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Editor’s Note

With the completion of this issue, JIMEL marks the end of another very productive year. As always, our editors strive to offer a diverse selection of scholarly articles of interest not only to academics, but also to the membership of our two sustaining ABA Forums, the Forum on Communications Law and the Forum on the Entertainment and Sports Industries. This appeal to our diverse constituencies is evident in the design of our February 7, 2014, symposium on remotely piloted aircraft, entitled “The Use of Drones in the Media and Entertainment Industries: The Domestic and International Legal and Policy Issues.” For those unable to make it to Southwestern Law School in Los Angeles, a complete transcript of the conference’s proceedings—including the presentations of media and entertainment experts from around the world—will be provided in our next issue.

I am also extremely pleased with the diverse articles that were selected for this issue. The topics, all timely and relevant, should appeal to a broad section of our readers.

Prof. Warren Grimes’ article, “The Distribution of Pay Television in the Unites States: Let an Unshackled Marketplace Decide,” is particularly germane in light of the recent standoff between CBS and Time Warner Cable. The article argues for a more rigorous application of antitrust principles to American television distribution. For cable customers, seven programmers account for ninety-five percent of television viewing hours in the U.S., and subscription fees are rising at twice the national inflation rate, while more and more consumers defect from pay television in favor of cheaper and more particular distribution channels. The author links this increase in price, and corresponding consumer loss, to “forced bundling,” a practice by which programmers require distributors to carry less popular channels in order to carry the more popular “must-have” channels.

The article draws a comparison between the Canadian and American television distribution systems and how the American system might benefit from a look to the Canadian model. It proposes a hybrid formula by which consumers can choose between various more specialized (“narrower”) bundles and à la carte choices of channels. The author, a leading expert on antitrust law, concedes that the effect might be a marginal increase in per-channel price, but that increase would be offset by consumers’ newfound ability to choose the channels they actually want.
Katharine Larsen and Julia Atcherley’s article, “Freedom of Expression-Based Restrictions on the Prosecution of Journalists Under State Secrets Laws: A Comparative Analysis,” explores the constraints that the right to free expression—and the derivative rights to receive and impart government information—impose on the nature and scope of state secrets laws as applied to journalists. The article examines the jurisprudence of domestic and international courts, as well as the policies and principles of intergovernmental entities, to offer an overview of the right to obtain government information and the growing international consensus on the burdens to be imposed on government bodies when they seek to prevent access to data or documents touching upon national security matters. The authors specifically survey the laws, policies, and practices of state governments and intergovernmental bodies applicable to journalists working at the intersection of the public’s right to receive sensitive state information on matters of public concern and the government’s efforts to prosecute the receipt and dissemination of that very same information. Ultimately, the authors identify the free expression-based constraints that, in this modern constitutional era, guide the evaluation of the validity of state secrets laws as applied to the work routinely undertaken by national security reporters.

Dr. Lazaros Grigoriadis’ article, “Exhaustion and Software Resale Rights in Light of Recent EU Case Law,” examines the potentially significant impact of the landmark UsedSoft ruling in Europe. The recent EU Court of Justice finding that the owner of copyright of a computer program cannot contest the resale of a copy of the program which was incorporated into a data carrier and sold in the EU raised a new question: whether permanent copies stored in a material medium, that are sold or downloaded by sale, can also not be opposed by the owner of the copyright. The UsedSoft case answered that the availability (by means of material medium or download) does not matter; rather, there must be a transfer of ownership. The exhaustion doctrine dictates that a user may legally resell a copy to another user and such subsequent acquisitions are lawful. The online transmission of a work falls within the right of distribution.

The author, an academic based in Greece, argues that this is an advantageous holding for users, but poses remedial implications for manufacturers seeking ways to circumvent this new holding. Still, a downloaded copy of a computer program does not entitle the acquirer to divide the license and resell only the user right—this would violate the exclusive right of reproduction. Thus, manufacturers will likely respond by renouncing the sale and instead grant a right to use a copy of a program for an unlimited period in return for payment of a fee. The
article looks comparatively to the “first sale” doctrine under U.S. law, which similarly authorizes a purchaser of a copy to resell that particular copy, without violating the copyright owners’ rights when copies are lawfully made.

Grace Clements’ article, “A Fistful of Dynamite: How Independent Film’s Cowboy Culture Creates Unstable Sales Agency Agreements,” posits that sales agency agreements for films may be revocable regardless of the contractual inclusion of an “irrevocable” provision. Since most sales agency disputes are arbitrated instead of litigated, the number of actual sales agents facing revocation by producers is unknown. But, the author argues, even the possibility that the sales agency is revocable may be enough to derail international agreements. As the international appetite for independent film grows, both in mainstream consumption and within niche markets, the potential instability of these agency agreements threatens detrimental ramifications to a multi-billion dollar industry.

Is an agency revocable at will even when it contractually claims to be irrevocable? The answer, to the chagrin of many agents, is yes; unless it is a “power coupled with an interest.” Unfortunately, what that means is unclear, and has been for two hundred years. The author investigates the meaning of “power coupled with an interest” through case law from the analogous hotel industry, where management companies were shocked to find their agency revoked by hotel owners. Special attention is given to the inadequacy of current remedies for foreign sales agents and the business solutions that must be put in place to protect foreign sales agents in contemporary practice. Because the strength of a contract is built on its stability, and the strength of an industry is built upon its contracts, the author concludes that fissures in the sales agency agreement must be sealed in order for the industry to advance.

Our dedicated volunteer staff is now actively reviewing submissions for Volume 5, Issue 2, scheduled for publication in mid-2014. Please feel free to contact us if you would like to suggest an article topic or if you would like us to consider an original manuscript for publication.

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The Distribution of Pay Television in the United States: Let an Unshackled Marketplace Decide

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Introduction

It was no pedestrian antitrust suit. Aiming at what Senator John McCain has called an “injustice . . . inflicted on the American people,”1 the class action complaint alleged that powerful television programmers were forcing large and unwieldy bundles of TV channels on distributors and ultimately the consumer, with overpayments that likely amount to tens of billions of dollars each year.2 The complaint alleged classic indicia of anticompetitive injury, including the massive overcharges, the suppression of competition among distributors, the loss of consumer choice, and (indirectly) the dead weight or output loss when consumers chose not to subscribe. The potential import of this case dwarfed even major cartel cases in which damages, even over a period of years, seldom reach the billion-dollar mark.

Consumer distaste for the elephantine and expensive channel offerings has long been focused on the distributor. It was only two decades ago that pay television distribution was dominated by underperforming, locally licensed cable TV monopolists. Today, although accounts of distributor abuse continue,3 there is opportunity for genuine competition among distributors. The high prices and lack of consumer choice are occasioned, in large part, not by the distributors, but by powerful television programmers who force the bundles.

The consumer class action complaint in Brantley v. NBC Universal, Inc.4 was dismissed before the merits could be addressed at trial or even on a summary judgment motion. On the surface, the Ninth Circuit

2. The estimate is explained in Part I.E. infra.
3. A major concern remains the vertical integration of many distributors into programming and Internet services. See Susan Crawford, Captive Audience: The Telecom Industry in the New Gilded Age (2013) (describing the monopoly risks arising from control of Internet pipeline by large, vertically integrated firms). See also Comcast Corp. v. Behrend, 133 S. Ct. 1426 (2013) (an unsuccessful consumer class action in which Philadelphia-area plaintiffs alleged that Comcast, with 69% of the local market, had exercised its power to prevent rival distributors from building competing networks); GAO, Report to the Acting Chairwoman of the Federal Communications Commission, Video Marketplace 10 (2013) (describing hesitancy of AT&T and Verizon to expand their fiber optic networks).
4. 675 F. 3d 1192 (9th Cir. 2012).
panel decision was just another failed Sherman Act class action suit. The plaintiffs were persistent, unsuccessfully appealing the dismissal, filing two successive petitions for rehearing en banc and, when these failed, filing an abortive petition for certiorari to the Supreme Court. Yet, these efforts were to no avail. When the Supreme Court denied certiorari in November 2012, the case, initiated five years earlier, was over. The pattern is a familiar one: when the Supreme Court has granted review, it has ruled favorably for defendants in a long string of antitrust cases brought by private plaintiffs.

Brantley has special significance because of the importance of the issues it raised in the distribution of pay television programming in the United States. Using largely public record materials, I begin here with an overview of the industry and its competitive performance, with special focus on the forced bundling by programmers. I then turn to the Brantley story, examining the complaint, the Ninth Circuit’s holding, and criticism of that holding. Finally, I examine commentary supportive of Brantley. That examination invites some broader reflection on the relevancy of the now century-plus Sherman Act experiment. From this antitrust perspective, the Ninth Circuit’s holding represents a meticulously cabined categorization that ignores the fundamental goals of the Sherman Act: to maintain competition and ensure that it disciplines a product’s development, production, and distribution (including bundling and pricing decisions), thereby maximizing the allocation of goods and services and preventing exploitative wealth transfers. I conclude that a truer application of the Sherman Act offers the best solution for unlocking competition and resolving the until-now intractable competitive issues in television distribution.

I. The Distribution of Pay Television in the United States

A. The History of Forced Bundling Restraints

From its nascent years in the mid-twentieth century, the cable television industry has offered cable channels in bundles, requiring con-
sumers to purchase large numbers of channels in order to receive the few that they actually watch.\textsuperscript{7} Television viewers of the past who chafed under the high cost of buying the entire bundled package, known as expanded basic cable, faced two obstacles to effective antitrust relief. The first hindrance was that cable distributors of an earlier era were government-licensed monopolists. Indeed, as recently as 1992, locally-licensed cable television providers controlled 95\% of the pay television market.\textsuperscript{8} Fostering competition in the face of government-sanctioned local monopolies was a potentially intractable problem for an antitrust court. Second, given the limited technology available in earlier years, defendants could offer a potentially powerful defense: forced tiered bundles were arguably an efficient method of distribution. Today, neither obstacle prevents effective antitrust relief.

The government-licensed cable distributor is no longer a monopolist. One in three consumers can choose among four or more distributors: a licensed cable company, a local telephone company that distributes programming with fiber optic cables, and two national satellite providers; most of the remaining consumers have three distributors to choose from.\textsuperscript{9} The share of pay television subscribers held by traditional cable distributors fell steadily over the past two decades, dropping to 57\% in 2012.\textsuperscript{10}

The second obstacle to antitrust relief, the technological limits on providing customized viewing to individual viewers, is also largely gone. More sophisticated technology makes it efficient to offer smaller and individually tailored packages to consumers. As detailed below, distributors have openly declared their readiness to provide such packages. The \textit{Brantley} complaint alleged that some television distributors outside the United States already provide television programming \textit{à la carte} or in smaller packages.\textsuperscript{11}

\textsuperscript{7} The history of cable television was surveyed in Cablevision Sys. Corp. v. Federal Communications Comm’n, 597 F.3d 1306 (D.C. Cir. 2010).

\textsuperscript{8} See id. at 1308-09.

\textsuperscript{9} GAO, Video Marketplace, supra note 3, at 9; FCC, FOURTEENTH REPORT: ANNUAL ASSESSMENT OF THE STATUS OF COMPETITION IN THE MARKET FOR THE DELIVERY OF VIDEO PROGRAMMING, 27 FCC RCD. 8610, 8627 (2012). The two largest cable TV providers are Comcast (with an estimated 22.8 million subscribers in 2010) and Time Warner Cable (estimated 12.4 subscribers in 2010). The satellite providers are Direct TV (estimated 19.2 million in 2010) and Dish (estimated 14.1 million in 2010). \textit{Id.} at 8668–69.

