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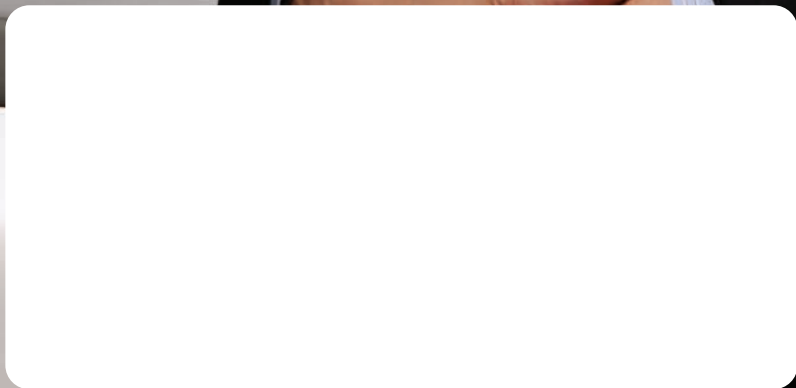
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## Some Like It Hot

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by Rod S. Berman

# SOME LIKE IT HOT

## Digital technology has raised questions about the reach of the tort of the misappropriation of hot news

**EVERY MORNING** news outlets clamor to alert consumers regarding what may be the hottest stocks to purchase at the moment. For a few hundred dollars a year, Theflyonthewall.com offers its wares in this competitive environment. Theflyonthewall.com 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. The Web site, frequently referred to as TheFly or simply Fly, has a crucial pitch for its potential subscribers: It provides its information before the New York Stock Exchange opens, which enables its subscribers to follow the advice of many of the

large financial institutions such as Barclays, Merrill Lynch, and Morgan Stanley. TheFly does not provide brokerage services or investment advice. It only reports the news, with 80 percent of its recommendation headlines posted before the financial markets open.

A term currently in circulation describes the longstanding phenomenon of up-to-the-minute time-sensitive information: “hot news.” Other news services provided hot news about the recommendations of traditional brokerage houses, but Barclays decided to proceed against TheFly. It did so in the Southern District of New York on a variety of theories in *Barclays Capital Inc. v. Theflyonthewall.com*,<sup>1</sup> the most significant being the misap-

propriation of hot news. The district court issued an injunction against TheFly, and TheFly has appealed to the Second Circuit Court of Appeals. The ultimate disposition of this case is garnering significant attention and commentary among practitioners and others affected by the hot news phenomenon.

In *Barclays*, the district court summarized TheFly’s appeal to its subscribers: “Emphasizing the timeliness of its reporting, [TheFly]

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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.”<sup>2</sup> In marketing its services, TheFly points to “its quick and comprehensive access to Recommendations made by Wall Street research analysts....Fly asserts that ‘[h]aving a membership with the Fly is like having a seat at Wall Street’s best houses and learning what they know when they know it....’ [I]t allows its subscribers to be a ‘fly on the wall’ inside the investment firms’ research departments.”<sup>3</sup>

Barclays, a major financial institution, 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 investors who are not clients of Barclays will gain access to its recommendations before the New York Stock Exchange opens.

Barclays regularly monitors the list of recipients entitled to receive its reports. The reports also include prohibitions on redistribution. Barclays’s customers include businesses of every size—including private equity firms and money managers, as well as families and individuals. Barclays markets its brokerage services to provide its customers paying the highest commissions—typically large institutional and wealthy individual investors—an edge in equity buying.

In its opinion, the district court in *Barclays* noted that the development and marketing of equity research is a “critical component” of Barclays’s business model.<sup>4</sup> 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 customers to reap significant monetary benefits from timely trades in the financial markets.<sup>5</sup>

TheFly, after extensive searching on the Internet and other public records, might find a Barclays equity research report on the near term (meaning within hours) projection for a stock price. These reports, as described in the opinion, typically “range from a single page to hundreds of pages in length.”<sup>6</sup> 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.”<sup>7</sup> A Barclays report may “indicate whether analysts believe the price of a stock is likely to increase,

decrease, or remain relatively steady.”<sup>8</sup>

According to the *Barclays* district court, 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’s] clients, because the Recommendations can provide them an early informational advantage.”<sup>9</sup> Barclays provides a personalized service to its key customers—“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.

TheFly was aware that Barclays’s reports 1) were generated confidentially, 2) were issued before the NYSE opened, 3) could materially impact stock prices, and 4) were intended for Barclays’s most private clients. Nevertheless, TheFly allegedly was able to locate some of Barclays’s 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.”<sup>10</sup> These actions, according to Barclays, constituted elements of a claim for the misappropriation of hot news.

