amount of $200,000.

The case was appealed to the Second Circuit Court of Appeals on April 9, 2010.[28] At the request of TheFly, on May 19, 2010, imposition of the district court's order was delayed by the Second Circuit pending the appeal (although its request for a stay was denied by the district court), and the appeal was expedited. The issues on appeal vary and include whether Barclays and TheFly are really competitors and whether TheFly's alleged free-riding has actually threatened the viability of the financial institutions equity research model. A plethora of *amicus curiae* briefs were filed including by Google Inc., Twitter, Inc., StreetAccount LLC, the Securities Industry and Financial Markets Association, Dow Jones & Company, Inc., The Associated Press, Gannett Company, Inc., The New York Times Company and The Washington Post.

The Second Circuit reversed the district court, not on the merits of the hot news tort but rather on the basis that that the New York State law claim for hot news misappropriation was preempted by the Copyright Act.[29] In reversing the district court, the Second Circuit pointed to several aspects of the district court's ruling.

The district court had relied upon the *NBA* multifactor "test," concluding that for a misappropriation claim under New York law to survive federal copyright preemption, and for Barclays to succeed on the claim, Barclays was required to demonstrate the five *NBA* case elements. The district court had concluded that the first two elements were undisputed by TheFly and were easily met. The district court also had decided with respect to the third factor, "free-riding," that since TheFly did no equity research of its own nor did it undertake any original reporting or analysis, Barclays could prove this element. In doing so, the district court rejected TheFly's argument that its efforts in the collection, aggregation and dissemination of information were sufficient to avoid a finding of free-riding.

The district court also concluded that the fourth factor, direct competition, was present since both TheFly and Barclays were engaged in disseminating recommendations to investors for their use in making investment decisions. The district court rejected TheFly's contention that the *NBA* case required the district court to find head to head competition in a primary market. The district court also concluded that the fifth factor, sufficiently reduced economic incentives, was present.

The Second Circuit decided not to address the viability of "hot news" misappropriation under New York law although in dictum, it did state that it would be bound by the conclusion of the panel in the *NBA* case.[30] Interestingly, the Second Circuit stated that "[w]ere we indeed called upon 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".[31]

Under 17 USC § 301, a state law claim is preempted by the Copyright Act if such a claim (i) seeks to vindicate "legal or equitable rights that are equivalent" to one of the bundle of exclusive rights already protected by the copyright law under 17 USC § 106 and (ii) if the work in question is of the type of works protected by the Copyright Act under 17 USC §§ 102 and 103.

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The Second Circuit readily found that Barclays' reports culminating with the recommendations satisfied the subject matter requirement because they are all works of a type covered by § 102, i.e., original works of authorship fixed in a tangible medium of expression.[32] "It is not determinative for the Copyright Act preemption analysis that the facts of the Recommendations themselves are not copyrightable. . . . Second, the reports together with the recommendations fulfill the 'general scope' requirement because the rights 'may be abridged by an act which, in and of itself, would infringe one of the exclusive rights provided by federal copyright law, . . . i.e., acts of reproduction, performance, distribution or display'".[33]

The majority panel also found that TheFly was not, under the *NBA* analysis, "free-riding": TheFly was not selling the recommendations as its own (providing specific attribution to the issuing firm, e.g., Barclays).[34] Approximately half of TheFly's 28 employees were involved in the collection of financial institutions' recommendations and the production of the news feed on which summaries of recommendations were posted. Thus, the Second Circuit distinguished *INS* where the defendant there was taking news gathered, and in the process of being disseminated, by the Associated Press and selling that news as though the defendant itself had gathered it.[35]

Because TheFly did not free-ride on Barclays' work product, the majority panel ruled that Barclays' cause of action for hot news misappropriation under New York law was preempted.[36] Based upon the Second Circuit majority opinion, hot news misappropriation claims under New York law may be limited to those factually fitting the *INS* case, namely where a news

aggregator without much financial organizational effort simply takes the copyrightable work product of the plaintiff and passes it off as its own without any attribution to its source.

Interestingly, the concurring opinion concluded that Barclays' hot news misappropriation claim was also preempted by federal copyright law, but not because of a failure to demonstrate the free-riding element of the *NBA* test, but rather because Barclays could not demonstrate direct competition with TheFly as required by the *NBA* test.[37] Moreover because of the preemption ruling, the Second Circuit did not reach the First Amendment issues much anticipated by those involved in news aggregator cases.