\textsuperscript{10} GAO, Video Marketplace, supra note 3, at 9.

\textsuperscript{11} Third Amended Complaint, ¶ 45, Brantley v. NBC Universal, Inc., 675 F.3d 1192 (9th Cir. 2012), \textit{cert. denied}, 133 S. Ct. 573 (2012) (No. CV 07-06101 CAS).
Despite an infrastructure conducive to competition, today’s distributors cannot compete meaningfully with one another because powerful programmers prevent it, employing a series of parallel contracts with all distributors. Today, seven powerful programmers account for about 95% of all television viewing hours in the United States. The Brantley complaint alleged that five of these firms—NBC Universal (now owned by Comcast Cable Communications, LLC, another named defendant), Viacom Inc., The Walt Disney Company, Fox Entertainment Group, Inc., and Time Warner Inc.—owned one or more “must have” channels that allowed the firm to dictate bundling and tiering restrictions to distributors. Each of these powerful programmers, leveraging the demand for its most popular channels, effectively forced carriage of all of its channels in bundles specified by the programmer. The problem is exacerbated by the substantial vertical integration of distributors and programmers. According to the FCC’s 2012 report, 127 national networks were owned by the five largest pay television distributors, including seventy-eight owned by Comcast, the largest distributor.

The market power possessed by a programmer depends primarily on the popularity of the one or more channels that it distributes. If a distributor does not carry a channel that its subscribers wish to watch, it risks losing market share to rival distributors that do provide the channel. This leverage is openly acknowledged and lamented by distributors who are subject to it. One indication of the strength of the programmer’s leverage is the ability to demand and receive higher payments for a popular channel even when the market share for that channel is declining. Faced with a loss in market share, a seller in

12. FCC, FOURTEENTH REPORT, supra note 9, at 8765–66.
13. Third Amended Complaint, supra note 11, ¶ 2. The complaint further alleged that, of the roughly sixty channels available in the basic and expanded basic tiers in the Los Angeles area, thirteen are entirely or partly owned by NBC Universal, nine by Viacom, seven by Fox, eleven by Disney, and sixteen by Turner and Liberty Media combined. Id. ¶ 42.
14. FCC, FOURTEENTH REPORT, supra note 9, at 8629. Time Warner Cable has, within the past two years, purchased exclusive rights to telecast the Los Angeles Lakers basketball games and the Los Angeles Dodgers baseball games. The contract to televise Dodger games reportedly provides for payment of $7 billion or $8 billion dollars over the 25-year life of the contract. See Joe Flint & Bill Shaikin, Dodgers’ TV Deal Could Be Game Changer, L.A. TIMES, Jan. 23, 2013, at A1.
15. See notes 37, 84–88 infra and accompanying text.
16. In its Sherman Act suit against Viacom, Cablevision alleges that Viacom has demanded increased payments for its four most popular channels even as the market share for those channels has declined. Amended Complaint, ¶¶ 42, 44, 46, 48, Cablevision Systems Corp. v. Viacom Int’l, Inc., Civil Action No. 13 CIV 1278 (LTS) (JLC) (S.D.N.Y. July 16, 2013).
a more competitive market would have an incentive to lower, not raise, its prices.

Even a small programmer may enjoy substantial leverage over distributors if it offers a popular channel that distributors must carry in order to compete for subscribers. That monopoly leverage is by itself not an antitrust issue. One would expect the programmer to demand a premium price for the channel, a price that distributors would willingly pay as long as it could be passed on to consumers without a substantial loss in subscriptions. The problem becomes more complex, however, if distributors are offering channels in very large bundles such as an expanded basic tier that includes sixty or more channels. Now the programmer with its popular channel has an incentive not just to demand a high price, but also to demand a tiering restriction: that its channel be included in the expanded basic tier. In isolation, the programmer’s demand is relatively unproblematic. The industry-wide picture, however, is that every programmer now makes similar demands, the tier grows increasingly large, and consumers end up with the unwieldy and expensive bundle that characterizes contemporary pay television distribution.

Especially troublesome conduct is that of the large programmers, who insist not only that their popular channels, but also a larger number of relatively unknown channels, be included in the expanded basic tier. In the pending Cablevision suit, the complaint alleges that Viacom requires its distributors to include not only its four most popular channels, but also up to a dozen other relatively unknown channels, some or all of which the distributor would not choose to purchase or include in the expanded basic tier.17 When Viacom’s behavior is multiplied by the restrictions of other programmers with must have channels, the market is powerfully distorted.

While increased competition among distributors may be a welcome development, that increased competition has given even greater leverage to the powerful programmer. Prior to 1992, if a programmer with a high demand channel wanted access to viewers in any geographic area, it had to deal with a local monopolist—the licensed cable TV provider. The outcomes of negotiations between an upstream and downstream monopolist (bilateral monopoly), although not as favorable for consumers as competition, are likely to be less injurious to welfare than when only one of the parties enjoys monopoly power.18

17. Id. ¶ 1.
In effect, the two monopolists need each other and are likely to negotiate terms that are less extreme than in a one-sided monopoly. After 1992, as satellite providers and phone companies began making inroads on the local cable company’s market share, the bilateral monopoly no longer existed. A powerful programmer was in the driver’s seat now and able to whipsaw a recalcitrant distributor by threatening to refuse to supply a high demand channel. The threat is compelling because the distributor risks losing substantial market share to rivals. More competition among distributors has had the perverse effect of increasing the leverage of upstream programmers, contributing to the high prices and unwieldy bundles that shape today’s market.

B. A Pricing Model Skewed to Capture Consumer Surplus

Economics and marketing literature distinguishes between pure bundling and mixed bundling. Pure bundling occurs when the component products are not sold individually. Mixed bundling occurs when a seller offers the bundled products separately as well as in bundled form. If the prices charged for individual items are unreasonably high, what may appear superficially as mixed bundling can operate as pure bundling.

The forced bundling of television channels allows programmers of popular channels to capture consumer surplus—the difference between the actual price charged and the price that would be charged under competitive conditions. Instead of a metering based primarily on use, the forced bundling allows charges based in part on the intensity of consumer loyalty to the programming. Employing a device known as inter-product price discrimination, programmers group together a bundle of channels knowing that, given diverse preferences, there will likely be at least one channel in the bundle to which a consumer will have an intense loyalty and a corresponding willingness to pay a high price.

19. The whipsawing technique was in evidence in August of 2013, when CBS forced cable distributor Time Warner Cable to pay $2 per month per subscriber to carry the CBS broadcast channel. The cable distributor lacked substantial leverage in this dispute because, without the CBS channel, irate customers of the distributor could have switched to another distributor. Joe Flint, CBS scores from Time Warner deal, L.A. TIMES, Sept. 4, 2013, at B1 (“CBS hit its target of more than $2 per subscriber per month over the life of the deal”).

20. The first explanation of this form of price discrimination is attributed to George J. Stigler, United States v. Loew’s, Inc., A Note on Block-Booking, 1963 SUP. CT. REV. 152. For a refinement of this theory and a summary of the literature, see Einer Elhauge, Tying, Bundled Discounts and the Death of the Single Monopoly Profit Theory, 123 Harv. L. Rev. 397, 405–07 (2009).

Programmers contend that they offer channels on an à la carte basis while offering substantial discounts to distributors willing to purchase a full bundle of the programmer’s channels (mixed bundling).\(^22\) Distributors counter that the à la carte prices are prohibitively expensive. Cablevision, in its 2013 complaint against Viacom, alleged that the programmer was charging more for less—the penalty for a package that included only Viacom’s four popular networks exceeded Cablevision’s entire annual budget for programming hundreds of channels—leaving Cablevision no choice but to purchase the much larger but less costly bundle that included the four popular networks and ten or more low demand channels.\(^23\)

The consumer surplus captured through the forced bundles is likely to vary substantially among customers. According to a December 2012 analysis, the average household paid approximately $90 a month for cable programming, of which nearly half is allotted to sports channels regularly watched by only 15–20% of consumers.\(^24\) The same source estimated that average consumer bills will rise to $125 per month over the next three years, the bulk of this increase flowing from higher fees that cable distributors must pay for sports programming.\(^25\)

The impact of inter-product price discrimination is exacerbated by the information asymmetries associated with purchasing unwieldy bundles of channels. Faced with a purchase decision involving 100 or more channels and changing content and prices over time, many consumers, in a practice known as “anchor pricing,”\(^26\) may simply use the available TV distributors’ prices as a measure of value. In


\(^{23}\) Amended Complaint, *Cablevision*, supra note 16, ¶¶ 8, 126 et seq. The complaint also alleged “on information and belief” that the penalty amount exceeded the advertising revenues that Viacom received for Cablevision’s carriage of the low demand channels. *Id.* ¶ 8.

\(^{24}\) Joe Flint & Meg James, *Sports Cost, Even If You Don’t Watch*, L.A. TIMES, Dec. 2, 2012, at A1. A Cox Cable representative estimated that in the Southern California market, more than half of subscriber fees flow from sports programming that only 15 to 20% of viewers regularly watch. *Id.* (quoting Cox Cable executive Bob Wilson). A July 2013 study of Los Angeles-area consumers showed that 59% of respondents would subscribe to “basic sports” programming and 29% would subscribe to “premium sports” programming. PwC, *Consumer Intelligence Series, Video Content Consumption*, available at http://www.pwc.com.

\(^{25}\) *Id.* (citing information from a market survey by a market research firm (NPD Group)).

\(^{26}\) See Max Huffman, *Marrying Neo-Chicago With Behavioral Antitrust*, 78 ANTITRUST L.J. 105, 129–30 (2012) (describing some of the literature addressing the price framing effects known as anchor pricing).
fact, because all distributors are subject to virtually the same forced bundling practices, there is little variation in distributor prices.27

Consider the distinctions between pricing in book publishing and pricing in pay television. Popular books can be sold at a higher price than less wanted titles, but the differential in pricing is typically narrow. A publisher makes money on popular books primarily by selling more of them. For the most popular books, such as a “Harry Potter” novel, dealers may cut their margins, offering the books at a discount in order to bring more customers into the store. This stands in contrast to television bundling practices where channels with high viewer loyalty are bundled with less popular channels, forcing viewers with a wide variety of interests to subscribe to many channels they have little or no interest in watching. Even a viewer with no interest in sports programming may still be willing to pay the high price of a bundle, which contains other programming that the viewer does wish to watch.

Television programmers have a dual source of revenue for their offerings. They make money by selling advertising—and this revenue source is closely linked to the number of viewers—but also by charging distributors a per-subscriber fee for channels. According to the FCC, 42% of 2010 net revenues came from advertising and 55% came from subscription fees, with subscriber fees rising more rapidly than advertising revenue.28

The variation in charges for channels can be substantial. New launch channels of independent programmers often must pay distributors to have their channels carried.29 Fees for other channels range from $0.01–5.00 per month.30 A viewer who has no interest in sports will pay the cost of the sports programming that is never viewed. Even sports fans overpay. A viewer who may prefer particular sports, or professional teams over college teams, or vice versa, still has to pay for sports programming seldom or never watched. The basic implica-

27. Another device described in the literature, drip pricing, may also play a role in the inflated prices consumers pay. See id. Some distributors advertise a monthly price that includes a bundle of channels, hoping to sway a consumer decision before adding additional charges for HD service, the use of a digital recorder, or for hookups to more than one television set.