### INS and NBA

Hot news misappropriation is a tort based upon a seminal U.S. Supreme Court decision, *International News Service v. Associated Press*,<sup>11</sup> a 1918 case. The INS—an entity associated with the infamous newspaper publisher William Randolph Hearst—lifted news reports from the Associated Press about military and political developments during World War I. The INS did this in lieu of spending the company’s own resources employing reporters covering the battlefields of Europe. When the AP posted it news reports on the East Coast on bulletin boards and early editions of newspapers—the hot news of the day—the INS would reword the information, formulate its own copy, and telegraph the paraphrased reports to the West Coast, where they were published in Hearst newspapers.

Copyright infringement was not at issue in *INS*. Instead, the Supreme Court found that the hot news at issue in the case was quasi property and permanently enjoined the INS from engaging in its practices involving the AP’s hot news reports. Justice Mahlon Pitney, writing for the majority, wrote that “the defendant has reaped where it has not sown.”<sup>12</sup>

The INS relied on the First Amendment

for its argument that once the news reports were made public, the information contained in those reports was free for anyone to use and publish. Moreover, the INS argued that even though the reports were developed at great expense by the AP, they could be freely used by others. Justice Louis Brandeis, writing for the dissent, agreed: “The 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.”<sup>13</sup> Thus to Justice Brandeis, the means by which the INS obtained the news, whether from public sources or the open market, were not an issue for redress by the Court. While Justice Brandeis thought that perhaps some remedy for the INS’s conduct might be in order, he nevertheless opined that the courts were ill-equipped to make that decision. Indeed, he wrote that the issue of news gathering conduct was one for Congress to address. Notwithstanding Justice Brandeis’s sensible approach, Congress has not taken action on hot news misappropriation in all the years since *INS* was decided. But courts have continued to address the topic.

In 1997, in *National Basketball Association v. Motorola, Inc.*,<sup>14</sup> the NBA sued the maker of a handheld pager that displayed real-time information regarding scores and statistics about professional basketball games while they were in the process of being played. Although the Second Circuit declined to find Motorola liable, the court articulated the now fairly well-established elements of a claim for hot news misappropriation:

- A plaintiff generates or gathers information at a cost.
- The information is time-sensitive.
- A defendant’s use of the information constitutes free riding on the plaintiff’s efforts.
- The defendant is in direct competition with a product or service offered by the plaintiff.
- The ability of other parties to free ride on the efforts of the plaintiff would so reduce the incentive to produce the plaintiff’s product or service that its existence or quality would be substantially threatened.

The *NBA* court emphasized that a hot news misappropriation claim “is about the protection of property rights in time-sensitive information.”<sup>15</sup>

One of the defenses urged by the defendants in hot news misappropriation cases is that the federal Copyright Act preempts state law claims for hot news misappropriation. However, this defense has been confronted and rejected, at least by the Second Circuit. In *NBA*, the Second Circuit held that the elements that it found to constitute a hot news misappropriation claim “allow [the] claim to survive preemption” by the Copyright Act.<sup>16</sup>

Nevertheless, after noting that “older New York misappropriation cases involving radio broadcasts...considerably broadened *INS*,” the *NBA* court concluded its analysis by holding that “only a narrow ‘hot-news’ misappropriation claim survives preemption....”<sup>17</sup> However, in June 2010, a Maryland district court in *Agora Financial, LLC v. Samler*<sup>18</sup> further refined the preemption conclusion in *NBA* by holding that if the alleged misappropriated information is not mere facts but is copyrightable, then the hot news misappropriation tort is preempted by the Copyright Act.<sup>19</sup> A review of the information that TheFly is alleged to have misappropriated suggests that some of it may be copyrightable, and thus Barclays’s claims regarding this information may be preempted.