Barclays sought a rehearing *en banc* contending that the Second Circuit's decision conflicted with multiple decisions of the U.S. Supreme Court. The petition for the rehearing *en banc* also discussed at length the Second Circuit's discussion of whether the *NBA* test was "holding" or "dictum" but this issue did not persuade the Second Circuit to rehear the case.

TheFly did not file a response to the request for *en banc* review and the Second Circuit quickly denied the request. Regardless of the decision by the Second Circuit, hot news misappropriation claims still survive under New York law. The question for a plaintiff is whether it can pigeonhole its facts into the five factor *NBA* test, like the *INS* set of facts, or whether the factors are more parallel to TheFly's facts and those of the *Motorola* case. Clearly, factually intensive hot news tort cases are more likely than not poor candidates for motions for summary judgment and it would be expected that the Second Circuit ruling will not foreclose news organizations from pursuing hot news claims against those who are aggregators of news.

Thus, before embarking on aggregating information and using information from other sources to distribute such information, a careful analysis must be undertaken to determine the risk of a hot news misappropriation claim being made. Even though the Second Circuit concluded that the *NBA* case was dictum, it nevertheless applied the test in evaluating the copyright preemption issue and therefore it must be regarded as the most seriously considered hot news misappropriation test.

So what next? Will a petition for *certiorari* be filed? Will it be granted? What issue will the U.S. Supreme Court tangle with? Only time will tell.

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[1] *Barclays Capital Inc. v. Theflyonthewall.com, Inc.*, No. 10-01372, 2011 BL 162245 (2d Cir. June 20, 2011).
[2] *Barclays Capital Inc. v. Theflyonthewall.com, Inc.*, 700 F. Supp. 2d 310, 322 (S.D.N.Y. 2010) ("*Barclays*").
[3] *Id.* at 323.
[4] *Id.* at 315.
[5] *Id.*
[6] *Barclays*, 700 F. Supp. 2d at 315.
[7] *Id.*
[8] *Id.* at 315-16.
[9] *Id.* at 316.
[10] *Barclays*, 700 F. Supp. 2d at 326.
[11] *Barclays Capital Inc. v. Theflyonthewall.com, Inc.*, No. 06-CV-04908, Complaint (S.D.N.Y. June 26, 2006).
[12] 248 U.S. 215 (1918) ("*INS*").
[13] *Id.* at 239.
[14] *Id.* at 250.
[15] 105 F.3d 841 (2d Cir. 1997).
[16] *Id.* at 853.
[17] 563 F. Supp. 2d 1102, 1107 (C.D. Cal. 2007) (preliminary injunction denied where plaintiff failed to provide sufficient evidence that defendant's use of the photographs in question threaten the existence of the service plaintiff provides).
[18] *See also Pollstar v. Gigmania Ltd.*, 170 F. Supp. 2d 974 (E.D. Cal 2000) ("hot news" tort adequately pled).
[19] 105 F.3d at 852.
[20] *Agora Financial, LLC v. Samler*, 725 F. Supp. 2d 491 (D. Md. 2010).
[21] *See Agora Financial, LLC v. Samler*, No. 09-CV-01200, Report and Recommendation at 15 (D. Md. June 17, 2010).
[22] BanxCorp d/b/a BanxQuote v. Costco Wholesale Corp., 723 F. Supp. 2d 596 (S.D.N.Y. 2010).
[23] *Id.*
[24] *Id.*
[25] *Barclays*, 700 F. Supp. 2d at 337.
[26] *Id.* at 344.
[27] *INS*, 248 U.S. at 245.
[28] *Barclays Capital Inc. v. Theflyonthewall.com, Inc.*, No. 10-01372, Notice of Appeal (2d. Cir. Apr. 9, 2010).
[29] *Barclays Capital Inc. v. Theflyonthewall.com, Inc.*, No. 10-01372, 2011 BL 162245 (2d Cir. June 20, 2011).
[30] *Id.* at 10.
[31] *Id.*
[32] *Id.* at 17.
[33] *Id.*
[34] *Id.*
[35] *Id.* at 18.
[36] *Id.* at 20.
[37] *Id.* at 24.