28. FCC, FOURTEENTH REPORT, supra note 9, at 8772 (Table 27).

29. See id.

30. Id. There were approximately 100 million pay-TV subscribers in the U.S. as of 2010. Id. at 8662 n.60. ESPN currently charges $5 per month for its network and is reported to earn 15% of all cable network revenues. Id. at 8779. If each of the 100 million subscribers pays $0.01 per month to receive a network, that produces an annual revenue stream of $12 million each year. At $5 per month, ESPN would generate $6 billion in annual revenue if all 100 million subscribers paid for its network.
tions for consumer price and choice are obvious: a consumer has only one meaningful alternative—she can “cut the cord” by declining to buy any pay television programming. An increasing number of consumers have chosen this option, and buyer revolt is likely to increase. A DirecTV executive, noting the steady increases in the costs of sports programming, concluded that the large, forced bundle was not “a model consumers can continue to support.”

Following the model for book publishing, a competitively superior pricing mechanism for television would reward the programmer with higher advertising and subscriber fees based on the number of viewers. The intensity of the viewers’ attachment to the program should not be exploited through a price-discrimination scheme that decreases output and captures consumer surplus. Although the Brantley litigation had not reached a stage that forced the parties to address the appropriate remedy, the best approach would be to free distributors of the bundling and tiering restrictions imposed by programmers, allowing distribution decisions to be made at the distribution level by those likely to be most responsive to consumer demand. Any distributor’s attempt to impose an unwieldy bundle or an oppressive price would be punished by a shift of consumer purchases to a more responsive distributor.

Programmers could still charge higher prices for popular programming, but could no longer impose bundling restrictions to engage in inter-product price discrimination or to raise the costs of rival programmers. Programmers might still be permitted to offer mixed bun-

31. Id. at 8670 (citing a source reporting that 13% of consumers who have broadband cut the cord in a single year). Writing in August of 2013, one industry analyst concluded: “Over the past twelve months, an estimated 898K households have cut the cord. In the twelve months ending a year ago, only 455K households cut the cord. The pace is accelerating.” Craig Moffett, U.S. Pay-TV: The Pace of Cord Cutting Quicksens, MOFFETT RESEARCH LLC (Aug. 6, 2013).

Another measure of the extent of cord cutting (or the reluctance of potential customers to purchase pay-TV) is the percentage of occupied households that have pay-TV. One source reports that this percentage dropped from 87.3% in the first quarter of 2010 to 84.7% by the last quarter of 2012. SNL Kagan Reports U.S. Multichannel Video Subscriber Universe Eked Out A Gain in 2012, available at http://www.prweb.com/releases/2013/3/prweb10549257.htm.

32. Flint & James, L.A. TIMES, supra note 24 (citing observations of Direct TV Executive Vice President Dan York).

33. Relief in an antitrust suit should focus on the pricing and bundling mechanisms employed by programmers. While potential abuses by distributors cannot be ruled out, once freed of programmer restraints, competition among distributors could discipline offerings in a manner that minimizes the need for regulation.

34. An FCC report discussed some of the customized bundling options that could appeal to consumers. FCC, FURTHER REPORT, supra note 21, at 37–44. The 2013 study of Los Angeles-area consumers found 73% of respondents preferred to customize their packages. Video Contents Consumption, supra note 24.
dling (selling channels both à la carte and in bundles), provided that the discount for bundled offerings corresponded to efficiencies generated by bundled selling. Rather than invite extensive litigation over cost efficiencies, a judicial decree might simply limit the size of programmer bundles and prohibit discounts above a set limit. For example, a programmer would set an à la carte price for each channel, subject to its right to bundle channels together as long as the discount for the bundle did not exceed a specified percentage (e.g., 10%) of the sum of the individual prices for the included channels. Competition at the distributor level would still allow consumer demand to discipline the à la carte prices set by the programmer. Under such a mechanism, the programmer is likely to be rewarded primarily based on the number of viewers of the channel, not on the intensity of a consumer’s loyalty to that channel. Programmers would still have a strong incentive to provide popular programming while viewers would have more choice, more low cost options, and substantial consumer surplus savings.

It might be argued that at least some consumers, perhaps a substantial percentage, prefer large bundles and the lower per channel cost that flows from these bundles. If so, the market would respond. Large bundles would still be offered by at least some distributors who would cater to this consumer preference. The final nature, size, and pricing of bundles would be determined primarily by consumer demand.

C. Impact on Distributors and Independent Programmers

Distributors forced to bundle are denied an effective competitive tool: the ability to offer customized or à la carte packaging that could attract new viewers or retain current viewers disgruntled by the high-priced and unwieldy bundles. The inability to compete on terms most desired by consumers is a barrier to entry and market penetration for distributors.35 Distributors can theoretically compete on price but, as a practical matter, the forced bundles leave the distributor little control over either the size of the bundle or the price charged for it. Although distributors can expand into programming and add channels to the bundled package,36 they cannot meaningfully reduce the

35. An AT&T representative, referring to the then fledgling U-verse distributor, took note of the restraints facing a new distributor: “We will be happy to offer à la carte programming as long as we are able to obtain access to the programming in that manner.” Comments of Robert Quinn, Senior Vice President of AT&T, quoted in Third Amended Complaint, supra note 11, ¶ 44.

36. FCC, FOURTEENTH REPORT, supra note 9, at 8651. Time Warner Cable, for example, has agreed to pay the Los Angeles Lakers over $3 billion to carry the team’s games exclusively. L.A. TIMES, supra note 24.
size of the package offered to consumers without excluding popular channels that subscribers want to watch. Representatives of distributors frequently complain about the system, but until recently seemed unwilling to challenge the programmers directly. The reluctance may stem from vertical integration—many distributors are also program providers—and the ongoing business relationships between distributors and programmers. In February 2013, an independent and non-vertically integrated distributor, Cablevision, filed suit in the Southern District of New York alleging that Viacom had violated federal and state antitrust law by forcing Cablevision to accept ten or more lesser-valued Viacom channels in order to obtain Viacom’s four most popular channels. Two of the four largest distributors (DirecTV and Time Warner Cable) have announced their support for the suit. The more aggressive anti-bundling stance of distributors probably was sparked by rapidly increasing cable bills and the increasing number of customers that decline to purchase the increasingly unwieldy and expensive bundles.

The relative uniformity of packages and prices across distributors is facilitated by use of most-favored-nation clauses. A distributor agrees to carry channels on price and bundling terms subject to the programmer’s commitment that it will grant the distributor any more-favorable terms offered to a rival distributor. Programmers will vigorously resist offering any distributor more favorable terms, lest they be forced to offer the same concessions to all other distributors. Most-favored-nation clauses have generated litigation. Their use may facilitate the setting of identical prices and bundling terms, undermining consumer choice and the possibility of smaller and less expensive bundles.

Independent programmers also are injured by the current system. Powerful programmers of must-have channels can fill the available

37. Complaints of small and rural distributors are described in FCC, FIFTEENTH REPORT, supra note 9, at 8761–62. See also the discussion of the Brantley Complaint, at Part II.A. infra.
38. Joe Flint, Viacom is Sued, supra note 22.
39. Id. (quoting a Direct TV statement: “There is no question that the current all-or-nothing system dictated by programmers is completely broken . . . . [F]or programmers to force this system on all pay-TV customers, just so they can line their pockets with extra profits, is shameful”). The largest and most vertically integrated distributor, Comcast, has not voiced support for the lawsuit.
distribution capacity with low demand channels that distributors would not wish to carry and consumers do not wish to watch. Hemphill and Wu have pointed out that this sort of parallel exclusionary conduct can be easier to implement and more harmful than parallel high prices. The heightened harm from this exclusionary conduct flows from stifling new and innovative programming from anyone other than the powerful programmers. The authors concluded that the drag on innovation in industries subject to rapid technological change is the “supreme evil” that antitrust should address.

Although foreclosure of rival programmers was not the focus in Brantley, there is ample indication that this foreclosure is occurring. The owners of Wealth TV, for example, have publicly complained about these difficulties. Goolsbee, in his 2007 study contracted by the FCC, found evidence that cable distributors are more likely to carry their own channels rather than those of rival programmers except in areas where there is adequate competition from satellite systems. Another FCC report explained that additional mainstream programming may not be carried by distributors because they prefer niche programming thought more likely to attract subscribers for the large bundles. The Cablevision complaint alleged the names of a number of upstream programmers that may have faced disproportionate distribution barriers because of the large number of low demand channels included in Viacom’s forced bundle.

D. The U.S. and Canadian Systems Compared

Distribution of television programming in Canada differs markedly from the United States. Vertical integration of Canadian programmers

42. Hemphill & Wu, supra note 40, at 1210–20, 1235 (“A scheme of parallel exclusion may be more harmful than one of parallel pricing, yet easier to maintain.”)
43. Id. at 1212.
44. FCC, FOURTEENTH REPORT, supra note 9, at 8635. See also the complaints of the Chief Operating Officer of Ovation TV, whose arts and entertainment channel had been dropped by distributor Time Warner Cable. David Lazarus, Give TV Subscribers More Choices, L.A. TIMES, May 7, 2013, at B1.
45. See AUSTAN GOOLSBEE, VERTICAL INTEGRATION AND MARKET FOR BROADCAST AND CABLE TELEVISION PROGRAMMING (Apr. 2007) (study commissioned by the FCC). Goolsbee’s study also found a lack of evidence for efficiencies in vertical integration between program providers and distributors, a finding consistent with anticompetitive gains from vertical integration.
46. FCC, FURTHER REPORT, supra note 21, at 32. At least one independent programmer has expressed support for the Cablevision antitrust suit against Viacom. Joe Flint, L.A. TIMES, supra note 22 (quoting Chad Gutstein, chief operating officer of the arts channel Ovation: “The U.S. TV market is not a free market and we support Cablevision’s effort to draw attention to the anticompetitive practices that keep independent networks like Ovation from competing on a level playing field.”).
47. Amended Complaint, Cablevision, supra note 16, ¶¶ 158–63.
and distributors is very high—according to one report, 81.4% compared to 23.1% in the United States.\textsuperscript{48} Canada’s high percentage of vertical integration, however, may be mitigated by relatively low concentration levels. As of 2012, Bell Media, the largest of Canadian media firms, controlled 28.6% of that nation’s TV viewing market.\textsuperscript{49}

Canadian distributors have for some time offered channels on a more customized basis that allows consumers more choices. A 2006 FCC report described Canadian distributors that require the purchase of an inexpensive basic bundle, then allow customers to add channels in small customized bundles.\textsuperscript{50} The Canadian Radio-television and Telecommunications Commission (CRTC) has taken steps to ensure that all pay-TV viewers can purchase smaller, customized packages of channels.\textsuperscript{51} The smaller bundles would come at a higher per-channel fee, but that fee can be more than offset by purchasing a smaller bundle. An example of this model is a satellite distributor in Canada, Shaw Direct, which now offers basic packages linked to choices for additional specialty bundles and over fifty channels available on an à la carte basis.\textsuperscript{52}

\textbf{E. Anticompetitive Effects of Forced Bundling Reassessed}

Estimates of the cost of the forced bundling have varied widely. In 2006, an FCC report dissected an industry-funded private study and, 


\textsuperscript{49} Id.