The Ninth Circuit recognizes the tort of hot news misappropriation and applies the *NBA* test. In *X17, Inc. v. Lavandeira*,<sup>20</sup> for example, a district court in 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.”<sup>21</sup>

In another recent application of hot news misappropriation theory, on July 14, 2010, a district court for the Southern District of New York in *Banxcorp v. Costco Wholesale Corporation*<sup>22</sup> issued a decision denying Costco’s motion to dismiss Banxcorp’s hot news misappropriation claim for failure to state a claim under Rule 12(b) of the Federal Rules of Civil Procedure. Banxcorp alleged that Costco obtained database compilations and market research performance indices, known as BanxQuote Indices,<sup>23</sup> from Banxcorp. This information includes 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.” Banxcorp claimed that Costco distributed the BanxQuote Indices in “direct mail, print advertisements, newspaper advertisements, websites, and marketing presentations.”<sup>24</sup> Moreover, according to Banxcorp, the BanxQuote Indices published by Costco contained information that was highly time-sensitive and subject to change by the plaintiffs since the data in the compilation and indices are intricately intertwined with, and based on, thousands of variable interest rates that are also subject to change at any time. Indeed, in at least one example, Costco allegedly misappropriated continuously updated hot information. 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.

### **District Court Injunction and TheFly’s Appeal**

The *Barclays* suit was tried in district court in March 2010. This was after both sides waived their claims for damages to the extent that the 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 the 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: “[E]ven if true, it is not a defense to misappropriation that a Recommendation is already in the public domain by the time Fly reports it.”<sup>25</sup>

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. Also, even though the court found that TheFly constituted a tiny com-

petitor, the subscription services provided by TheFly “substantially threatened” the economic viability of Barclays’s 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 leaked information affecting market price.

As a result of its findings, the district court issued an order enjoining TheFly from distributing reports released by Barclays at the close of the New York financial markets until half an hour after the financial markets opened the next day or at 10 A.M., whichever came later. Further, for reports that Barclays issues when the markets open, TheFly must wait two hours after Barclays’s recommendations are released by 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.”<sup>26</sup> The court pointed out the Supreme Court’s admonition in *INS*: An injunction against dissemination of hot news should only last “until its commercial value as news to the complainant and all of its members has passed away.”<sup>27</sup> However, the court held that TheFly would not be held in contempt of the injunction if it engaged in the actual analysis of mar-



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ket movements and referred occasionally to a recommendation in the context of its own independent analytical reporting on significant market activity that had already taken place.

Although not stated explicitly by the district court, it is likely that the court would not find TheFly in contempt if the information it reports is not time-sensitive. But how time-sensitive must information be for its misappropriation to be actionable under a hot news claim? In *Financial Information, Inc. v. Moody's Investors Services, Inc.*,<sup>28</sup> the Second Circuit required "immediacy of distribution...to sustain a 'hot news' claim," finding that this requirement was not met when "the information [the defendant] published would have been at least ten days old."

The district court awarded hardly any statutory damages to the plaintiffs for TheFly's copyright violations—and other than affecting the defendant's credibility, the finding that copyrights were violated did not guide the court's ruling on the hot news claim. Still, the court awarded attorney's fees of \$200,000 to the plaintiff.

The appeal in *Barclays* was filed with the Second Circuit on April 9, 2010.<sup>29</sup> At the request of TheFly, on May 19 the 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 has been expedited. The issues on appeal include whether Barclays and TheFly are really competitors and whether TheFly's alleged free riding has actually threatened the viability of Barclays's equity research model.

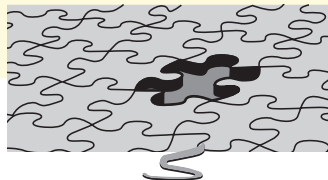
Google Inc., Twitter, Inc., and StreetAccount LLC are among the many companies filing amicus curiae briefs in the case. Google and Twitter argue that reversal is required because after *INS*, the Supreme Court rejected the "sweat of the brow" theory for protecting facts.<sup>30</sup> They are concerned that the ruling could have a significant impact on the traditional way that television and radio stations broadcast information obtained from newspapers. For Google and Twitter, the issue is how long they have to refrain from disseminating breaking news that they have acquired but not developed as a result of their own news gathering efforts.<sup>31</sup> Google and Twitter argue that delay in reporting news deprives "the public of important, time-sensitive, factual information"<sup>32</sup> and suggest that issuing an injunction on news gathering is an abuse of the First Amendment. They contend that Barclays should be required to enter into less constitutionally intrusive confidentiality agreements, and those agreements could then be enforced against those who disclose confidential information.