\textsuperscript{51} Michael Lewis, \textit{CRTC rulings promise more channel choice for consumers}, TORONTO STAR (July 20, 2012), available at http://www.thestar.com/business/2012/07/20/crtc_rulings.promise_more_channel_choice_for_consumers.html. See also CRTC, \textit{CRTC takes action to ensure a wide choice of television programming on all platforms} (Sept. 21, 2011), available at http://www.crtc.gc.ca/eng/com100/2011/rr110921.html (calling on Bell Canada, Quebecor Media, Rogers Communications and Shaw Communications to “give Canadians more flexibility in choosing the individual services they want” and requiring the firms to report on compliance by April 1, 2012).

\textsuperscript{52} As of May 29, 2013, Shaw Direct was offering a small package with “up to” fifty-five standard definition and seventeen HD channels for $33.89 per month (amounts in Canadian dollars). Shaw also offered five levels of choice packages (ranging from $63.62 to $97.96 per month). Each included a basic package of 120 or more standard and HD channels supplemented by consumer choice among thirteen specialty bundles (each with five to ten channels covering areas such as sports, movies, or news). For example, the $63.62 per month plan allowed consumers to choose, at no extra cost, any three of the thirteen bundles. A mid-priced plan ($82.81 per month) allowed the consumer to choose any nine of the thirteen bundles. A viewer that had no interest in high-cost sports programming would be free to pick specialty packages that did not include sports channels. <http://www.shawdirect.ca/english/default.asp>. As of Jan. 2, 2014, Shaw still offered similar choices among the thirteen specialty bundles, albeit at prices that were $3 to $4 higher than seven months earlier. \textit{Id.}
based on some adjusted analysis, concluded that à la carte offerings could produce results ranging from 4% higher prices to 13% lower prices (with a decrease in three out of four cases). In 2013, a stock analyst estimated that à la carte sales of pay television would result in a $70 billion annual revenue loss to television programmers. Any estimate that the saving would be minimal or even negative cannot reflect current market conditions, where almost half of the consumer’s bill covers sports television that many customers do not watch. Since 2006, the explosion in regional and national sports networks has been the major determinant of subscription fees that have been rising at twice the nation’s annual inflation rate. If almost half of the annual fees go to pay for sports television, and many viewers don’t wish to watch sports programming, there is an obvious loss to consumers that, cautiously, one can estimate as in excess of $10 billion a year (that figure represents less than 10% of annual subscription fees paid by U.S. consumers).

The stock analyst’s estimated $70 billion annual loss of revenue for TV programmers is too high. The estimate is apparently based on the assumption that all bundling, even smaller more customized bundles that would be attractive to consumers, would be prohibited. That result is unlikely. A system of mixed bundling in which à la carte prices are linked to a program’s popularity should be permitted by any antitrust decree. In addition, freely competing distributors would continue to offer bundles that would attract and retain subscribers. In particular, the marketing literature suggests that small bundles of channels carrying related programming would survive in a more competitive environment. Programmers would certainly lose revenue if competition prevailed, but they could increase per channel distribution fees to offset some of this loss. A programmer’s most popular channels would continue to command high subscription fees; less popular channels might not survive, but such channels generate lower advertising revenues and any lost revenue would be at least partially offset by savings

53. FCC, Further Report, supra note 21, at 7–14.
55. GAO, Video Marketplace, supra note 3, at 16 (finding a 33.5% increase in prices for expanded basic cable TV during the years 2005 to 2011, compared to a 15.5% increase in the consumer price index).
56. See notes 72–73 and accompanying text infra.
from no longer producing the channel. The stock analyst’s estimate also apparently does not factor in the likely increase in advertising revenues that would flow from more attractive packaging of television programming. More subscribers would increase television viewing and the advertising revenues that flow to programmers.

A more meaningful measure of the overcharges from forced bundling would be to compare pay-TV prices in the United States and Canada. The Canadian benchmark can provide a rough approximation of how much consumers would save under a system that gives consumers more choice. The Canadian example is the best available national comparison for the U.S. system. Much of the English language programming available in Canada is the same or similar to that available in the United States. Regulators in both countries require carriage of certain channels, but neither nation directly regulates pay-TV prices. Similar cultural values, income levels, and broadcasting technology are likely to lead to similar standard and HD programming choices. Local news and sports programming will be different, but that is true regionally within a country as well as across borders. With roughly ten times the population base, United States distributors may have a large base of programming to choose from, but even modern technology limits a distributor’s ability to increase the number of channels. There are also limits to how much television an individual can watch. The average U.S. viewer chooses among roughly seventeen channels, and there is no reason to believe this number differs substantially in Canada.

With over 100 million U.S. pay-TV subscribers doling out an average of $1080 per year, U.S. pay-TV viewers are paying $108 billion each year for subscription television. In Canada, the average consumer pays only $720 (Canadian) per year. These numbers are approximations and subject to rapid change, as subscription rates rapidly rise in both countries. Still, they provide a rough guide to the magnitude of overpayments occasioned by forced bundling. Working from these figures, the average U.S. consumer is paying $360 per year more than her Canadian counterpart.

Exchange rates over the past five years tend to value the Canadian dollar one or two percentage points higher, so one can cautiously de-
duct a further 5% from this amount, leaving a total overcharge of $342 per year per U.S. viewer. When this amount is multiplied by the 100 million subscribers, the total annual overcharge would be $34.2 billion.59

It is possible that U.S. viewers are more likely than their Canadian counterparts to pay extra for premium channels, skewing the comparison of monthly rates. Assuming that this is the case (I found no documentation to support or refute it), the differential between U.S. and Canadian rates can cautiously be reduced by a further 20%, lowering it from $34.2 billion to $27.4 billion. The range of estimated overpayments would then fall somewhere within these high and low figures.

It could be argued that the lower payments in Canada are insufficient to maintain the level of innovative programming generated in the United States and expected by U.S. viewers. Although the most popular U.S.-generated programming is typically available in both countries, it is possible that U.S. viewers are subsidizing this programming that is then made available at lower cost to Canadian consumers. Canadian pay-TV subscribers, however, apparently still pay enough to support a great deal of programming targeted to Canadian audiences. The argument that innovation would be stifled by allowing consumers more choice runs squarely into the reality that the parallel exclusionary conduct is a drag on independent programming. By excluding or raising barriers for independent programming, the exclusionary conduct is likely to limit the introduction of both high quality and low cost alternative programming.60 The high returns of forced bundling favor only the established programmers and may be squandered on x-inefficiencies (wasteful conduct associated with monopoly power). The level of investment in programming and the selection of which channels are to be distributed should be based on a competitively disciplined pay television market in which consumers, not powerful programmers, make the choices.

There are several reasons why the Canadian benchmark may understate the loss for U.S. consumers. Canadian regulation itself is a political compromise. While Canadian consumers have more bundling choices than their U.S. counterparts, the Canadian system offers neither pure à la carte pricing nor mixed bundling (that would provide

59. The ESPN network alone adds approximately $5 to the average subscriber bill, yet, as noted above, only 15–20% of consumers watch sports programming regularly. If 50 million subscribers (half the total pay-TV subscribers in the U.S.) made the decision to drop ESPN coverage, the annual savings would be $3 billion ($5 per month × 12 months × 50 million subscribers).

60. Hemphill & Woo, supra note 40, at 1210–11 (noting that innovation of both high quality and low cost substitutes could be harmed by parallel exclusionary conduct).
consumers a meaningful à la carte option). U.S. consumers may have more choices for distribution (as many as four or five distributors) than their Canadian counterparts, a circumstance that should allow competitive forces greater play in the U.S. It is quite possible that removal of the forced bundles would save U.S. consumers even greater amounts. In addition, the range of $27 to $34 billion annual overcharge does not include the deadweight loss for U.S. consumers who do not subscribe because of the high costs. Connor and Lande have examined the literature on wealth transfer and deadweight losses based on a survey of cartel cases and found that the estimates of deadweight loss range from $3 to $20 for every $100 in overcharges. Transferring these estimates to the $34.2 billion estimated annual overcharge for pay television, the deadweight loss is likely to be in the range of $1 billion to $6.8 billion. Based on these numbers, the total welfare losses from forced bundling are likely to be $28 billion to $41 billion annually. This figure still does not include the loss suffered by consumers from inability to receive programs from independent broadcasters such as Wealth TV or Ovation that, in the absence of the forced bundling, might be more widely carried by distributors. It is difficult to calculate the value of this lost programming.

When powerful programmers dictate programming, the result can be overinvestment in the wrong type of programming or in other x-inefficiencies. Programmers themselves are subject to the leverage exercised by sports teams, which have a cadre of loyal fans. These fans are a small percentage of total television viewers, but many are likely to make purchasing decisions solely on the basis of whether a distributor offers television coverage. In bidding against one another to obtain exclusive televising rights, programmers may themselves be exploited to overpay. Consider two examples: one involving TV coverage of the Olympics and a second involving exclusive television rights for Los Angeles professional sports teams.

The Canadian Broadcasting Corporation (CBC), owned and controlled by the Canadian government, has, on occasion, been the sole bidder for carriage of the Olympic games in Canada. This contrasts with the United States, where competing networks typically bid against one another to obtain televising rights for the Olympic Games. One

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analysis concluded that for the 2000 Olympic games in Sidney Australia, NBC and its affiliated networks showed 441 hours of coverage, compared to the 1309 hours showed by the CBC. U.S. citizens living near the Canadian border often preferred the CBC’s coverage not only because it was more comprehensive, but also because events were shown live rather than on a delayed basis. Yet, for rights to televise the 2000 Olympics, NBC paid $705 million to the International Olympic Committee, while the CBC paid only $32 million. On a per capita basis, the cost was $2.47 per person in the United States but only $1.07 per person in Canada. U.S. consumers did not pay this premium directly, but did so indirectly through higher TV subscriber fees, reduced coverage, coverage of fewer live events, and the heavy dose of television commercials for events carried on NBC’s non-pay channel.

For the 2012 Olympics, Canadians watched telecasts provided by CTV Olympics, a consortium organized by Bell Media and Rogers Media. This time, the consortium reportedly outbid the CBC for broadcasting rights, but the U.S./Canada differential in cost per resident remained. The consortium reportedly paid $63 million for the broadcasting rights, an average of $1.80 per Canadian. NBC, the U.S. broadcaster, paid $1.18 billion for its rights, or an average of $3.73 per U.S. resident. This time, both the Canadian and U.S. broadcasters claimed to have provided more than 5500 hours of total coverage. The Canadian broadcasters lost money while NBC claimed to have broken even. One explanation for these results is that U.S. consumers pay higher television subscription fees than their Canadian counterparts.

63. Id. at 255 (concluding that the per capita cost of U.S. Olympic coverage of the 2000 Sydney games was 2.3 times as much as Canadian coverage).
64. The CBC was a monopsonist in purchasing Olympic coverage from the IOC monopolist. The CBC’s monopsony leverage created a bilateral monopoly and may have benefitted Canadian consumers in obtaining more coverage for less.
67. Id. (Reporting that the Canadian Consortium lost more than $20 million); Comcast: NBC Universal Broke Even on London Olympics, Expects Profits From Future Games, HOLLYWOOD RPTR., available at http://www.hollywoodreporter.com/news/comcast-nbcuniversal-london-summer-olympics-brokeeven-383380 (quoting Comcast CFO: “the London Olympics were breakeven when you take into account other Olympics-related revenues that are booked over multiple quarters”). NBC uses the summer Olympics to promote its fall television programming.
68. See supra note 58.
This comparison of U.S./Canada Olympic coverage highlights the leverage that sports organizations (such as sports leagues, teams, or the IOC) possess in negotiating television rights. This leverage would be a factor regardless of distribution practices, but the forced bundlings exacerbate the leverage, allowing the sports organizations (and the programmers who obtain exclusive rights) to extract consumer surplus from the viewing public.

A second example draws on the Los Angeles television market. In a bidding war, Time Warner Cable won the exclusive right to broadcast baseball games of the Los Angeles Dodgers for the next twenty-five years and will reportedly pay the Dodgers $7 billion to $8 billion.69 In a separate deal, the same distributor won the exclusive rights to broadcast Los Angeles Lakers basketball games for a reported $3 billion. According to one source, these two transactions alone are likely to add $8 a month to Southern Californians’ pay-TV bills, regardless of whether they watch any of the contests.70

Future allocation distortions from such transactions cannot be accurately predicted, but it seems likely that overpayments to sports franchises distort the market for the sports television, with ripple effects on the remainder of television programming. While the athletes and team owners may benefit, these overpayments will substantially raise cable TV bills and may price many viewers out of the market. If distributors were allowed to offer these sports channels as à la carte offerings,71 overall viewing of these games would not necessarily decrease. Fans of these teams would still have an incentive to make the à la carte purchase, even at a higher per channel cost, perhaps lowering their overall cable bill by not purchasing channels they seldom or never watch. Programmers, however, could no longer spread the cost of televising a particular team’s games among millions of subscribers who have no interest in watching the games. The direct involvement of consumers in choosing which channels they wished to purchase would produce much needed competitive discipline, making it less likely that pro-

70. Lazarus, supra note 44. In a consumer class action suit, the two Time Warner Cable contracts have been challenged as a violation of California’s Unfair Competition statute. See Fischer v. Time Warner Cable, Inc., No. BC512259 (Cal. Sup. Ct., Los Angeles).
71. A Dish network senior vice president, speaking to the desirability of à la carte offerings of the L.A. Lakers games, lamented that Time Warner Cable refuses to make this option available (“I would do that deal in a heartbeat.”). Flint & James, supra note 24.
grammers would pay non-competitive rates for exclusive sports coverage.

F. Why Programmers Continue to Require Bundling

Aside from obvious revenue gains, programmers may continue to bundle because they are familiar with longstanding bundling practices and fear the uncertainty of a more competitively disciplined world. Much of the additional revenue that programmers receive may be spent on sports programming or in-house programming ventures that a more competitively disciplined system would not support. The economics and marketing literature suggests, however, that the loss of revenue from abandoning forced bundling may be at least partially offset by increased output from a system more responsive to consumer demand. One analysis showed that pure bundling is likely to be more profitable than individual component sales when there is complementarity among the bundled products, but not when the bundled items are regarded as substitutes.72 Another analysis showed that mixed bundling revenues, although less than pure bundling revenues, will decrease less when bundles consist of items that are relatively consistent in their appeal.73 Under this analysis, the loss from a mixed bundling strategy would likely be lessened if programmers or distributors offered smaller bundles that had relatively consistent appeal in the channels offered. For example, a smaller bundle made up of only sports offerings would probably do better than one that included both cooking shows and sports offerings.

Time Warner Cable CEO Glenn Britt has argued that programmers should shut down less popular networks, lower costs, and offer consumers lower prices. “The companies involved would make just as much money as they do now because of the costs.”74 Indeed, if smaller, more customized bundles were the norm, cable distributors could sell more television as more viewers subscribed at reduced prices; consumer choice would be a controlling discipline on prices and availability of programs. Advertising revenues that flowed to pro-

72. Peter T.L. Popkowski Leszczyc & Gerald Häubl, To Bundle or Not to Bundle: Determinants of the Profitability of Multi-Item Auctions, 74 J. of Marketing 110, 120 (July 2010). If pure bundling is the most profitable strategy for programmers, that result is consistent with a finding that the additional revenues generated are associated with anticompetitive injury, including deadweight and consumer welfare loss.


ducers would likely increase as more viewers watched the programs, offsetting at least some of the loss that producers suffered because the producers could no longer charge discriminatory high prices for the bundled packages.

Representatives of programmers, however, continue to oppose any change in the current system, which has the momentum of decades behind it. A Fox Entertainment Executive recently told stockholders that he has no fear that consumers will revolt against high prices and unwieldy bundles of channels: “People will give up food and a roof over their head before they give up TV,” he said. The executive’s confident prediction may or may not prove accurate, but there is no doubt that powerful programmers will resist change. Each programmer has an independent incentive to require distributors to bundle all of the programmer’s channels, including low demand channels. This makes sense to the programmer because even low demand channels can generate significant subscription and advertising revenues. Pay-TV programmers obtain over 40% of their revenues from advertising. In the short term, the status quo maintains or enhances revenues for leverage-wielding programmers. The inability to price based on the viewer’s intensity of loyalty would end much of the price discrimination that currently brings supracOMPETITIVE profits to these programmers and supports in-house programming operations.

In the longer term, continued programmer insistence on bundling is a non-sustaining business model leading to collective suicide. The short-term greed of programmers may simply accelerate cord-cutting and a shift away from pay-TV. There is, however, an interdependence to the programmer’s opposition to change. If all programmers simultaneously dropped forced bundling and tiering restrictions, distributors could package programming more attractively and draw additional subscribers. The programmer’s lost revenue could be at least partially offset by more subscribers paying for popular programming and increased viewing of pay-TV, producing higher advertising revenues.

75. See Hemphill & Wu, supra note 40, at 1226–30 (describing the recidivism tendencies among firms accustomed to parallel conspiracy conduct). Programmers contend that they do not compel distributors to purchase bundles, but merely offer discounts when the distributor chooses to purchase a full selection of channels offered by the programmer. Flint, supra note 21. Programmers also contend that the large bundles lower transaction and production costs. FCC, FOURTEENTH REPORT, supra note 9, at 8762–63.


77. See supra note 28 and accompanying text.
A programmer acting alone to abandon bundling and tiering restrictions would obtain few of these offsetting benefits because large bundles would remain the norm. Viewers would still be unable to get small, customized packages that could substantially increase the number of subscribers. Without these offsetting benefits, each programmer has a reinforced incentive to continue bundling practices.

**G. Efficiency Defenses for Programmer-Forced Bundles**

Various efficiencies have been suggested as justifications for the programmers’ large bundles. Hovenkamp has argued that “per channel cost savings may explain why a cable company bundles large numbers of channels into a single package.”78 Once the significant cost of cable installation is paid, “adding additional channels costs very little more than the licensing fee.”79 Hovenkamp’s arguments seem more directed to distributor imposed bundling than to the forced programmer imposed bundling that is the basis of the anticompetitive concern. It is correct that distributors would have to raise per-channel subscriber fees if only a few channels were purchased. Distributors, however, are not content with the large unwieldy bundles that powerful programmers force upon them. Many distributors now want to be released from the forced bundling, as evidenced by the *Cablevision* suit and public statements reacting to it. The cost assumptions underlying Hovenkamp’s argument are also questionable. With the heavy demands of high-definition (HD) digital placed on the system, and the competing need for bandwidth required to provide Internet access, *Cablevision* claims that Viacom’s forced bundles compel the distributor either to expand capacity at considerable cost or curtail other programming that they would prefer to offer.80 Licensing fees, which Hovenkamp mentions in passing, are very substantial and increasing rapidly; *Cablevision* claims that its program licensing fees amount to over a billion dollars a year.81 Thus, while there is truth to the point that a larger bundle can be provided more efficiently than individual channel sales, programmer forced bundling is neither required nor justified by this efficiency. To the extent a distributor wishes to capture this efficiency, it would still be free to offer appropriate bundles once programmer enforced bundling ceased.

79. *Id.*
80. Amended Complaint, *Cablevision*, supra note 16, ¶¶ 33, 139.
81. *Id.* ¶ 34.
Dennis Carlton and Michael Waldman have suggested that the efficiency most likely to apply to programmer enforced bundles is that related to search and sorting costs. The argument is that because television channels vary in quality and degrees of preference, by bundling them together, programmers and distributors can save the cost of sorting them into appropriate value categories while consumers save search costs of determining which channels to buy. There are fundamental difficulties with this suggestion. The first is that program providers that market their channels to distributors are already placing a value on individual channels. This is necessarily the case for small independent programmers who have only one or two channels to offer. For larger programmers offering a forced bundle, the hard-nosed and intensive negotiations between programmers and distributors involve careful discussions of the value of each channel. Programmers monitor who watches a program and how much advertising revenue it generates. Viewership ratings are often in the public domain, and published sources even discuss the cost of individual channels. Whatever the cost of sorting by value, many distributors openly seek the opportunity to sell individual channels or smaller, customized packages. As far as consumer searching costs, while some consumers may prefer a blanket purchase of a large bundle of channels, increasing numbers of cost conscious consumers have demonstrated their displeasure with the large forced bundles by shaving or cutting the cord.

The more fundamental flaw in both Hovenkamp’s and Carlton and Waldman’s efficiency speculations is that they fly in the face of the most basic tenet of the economics and law governing our free market system. The competition paradigm is to let the marketplace determine the size and pricing of bundles. Once the forced bundling restraints are lifted, distributors will be free to experiment with various bundled or un-bundled offers. Consumers who do not wish to bear search costs would still have bundling choices. Distributors who saw substantial efficiencies in bundling as opposed to à la carte sales would be free to experiment with bundled offerings to see whether consumers were receptive.

Although not mentioned by Hovenkamp or Carlton and Waldman, from the programmer’s point of view, there are credible claims of limited


83. FCC, FOURTEENTH REPORT, supra note 9, at 8771–72.
efficiencies arising out of the joint production and marketing of a closely related group of channels. The ESPN family of channels, for example, may do planning and production through common employees that work interchangeably for the related channels. The efficiencies linked to production and marketing, however, would diminish substantially when a large group of relatively unrelated channels is bundled together. Such efficiencies could not explain why, as alleged in the Cablevision complaint, a powerful television programmer would price a small bundle of popular channels at a price that vastly exceeds the cost of a larger bundle that includes the popular channels—allegedly by an amount that exceeds the distributor’s entire annual programming budget.84

II. The Brantley Litigation

A. The Complaint

In 2007, a class of consumers brought a Sherman Act action alleging that powerful television programmers employ contract provisions that force distributors, and through them consumers, to purchase the entire slate of expanded basic cable offerings. The nature of the restraint was described in paragraph 4 of the Third Amended Complaint, “Competition among distributors for consumer business has been significantly suppressed and eliminated because . . . [distributors’] creativity in offering smaller packages or channels on an unbundled basis has been circumscribed by the contract between each distributor and each programmer, which prohibits such offerings.”85

The complaint alleged no horizontal conspiracy, but did allege interdependent conduct among the defendant programmers in imposing parallel vertical bundling restraints on television distributors: Each programmer acted “with the knowledge and anticipation that each other major programmer will do likewise.”86 If distributors were free to design distribution packages in a manner that maximized consumer subscriptions, the benefit from this increased output would flow to

84. Amended Complaint, Cablevision, supra note 16, ¶ 8. Viacom could argue that it is paying distributors to carry their low demand channels, an efficient result because it allows Viacom to make some advertising revenues on these channels. The complaint, however, alleged on information and belief that the penalty amount exceeds any advertising revenue that Viacom received from carriage of these channels. Id. Moreover, the forced inclusion of these channels is at the expense of channels of independent programmers potentially more attractive to consumers (and that would generate larger ad revenues for the independent programmer). Distributors would not choose to carry Viacom’s low demand channels but for the high penalty they would have to pay (and pass on to consumers) to exclude them.
85. Third Amended Complaint, supra note 11, ¶ 4.
86. Id. ¶ 43.
competition-savvy distributors. The complaint quoted the Chairman and CEO of defendant EchoStar (Dish Network), “Unfortunately, the largest programmers, particularly those that own a big network, have the muscle to control the way that pay television providers offer programming to consumers . . . [B]undling of must-have and other content in a single deal is a well-established problem in the industry . . . [R]estrictions on how . . . [distributors] present their packages curtail the ability of [distributors] to design alternative programming packages.”