Not surprisingly, the Securities Industry and Financial Markets Association (SIFMA)

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urges in its amicus curiae brief that the Second Circuit affirm the district court's order to remedy what SIFMA deems an industry-wide problem affecting many of its members.<sup>33</sup> Even the district court noted that in light of TheFly's lead, other companies are reporting on the recommendations of financial institutions before and shortly after the financial markets open. SIFMA argues that an injunction is critical so that financial institutions will still have the economic incentive to produce equity research. The injunction, according to the brief, will also protect the exclusivity of analysis provided by financial institutions to their key investors. Indeed, according to SIFMA, the exclusivity of time-sensitive news provided by financial institutions must be protected from misappropriation by the institutions' competitors. SIFMA contends that affirmance of the injunctive order is necessary not only to deter TheFly but also the other entities engaged in activities similar to TheFly's. SIFMA notes that timely analyst information facilitates efficient markets—and "efficient markets serve the critical public interest of promoting the effective use of society's limited resources."<sup>34</sup>

SIFMA does not mention Justice Brandeis's dissent in *INS*. Nor does SIFMA discuss what the First Amendment should preclude in a world of instantaneous transmission of information via handheld devices. It does not address whether a court should provide a monopoly on public information to SIFMA members and enjoin the dissemination of facts in the public interest even if those facts are obtained by misappropriation.

Several companies have submitted amicus curiae briefs that do not support either party, including Dow Jones and Company, Inc.; the Associated Press; Gannett Company, Inc.; the New York Times Company; and the Washington Post Company. These entities have expressed their views regarding news gathering but have not taken a position in the outcome of the *Barclays* dispute. Dow Jones, for example, urges the court to take "care and surgical precision" in applying the hot news tort to ensure a balance between the First Amendment and the "proprietary interests at stake."<sup>35</sup> According to Dow Jones, "If injunctions containing these restraints were to become the norm in hot-news cases, they would interfere with legitimate journalistic activity and pose a serious conflict with the First Amendment."<sup>36</sup>

So the Second Circuit must perform a classic balancing act. Should it follow Justice Pitney writing for the majority in *INS* and confirm that TheFly has not sown what it has reaped and thus the district court was right to issue its injunction? Or should it take the position of Justice Brandeis's dissent in *INS* and reverse the lower court decision in

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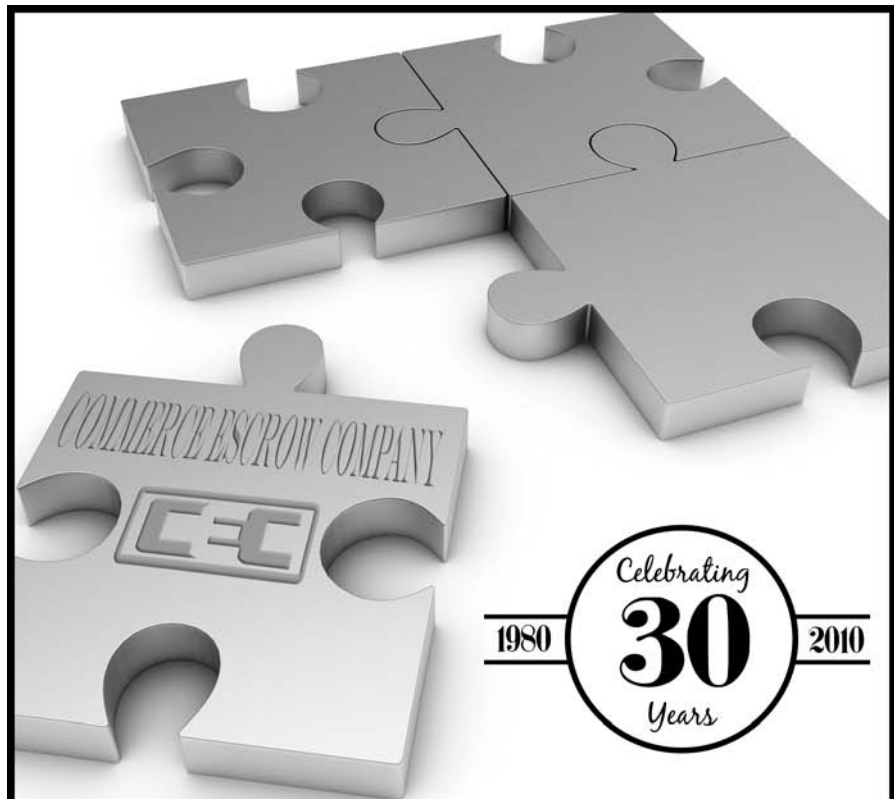
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*Barclays*, finding it in conflict with the First Amendment right to gather and publish facts? Most likely, in line with its *NBA* decision, the Second Circuit will find that the First Amendment precludes the district court's broad injunction.