The complaint also quoted a spokesman for the Broadband Service Providers Association, which largely represents telephone companies that distribute television programming through fiber optic lines: “Whole-sale programming practices that include tying and bundling of content and the required placement on particular tiers constrain the way [distributors] can package their services to subscribers and their ability to respond to consumer demand in their competitive [distribution] markets.” There were several pages of similar quotes in the complaint.

From the outset of the litigation, the parties disagreed whether a Sherman Act Section 1 complaint alleging industry-wide vertical restraints required an allegation of foreclosure in the upstream market for television programmers. The district court agreed with defendants that the case was for a tying violation that required upstream foreclosure. Plaintiffs amended the complaint to include such an allegation, then dropped this amendment, entering into a stipulation that anticipated the filing of motions that would allow definitive resolution of the foreclosure issue.

In its final form, the Third Amended Complaint omitted any claim of foreclosure of upstream programming rivals, but strongly and repeatedly alleged injury to distributors flowing from the vertically-imposed contractual restraints.

87. Id. ¶ 44.
88. Id.
89. Id. ¶¶ 4, 44. Petitioners crafted the complaint as a rule of reason claim, abjuring any reliance on the modified per se rule that governs tying conduct. See Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2 (1984). Although the forced vertical bundling restraints at issue had similarities to certain types of tying conduct, a critical distinction was that the industry-wide and interdependent nature of the restraints generated cartel-comparable injury not present in routine tying cases.
90. Lead counsel for the plaintiffs explained that establishing foreclosure of upstream programmers would require substantial time and expense and lacked relevance in a consumer class action seeking relief focused on consumer choice and overcharge. Brantley v. NBC Universal, Inc. Petition for Certiorari, Appendix at 68.
91. Third Amended Complaint, supra note 11, ¶ 3 (absent the vertical restraints, distributors “would develop ways to differentiate themselves,” by offering smaller bundles or à la carte channels; Id. ¶ 4 (“competition among distributors . . . has
B. The Legal Pedigree for the Brantley Complaint

Unlike Brantley, most of the Supreme Court’s tying cases have involved requirements ties. By setting a high price on the complementary tied product used in conjunction with the tying product, this device can be used to discriminate against intensive users of the tying product (sometimes referred to as intra-product price discrimination). The forced bundles at issue in Brantley involved no complementary products and no requirements tying. The Court’s most prominent bundling case involving this sort of full-line forcing is United States v. Loew’s, Inc.,93 where the Court found that powerful movie distributors had violated Section 1 of the Sherman Act by compelling television stations to purchase for screening bundles of low-demand movies in order to obtain high demand movies. The Court did not mention inter-product price discrimination, instead resting its conclusion on the foreclosure effect of the bundles on programmers who competed for television airtime with the movie distributors. Assessing the decision afterwards, economist George Stigler offered an alternative explanation. The bundling was harmful, Stigler wrote, because of the inter-product price discrimination associated with the use of such bundles, effectively forcing the purchaser to pay more based on the diverse but intense loyalty that each purchaser had for one or more of the movies in the bundle. Stigler’s theory has since been refined and developed in the economics literature.96 The theory also gained currency in Supreme Court opinions, including a dissenting opinion of Justice White in Fortner Enters., Inc. v. United States Steel Corp.97 and the majority opinion of Justice Stevens in Jefferson Parish Hosp. Dist. No. 2 v. Hyde. Citing Stigler, Justice Stevens wrote that

94. See id. at 48–49.
95. Stigler, supra note 20, at 153.
96. Elhauge has reviewed the relevant literature and extended the analysis. Elhauge, supra note 20, at 405–06.
97. 394 U.S. 495, 513–14 (White, J., dissenting) ("Tying arrangements may be used . . . as a counting device to effect price discrimination [requirements ties]; and they may be
tying “can increase the social costs of market power by facilitating price discrimination, thereby increasing monopoly profits over what they would be absent the tie.”

The price discrimination effects of tying have thus been targeted by the Court both for requirements ties (intra-product price discrimination) and for full-line forcing ties (inter-product price discrimination). In both cases, these wealth transfer effects are likely to be a primary (if not the predominant) injury to competition. But, both ties are likely also to have exclusionary effects. In Brantley, the plaintiffs alleged these exclusionary effects on the downstream competition among distributors. The defendants, however, argued that the price discrimination effects were not cognizable under antitrust law and that (based primarily on Loew’s) only foreclosure of an upstream competitor was sufficient to state a case for tying. That argument found traction in the district court and on appeal.

The plaintiffs, in addition to relying on price discrimination and downstream foreclosure injury, also rested their case on the industry-wide and interdependent nature of defendants’ conduct. The plaintiffs stressed the majority opinion in Leegin Creative Leather Prods., Inc. v. PSKS, Inc., where the Court took special note of the anticompetitive risks when a vertical restraint was industry-wide in scope. The Brantley complaint stressed that injuries to competition arising from this case were comparable to those of a cartel: higher prices, foreclosure injury to downstream competition, and loss of consumer choice. The plaintiffs relied on the Court’s venerable teaching that a rule of reason case is not based on “formalistic line drawing” but on “demonstrable economic effect.”

98. 466 U.S. 2, 14–15 (1984). See also id. at 13 n.19, at 35 (O’Connor, J. concurring) (“purpose of tying law” is “to identify and control those tie-ins that have demonstrable exclusionary impact in the tied product market, or that abet the harmful exercise of market power that the seller possesses in the tying product market”).

99. Loew’s focused on upstream foreclosure because there was little direct impact of the restraints on downstream consumers. While consumers might have reduced television choices as the result of upstream foreclosure of programmers, the Loew’s Court was not dealing with direct pricing or forced bundling issues on downstream consumers (there were no consumer subscription fees and a viewer could freely switch channels or turn off the set if the offerings were not attractive). In contrast, the forced bundling in Brantley involved direct and substantial downstream anticompetitive effects on both distributors and consumers, including increased prices, decreased output, limited consumer choice, and foreclosure of downstream competition.

100. 551 U.S. 877, 897 (2009) (an industry-wide restraint “should be subject to more careful scrutiny”).

101. Id. at 887–88 (quoting Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 58–59 (1977)).
C. The Ninth Circuit’s Opinion

In October of 2009, the district court dismissed the complaint with prejudice, ruling that a viable Section 1 tying complaint required an allegation of foreclosure among upstream television programmers. The Ninth Circuit affirmed. The opinion recited three areas in which Sherman Act Section 1 claims are cognizable: (1) a horizontal conspiracy; (2) a vertical conspiracy involving tying conduct that forecloses rivals from participation in the tied product market; or (3) a vertical conspiracy that facilitates horizontal collusion. On two occasions, the opinion acknowledged express language in the complaint alleging competitive injury to downstream distributors. The panel decision then ignored its own description of the complaint, stating that the complaint did not allege “any effect . . . on Distributors’ competition as to cost and quality of service” and that the petitioners “disavow any intent to allege that the practices . . . foreclosed rivals from entering or participating in the upstream or downstream markets” (emphasis added). The Court further stated that the plaintiffs “have not alleged how competition (rather than consumers) is injured.” The panel conceded the possibility that “competition could be injured or reduced due to a widely applied practice that harms consumers” but insisted that “the complaint does not include any allegation of injury to competition, as opposed to injuries to the plaintiffs.”

III. Evaluating the Ninth Circuit’s Opinion

A. Criticism

The Ninth Circuit’s reading of the complaint was myopic if not disingenuous. The Supreme Court requires that, on a motion to dismiss, “when addressing well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief.” Several pages of the Brantley com-

103. Brantley v. NBC Universal, Inc. (Brantley II), 675 F. 3d 1192 (9th Cir. 2012). An earlier opinion reaching the same result was withdrawn. Brantley v. NBC Universal, Inc. (Brantley I), 649 F.3d 1078 (9th Cir. 2012).
104. Brantley II, 675 F.3d at 1198–1200.
105. Id. at 1196 (“Plaintiffs allege that these business practices impair competition among Distributors for consumer business”); id. at 1201 (paraphrasing the Complaint’s allegation that the bundling restraints limit “the manner in which Distributors compete with one another in that Distributors are unable to offer à la carte programming”).
106. Id. at 1203–04.
107. Id. at 1201.
108. Id. at 1203–04.
plaint alleged in great detail, using the distributor-executives’ own words, how competition among distributors was undermined. The language of the Ninth Circuit suggests a view that these were merely allegations of consumer harm unrelated to injury to competition. To reach this conclusion, Section 1 of the Sherman Act would have to be construed as defining injury to competition differently in vertical cases than in horizontal cases (the downstream injury to distributors and consumers would be cognizable in a horizontal case). That is a difficult proposition to defend.110

Brantley was a rule-of-reason case. It is well established that under the rule of reason, a court should not be cabined into strict categorizations but should weigh “all of the circumstances of a case in deciding whether a restrictive practice should be prohibited.”111 “Direct evidence of anticompetitive effects should be sufficient to establish the plaintiff’s prima facie case regardless of whether the restraint is categorized as horizontal or vertical.”112 The Ninth Circuit adopted a strict categorical view of the Sherman Act which apparently allows, in their words, only for “standard-issue threats to competition” such as excluding “sellers of the tied product” or facilitating “horizontal collusion.”113 In fact, the complaint alleged classic anticompetitive injuries comparable to those of a cartel—including overpayments, loss of consumer choice, and foreclosure injury at the distributor level.

The panel’s failure to take the complaint at face value also generates confusion and uncertainty about the precedential effect of the ruling. If the Court’s ruling was based on its mistaken view that the complaint did not allege any harm to competition at the downstream or upstream level, then, the palpable injustice notwithstanding, the decision could be read narrowly and consistently with preexisting law. If, on the other hand, the court is holding that harm to downstream competition is not cognizable under a Section 1 vertical restraints case, the holding is at once illogical and potentially broader and more pernicious in its implications.

The panel’s rigid decision allowed it to avoid any meaningful and coherent economic analysis. This same rigidity was evident in the

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110. The leading antitrust treatise makes the point that “horizontal and vertical restraints do not always threaten competition in different ways, or call for different analysis.” 7 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1503a, at 392 (3d ed. 2010).
113. Brantley II, 675 F.3d at 1201.
court’s effort to analyze the competitive implications of the unwieldy bundles of channels offered to consumers. The court stated that the alleged bundles would require consumers to purchase “low-demand channels, which they do not want.” The Court went on to explain that a buyer can never be forced to pay more because a valued product is tied to the sale of an unwanted product (the higher price for the tie would simply be a higher charge for the valued product). The binary world reflected in the court’s example does not comport with reality. Television consumers do not simply buy based on the polar opposites of high valued and unwanted channels—they make their purchasing decisions based on a whole range of value preferences and the informational vacuums associated with constantly changing content and pricing for large and unwieldy bundles.

B. Support for the Ninth Circuit’s Opinion

1. ERRORS BASED ON A MISAPPREHENSION OF THE COMPLAINT

The Ninth Circuit’s decision has its supporters. That support may be attributed in part to the Ninth Circuit panel’s mischaracterization of the complaint. Carlton and Waldman accepted the panel’s statement that this case was about consumer injury with no alleged injury to competition. Crane argued that Brantley was rightly dismissed because it involved, at most, consumer wealth injury not linked to any “anticompetitive-element.” These statements are apparently based on the Ninth Circuit’s claims that the complaint failed to allege harm to competition as distinct from injury to consumers. As detailed above, that description of the complaint is simply wrong. Even a cursory reading demonstrates that the complaint was focused on forced restric-

114. Id.
115. Id. at 1202–03 (citing Hirsch v. Martindale-Hubbell, Inc., 674 F.2d 1343, 1349 n.19 (9th Cir. 1982).
116. Carlton & Waldman, supra note 82; Crane, supra note 82; Hovenkamp, supra note 78.
117. Carlton & Waldman, supra note 82, at 7 (Harm to consumer welfare was insufficient because “[t]here was no allegation . . . concerning harm to competition.”).
118. Crane, supra note 82, at 32. Crane also argued that the important principle of Brantley is that harm to consumer welfare, when there is no reduction of “the competitiveness of any market, is not cognizable under the antitrust laws.” Id. at 27.
119. Crane also described the plaintiff’s decision to drop allegations of foreclosure of upstream programmers as flowing from discovery that showed no such foreclosure. Id. at 28 & n.6 (citing the panel’s decision, 675 F.3d at 1196). This statement is inaccurate. When the plaintiff’s lead attorney explained the decision to drop an allegation of upstream foreclosure injury, he cited the lack of relevance of such foreclosure in a consumer class action, but also emphasized his conviction that such foreclosure could be demonstrated if more expensive and time consuming discovery were pursued. There are tactical difficulties in getting independent programmers to testify in court against the very programmers and distributors they must work with to distribute
tions on distributors who have repeatedly and quite publicly lamented their inability to fashion channel offerings responsive to consumer demand.

Perhaps because Carlton and Waldman accepted the Ninth Circuit’s misreading of the complaint, they argued that behavior similar to the bundled offerings of pay television providers typically does not give rise to “arguments concerning an antitrust violation.”\(^\text{120}\) They offered the example of a book containing a collection of an author’s short stories, none of which is separately published. Consumers might prefer to buy only their own smaller selection of the author’s stories, but Carlton and Waldman concluded that “we know of no one who argues that such behavior . . . should be of serious concern to the antitrust authorities.”\(^\text{121}\)

The example is inapt. Even clear violations of the Sherman Act go unchallenged when they involve insignificant and isolated transactions.\(^\text{122}\) To come close to the conduct challenged in \textit{Brantley}, the example would have to be modified: consumers would be offered, on a take it or leave it basis, a monthly $90 (soon estimated to be $125) multi-volume collection of new essays, stories and materials by various authors covering a wide range of topics including sports, current events, politics, history, animal behavior, entertainment, cooking, religion, and fictional works such as mysteries and literary and romance novels. The book publishers would be forced, not by consumer demand, but by upstream entities that controlled the authors’ works, to include all of these titles together in the multi-volume collection. The scheme would have to be industry-wide, facilitated by most-favored-nation clauses, so that each publisher would be forced to assemble virtually identical works together and charge nearly identical prices, leaving the consumer little choice among publishers. Moreover, this would not be a simple one-time purchase. In effect, book buyers would be compelled to join an ongoing book-of-the-month club in order to receive desired materials. Consumers could choose among

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120. Carlton & Waldman, \textit{supra} note 82, at 3.
121. Id.
122. Two rival grocery store vendors who agree to fix the price of lettuce may have committed a \textit{per se} violation of the Sherman Act, yet their conduct, as long as it is local and isolated, is unlikely to be challenged by antitrust authorities. Indeed, the law governing tying conduct contains its own threshold test to exclude relatively inconsequential conduct: unless there is substantial commerce in the tied product market, the \textit{quasi per se} rule will not apply to the conduct. \textit{See} Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12–18 (1984).
four or five publishers, but this would allow only slight variance in price and no meaningful reduction in the unwieldy bundle that is offered. Each buyer would be faced with the choice of buying, on a recurring monthly basis, an expensive collection of books covering a great many topics in which the buyer has little or no interest or not getting the materials the reader wished to read.

2. CLAIMS THAT FORCED BUNDLING IS CONSISTENT WITH TOTAL WELFARE

Crane’s and Carlton and Waldman’s articles attempted a coherent economic analysis that was absent in Brantley. Both approached the forced bundling with a total welfare analysis based on the perfect price discrimination model. Carlton and Walton implicitly assumed that

(1) forced bundling could be implemented without any decrease in consumer output and even argued that the forced bundling could increase output by capturing consumer demand for “least liked channels;”¹²³

(2) the total welfare model is the most salient measure of anticompetitive injury, even if that model ignores the much more substantial wealth transfer injury to consumers¹²⁴ and obvious and substantial allocative distortions in upstream or downstream markets; and

(3) consumers have a well-defined reservation price (the highest price a consumer is willing to pay) not only for a simple one-time sale of a single product, but also for a very large and complex bundle of television channels, the contents and price of which are constantly changing.

If the seller can find and set the exact reservation price for each buyer, the seller could capture all available consumer surplus without any decrease in output. The inter-product price discrimination achieved through forced bundling might, in theory, achieve or at least approach this “perfect” price discrimination. This result, however, assumes the prescience of the seller in determining each consumer’s reservation price and an uncanny ability to set bundled prices at precisely the level that matches each consumer’s reservation price. In a real world of complex and nuanced consumer information and preferences, attaining these goals is impossible. Indeed, insofar as the forced channel bundles are

¹²³. Carlton & Waldman, supra note 82, at 7.
¹²⁴. Carlton & Waldman also argued that the forced bundling could increase consumer welfare, an argument addressed in the following section.
concerned, the evidence is clear: output for pay television is decreased as more and more consumers cut the cord. The Brantley complaint alleged that consumers are deprived of attractive, more customized and lower cost offerings, a deprivation that would necessarily decrease total output of pay television. The FCC agrees, having concluded in its 2012 report that many customers are “cord shaving.”125 So do distributors, who have signaled their fear of customers rejecting the elephantine bundles through public statements and through their support of the Cablevision suit against Viacom.126 To be sure, the loss of output may be explained as a standard consumer response in a competitive market when suppliers offer prices not in line with consumer demand. Such an argument suggests a “cellophane fallacy”—a flawed assumption that output loss signals the need for a broader market definition—that Richard Posner and others have identified and criticized.127 The evidence that this is not a competitive market, in particular the uniform industry-wide practices and the inability of willing distributors to offer smaller customized packages of channels, is a powerful demonstration that the loss of subscribers is a deadweight loss to society.

Total welfare is, in any event, a decidedly inadequate measure of anticompetitive injury and not the law of the land. The wealth transfer (consumer welfare) loss from an abusive exercise of market power is likely to far outweigh any deadweight loss (reduction of sales flowing from the supracompetitive price).128 In their study of the damages from cartels, Connor and Lande canvassed other surveys and conclude that the deadweight or total welfare loss from cartels ranges from 3–20% of the wealth transfer loss.129 The Supreme Court has recognized consumer welfare as the relevant antitrust standard130 and has

125. FCC, FOURTEENTH REPORT, supra note 9, at 8670–71.
126. See supra notes 38–39 and accompanying text.
127. RICHARD POSNER, ANTITRUST LAW 150–51 (2d ed. 2001) (pointing out that reduced output associated with a monopolist’s price increase can be a manifestation not of the need for a broader market definition but that the monopolist is exceeding the limits of monopoly pricing and causing substantial deadweight loss).
128. In the neo-classical economist’s model, monopoly profits (wealth transfer) are represented by a triangle that may have twice the volume of the triangle representing allocative or deadweight losses. See DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 135, fig. 5.2 (2d ed. 1994) (depicting monopoly profit maximization). If the wealth transfer gain for the monopolist does not exceed the deadweight loss from increased prices, it is no longer profitable for the monopolist to raise its price.
measured damages based in part on wealth transfer losses occasioned by an antitrust violation. Indeed, while Crane suggested that the loss of consumer welfare by itself is not sufficient to state an antitrust claim, he never challenged the premise that loss of consumer welfare is a relevant standard for determining injury to competition. Carlton and Waldman went to lengths to explain why consumer welfare is not necessarily harmed by the bundling of television channels, implicitly acknowledging the relevance of the consumer welfare standard.

The reduction-in-output definition of welfare ostensibly offers a relatively easy test for a court to apply and a politically attractive choice for those who would minimize the role of antitrust. In many cases, the wealth transfer injury that typically goes hand in hand with the loss of output makes the choice between the two standards a moot point. Equating market output with welfare, however, disrespects the competitive paradigm. The antitrust laws protect competition, not a given seller’s output in its favorite market. An allocation of goods and services as it would occur in a competitive economy across all markets is the only proper measure of efficient allocation. Here are two fundamental ways in which a narrow output definition strays from that norm: (1) increased output in a particular market may occur if the consumer is forced to make a second or third choice purchase decision that would not be forced on the consumer under more competitive conditions; and (2) increased output in a particular market, if it occurs at supracompetitive prices, will rob consumers of wealth that would have been used to make purchases in other markets (output will be decreased in those non primary markets).

Measuring allocation across the economy as a whole is consistent with the welfare standard Adam Smith described: that monopoly frustrates an allocation of resources “as nearly as possible in the proportion

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131. Compensation to the victims of anticompetitive conduct, a measure that includes lost consumer surplus, has long been a prime goal of antitrust enforcement. Blue Shield of Virginia v. McCready, 457 U.S. 465, 472 (1982) (describing the twin goals of antitrust as deterrence and providing “ample compensation to the victims of antitrust violations”).

132. Crane, supra note 82, at 32 (“Tying arrangements that do not diminish the competitive functioning of the market” should not be condemned because they “merely result in some possible extraction of consumer surplus”).

133. Carlton & Waldman, supra note 82, at 7–8.
which is most agreeable to the interests of the whole society.”

Measuring loss of output only in the relevant consumer market (the loss of consumer subscribers) ignores allocation injury in secondary or tertiary upstream or downstream markets, something Smith’s definition did not do. For example, a sole producer of mattresses might raise prices until output begins to decrease at a sufficient rate to render further price increases unprofitable. The decline in output of mattresses is a loss of total welfare, but there is an even greater wealth transfer loss to those consumers who continued to buy mattresses at the monopoly price. That loss would deprive consumers of funds that they would have preferred to spend on other goods and services.

The secondary or tertiary effects of monopoly pricing are amply demonstrated in the forced bundling of large numbers of unrelated television channels. This process, in addition to driving many consumers to cut the cord, has substantial allocative effects on both upstream and downstream markets. As the Cablevision complaint alleges, independent upstream program providers find it more difficult to find space in the bundle and may not be able to enter or penetrate the market. There is also substantial indication of overpayment for Olympic coverage and other sporting events, a distortion occasioned in part by the supracompetitive subscription rates that consumers pay for large bundles of channels. Downstream from the programmers, new or efficient distributors who might offer higher quality signals or more attractive packages of channels may also find it difficult to enter or penetrate the market. At the consumer level, consumers suffer not only deadweight loss (by not subscribing) but also much more substantial wealth transfer losses (estimated based on the Canadian benchmark to be between $27 billion and $34 billion per year). The secondary or tertiary allocative effects of this wealth transfer loss will be reflected in lower consumer dollars flowing to other uses such as restaurants, movies, vacations, or other use of wealth transfer dollars. These distortions do not reflect the use of resources “most agreeable to the interests of the whole society” that Adam Smith envisioned. All of these secondary and tertiary distortions would be ignored or discounted if welfare were measured solely by output in the relevant consumer market.