But the Second Circuit must also make sense of TheFly's incomprehensible decision to waive its First Amendment defense at trial. Will the Second Circuit nevertheless consider the defense even though it was only first articulated in TheFly's reply to Barclays's opposition to TheFly's motion to stay the injunction? Will the Second Circuit—and the public—be deprived of the opportunity to revisit whether *INS* is inconsistent with the First Amendment? Perhaps the district court's decision will be limited to its facts because the principal witness for TheFly “was not a reliable reporter of facts....He frequently contradicted himself. His unreliability appeared attributable to his motive to escape liability.”<sup>37</sup> Would the district court's decision be any different if New York law did not apply?<sup>38</sup>

The Second Circuit's answers to these questions are clearly not just of interest to the disputants in *Barclays*. Practitioners and judges as well as those in the financial and news gathering industries are all interested flies on the wall, awaiting the decision.

However, no matter how the Second Circuit rules, the ultimate arbiter of these issues remains the Supreme Court. The real breaking news regarding this issue will be whether *Barclays* becomes the vehicle for the Court to reevaluate the viability of the scope of injunctive relief in hot news misappropriation cases. ■

<sup>1</sup> *Barclays Capital Inc. v. Theflyonthewall.com*, 700 F. Supp. 2d 310 (S.D. N.Y. 2010).

<sup>2</sup> *Id.* at 322.

<sup>3</sup> *Id.* at 323.

<sup>4</sup> *Id.* at 315.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* at 315-16.

<sup>9</sup> *Id.* at 316.

<sup>10</sup> *Id.* at 326.

<sup>11</sup> *International News Serv. v. Associated Press*, 248 U.S. 215 (1918).

<sup>12</sup> *Id.* at 239.

<sup>13</sup> *Id.* at 250 (Brandeis, J., dissenting).

<sup>14</sup> *National Basketball Ass'n v. Motorola, Inc.*, 105 F.3d 841 (2d Cir. 1997).

<sup>15</sup> *Id.* at 853.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 852.

<sup>18</sup> *Agora Fin., LLC v. Samler*, \_\_\_ F. Supp. 2d \_\_\_, No. WDQ-09-1200 (D. Md. June 17, 2010).

<sup>19</sup> *See id.*, Report and Recommendation at 15.

<sup>20</sup> *X17, Inc. v. Lavandeira*, 563 F. Supp. 2d 1102, 1107 (C.D. Cal. 2007) (The court denied the plaintiff's request for a preliminary injunction when the

plaintiff failed to provide sufficient evidence that the defendant's use of the photographs in question threatened the existence of the service the plaintiff provides.).

<sup>21</sup> *See also* *Pollstar v. Gigmania Ltd.*, 170 F. Supp. 2d 974 (E.D. Cal. 2000) (hot news tort adequately pled).

<sup>22</sup> *BanxCorp d/b/a BanxQuote v. Costco Wholesale Corp.*, \_\_\_ F. Supp. 2d \_\_\_, No. 09-cv-1783 (S.D. N.Y. July 13, 2010).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Barclays Capital Inc. v. Theflyonthewall.com*, 700 F. Supp. 2d 310, 337 (S.D. N.Y. 2010).

<sup>26</sup> *Id.* at 344.

<sup>27</sup> *International News Serv. v. Associated Press*, 248 U.S. 215, 245 (1918).

<sup>28</sup> *Financial Info., Inc. v. Moody's Investors Servs., Inc.*, 808 F.2d 204, 209 (2d Cir. 1986).

<sup>29</sup> *Barclays Capital Inc. v. Theflyonthewall.com*, No. 10-1372 (2d Cir., filed Apr. 9, 2010).

<sup>30</sup> *Id.*, Brief of Amici Curiae Google Inc. and Twitter, Inc., at 2-3 (citing *Feist Publ'ns, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340, 349 (1991)).

<sup>31</sup> *Id.* at 3.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*, No. 10-1372, Brief of Amici Curiae the Securities Industry and Financial Markets Association (SIFMA).

<sup>34</sup> *Id.* at 26.

<sup>35</sup> *Id.*, No. 10-1372, Brief of Amici Curiae Dow Jones & Company, Inc., at 1.

<sup>36</sup> *Id.* at 2.

<sup>37</sup> *Barclays Capital Inc. v. Theflyonthewall.com*, 700 F. Supp. 2d 310, 327 n.25 (S.D. N.Y. 2010).

<sup>38</sup> *See* *Associated Press v. All Headline News Corp.*, 608 F. Supp. 2d 454, 460 (S.D. N.Y. 2009) (suggesting Florida may not recognize a hot news tort).

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