135. An output definition of antitrust injury as embraced in the Crane and Carlton & Waldman critiques is also inconsistent with the Ninth Circuit’s holding in Brantley that vertical restraints are unlawful when they result in upstream foreclosure. Such foreclosure may or may not be linked to a loss in consumer output—upstream foreclosure
Crane’s critique of the complaint included an analysis of whether a consumer can ever be forced to buy something unwanted. Crane contended that consumers won’t pay more than they consider the product to be worth, offering the example of a Bedouin forced at gunpoint to purchase sand. The Bedouin, Crane suggested, is not really buying the sand, but buying his life. Extending the logic from the Bedouin’s straightforward life or death situation to the purchase of a complex bundle of dozens of television channels, Crane concluded that the bundling distributors cannot charge more than the “buyer’s reservation price . . . for things that the buyer values.”

Carlton and Waldman argued that bundling of television channels can actually increase total welfare because with bundles, consumers will end up purchasing not only their most preferred but also their “least liked channels,” channels liked enough to purchase but not at the higher price offered when sold as unbundled channels.

Assuming that total welfare were the relevant standard, the logic of the critics’ analyses is compelling only in a polar world in which the buyer has no second choices or nuanced preferences. Complex consumer decisions cannot be forced into a binary digital world of “ones and zeros”—a simple yes-or-no response cannot adequately describe the spectrum of desires and priorities that guide consumer choice. The critics, however, embraced this world, assuming that each consumer has a fixed reservation price for the channels individually or for the large and complex bundle that is offered to them.

The concept of a reservation price is useful for economic modeling when there is a sale of a relatively simple product (with no optional add-ons) and when the sale is isolated in time, with no dynamic element (no recurring sales with changing content and pricing). The concept assumes that individual consumers are informed and make prices through their own informed buying choices. That premise is undermined by behavioral economics and marketing literature that suggests that consumers are informed by, and make decisions in the context of, the benchmark prices that are offered to them. When multiple products are involved in the sale, the consumer’s consciousness of individ-

137. Id.
ual prices is reduced. If the price of a bundled package of television channels rises gradually over time (at a rate substantially exceeding inflation), many consumers may accept higher rates as a genuine benchmark of value. Using market options to assess value can be a healthy exercise, but only if competition is preserved as the price regulator. In a well-functioning market, a combination of consumer demand and seller supply sets the competitive price and determines the viability of bundled or unbundled offerings. If competition is thwarted through power abuses, the resultant prices and the size of bundled offers will not efficiently allocate. This is precisely what the Brantley complaint alleged and it implicates an injury to total welfare as well as to consumer welfare.

Consider again the validity of a “reservation price” when the product is complex and involves potential add-ons. There are absolutes in the consumer world, but when entering the purchasing arena for a complex product, the consumer typically brings a series of preferences mitigated by cost awareness and a willingness to buy up or down the prestige ladder based on price and quality preferences. A potential buyer may enter an auto show room with a definite idea of which model to purchase, including the preferred color and extra equipment. The dealer, however, may not have precisely that model, and the consumer may end up paying more for a vehicle that includes a sunroof and chrome wheels, neither of which the consumer would have chosen to buy had the ideal vehicle been available. In such a transaction, the dealer sells extra equipment (and gets a higher price than the consumer would have preferred to pay). A second, third, or fourth best choice for a consumer need not involve the purchase of a wholly unwanted good—merely one that under more competitive circumstances would not have been the choice. Television viewers may place some minimum value on some of the hundred plus channels that they receive in the bundle, but it would not be the consumer’s choice to purchase these additional channels. The consumer is forced to buy a Cadillac or no vehicle at all when she would really prefer to buy a Chevrolet. A perfect or even second best allocation of goods and services is not


141. Many consumers, for example, would never purchase tobacco products for personal use.
attained by this transaction. Total welfare, as Adam Smith envisioned it,\textsuperscript{142} is undermined.

The occasional sale of an automobile with unwanted extra equipment does not (and should not) give rise to a viable antitrust claim. There is probably sufficient competition in the retail automobile market (both interbrand and intrabrand) to discipline sellers who might attempt to sell vehicles laden with unwanted extra equipment. But, the forced bundling of television channels is a different matter. To analogize Brantley, all automobile manufacturers and their distributors would be offering their cars laden with the same extra equipment, even though most consumers only prefer a small fraction of this equipment. Many of the auto dealers might wish to offer consumers the choice of a more stripped down vehicle, but the upstream manufacturers would prohibit them from doing so. All consumers, as a result, are forced to buy nearly identical expensive vehicles laden with extra equipment they do not desire. A consumer can still decline to buy altogether, but this consumer decision is a loss of output or deadweight loss. Putting these facts together, the industry-wide bundling requirements cause television consumers to pay more (a wealth transfer injury), cause some consumers to decline to subscribe to pay-TV (an output reduction and injury to total welfare), deprive consumers of choice, and force television distributors to curtail their own competition (preventing them from offering smaller or customized packages responsive to consumer demand). Foreclosure of distributor competition is an injury even under the narrow definitions of actionable tying urged by Crane and Carlton and Waldman. In addition, independent upstream program providers face enhanced barriers to entry because of the bundling system controlled by powerful upstream programmers.\textsuperscript{143}

Consider now the dynamic element involved in a recurring purchase of bundled television channels. The consumer’s initial choice is already complex and surrounded with informational issues. For viewers living in an urban environment, there may be four or more distributors offering bundles of pay television channels. The distributors compete with one another on introductory offers (attempting to lock in the consumer by offering a discounted introductory price) and in offering ancillary services or products (the number of television receivers that can

\textsuperscript{142} See note 134, \textit{supra} and accompanying text.

\textsuperscript{143} \textit{Supra} notes 44–47 and accompanying text. As previously described, foreclosure of rival programmers was not alleged in \textit{Brantley} but has been emphatically alleged in \textit{Cablevision}. See Part I.C., \textit{infra}. 
be included or the availability and pricing of recording devices). There is little competition, however, in terms of the nature or extent of the bundles. Since each distributor is subject to the same leverage from the large programming firms, each ends up with a very similar unwieldy bundle of channels. In the long run, after the introductory discounts have expired, the consumer pays a nearly identical price to any available distributor for the expanded basic tier of television channels. Even the most attentive and well-informed television consumer cannot avoid the leveraging power of the programmers who force their bundles on recalcitrant distributors. The complexity of the transaction and the momentum associated with staying with a package may undermine rational choice. The consumer may grudgingly accept increases in the number and cost of channels that, over time, are gradually added to the package. In the context of this complex and dynamic environment involving recurring purchases, channels added or dropped without the consumer’s consent, and constantly escalating prices, the concept of a reservation price has little relevance. The consumer is a price taker, not a price maker.

Many of the informational issues facing the consumer may be viewed as consumer protection issues. For antitrust, the salient issue is the structural component to these informational problems. Freed from the forced-bundling restraints and the facilitating most-favored-nation contracts, independent distributors—those not extensively involved in programming and confronting no conflict of interest—would respond to consumer demand by offering smaller, more customized and consumer friendly packages. They cannot do so because of the leverage exercised by large programmers, and it is in this respect that antitrust has a clear role to play.

The bottom line is that the concept of reservation price may be compelling when the product offering is simple and when there is no dynamic element to the sales. The recurring bundled sale of hundreds of television channels, with the price and offerings changing over time, most decidedly does not fit these criteria. Although calculations of the total welfare of consumers are difficult to make, total welfare will not be enhanced if distributors are shackled and unable to design packages that are responsive to consumer demand. Each time a consumer decides to cut the cord, that welfare is further reduced.

144. FCC, FOURTEENTH REPORT, supra note 9, ¶¶ 86–88, at 38–39 (describing methods of price competition among distributors).

145. I am indebted to Prof. Einer Elhauge for his insights in an as yet unpublished manuscript. Einer Elhauge, Rehabilitating Jefferson Parish: Why Ties Without a
3. CLAIMS THAT FORCED BUNDLING MAY INCREASE CONSUMER SURPLUS

Carlton and Waldman offered an example to show that bundled television sales are unlikely to harm consumer welfare, and “can even increase consumer welfare.”\footnote{Carlton & Waldman, supra note 82, at 6–7.} In their hypothetical, 1000 consumers are offered a bundle that includes ESPN and ten other channels. Each consumer values ESPN and is willing to pay $15 a month to receive it. Preference varies for each of the ten other channels: a distinct group of 10% likes each of the ten channels and is willing to pay up to $12 for that one channel, but only willing to pay $1 each for the remaining nine channels. Tracking the example, if ESPN and each of the remaining channels are sold as a bundle, the distributor could maximize profits by charging each of the 1000 consumers $36—$15 for ESPN, plus $12 for the second highly-preferred channel, plus $9 ($1 each) for the remaining nine channels. Carlton and Waldman concluded that this bundling increases total (social) welfare because, with individual pricing, the ten non-ESPN channels would be priced at $12 each and not sold to 90% of the consumers who value these channels at only $1 each. By bundling, the distributor implements perfect price discrimination that captures consumer surplus and offers the nine least preferred channels to each consumer at a price the consumer is willing to pay.

Carlton and Waldman then changed their hypothetical to assume that 10% of the consumers have a higher reservation price—$2 each—for the nine least-preferred channels. The distributor would not raise its $36 bundled price; to do so would risk losing the other 90% of the consumers who only value the nine channels at $1 each. The 10%, as a result, would enjoy a consumer surplus because they would be willing to pay $45 for the bundle, but would be charged only $36.\footnote{Id. at 7.}

The hypothetical, however, fails to demonstrate that, as a matter of theory or practice, consumer welfare would be increased. Carlton and Waldman assumed that there is no consumer welfare loss associated with their hypothetical bundle (and a gain if some consumers are willing to pay more for certain less-desired channels). At best, this example demonstrates that the consumer welfare loss from the bundling will be less severe because the seller is unable to implement perfect price discrimination.

\textit{Substantial Foreclosure Share Should Not Be Per Se Legal.} Elhauge concludes that the forced bundling of TV channels will likely decrease total welfare.

\footnote{Elhauge concludes that the forced bundling of TV channels will likely decrease total welfare.}
discrimination. Elsewhere, Carlton and Waldman agreed that the price discrimination feature of bundled selling is designed to capture consumer surplus.\textsuperscript{148} To ignore this dominant feature of bundled sales and argue, even hypothetically, that this pricing could increase consumer welfare is highly implausible. Imperfections in the price discrimination implemented through bundling may reduce the consumer welfare loss, but cannot reasonably be viewed as eliminating the entire revenue gain that the price discrimination is designed to capture.

ESPN can command a high price not simply because it is of interest to a significant number of subscribers, but because those viewers have an intense loyalty to the programming. Only 15–20\% of subscribers are estimated to watch sports programming regularly.\textsuperscript{149} If we make the cautious assumption that there are 50\% of subscribers who have at least one household member who watches sports regularly, that means that the other 50\% of subscribers will be paying well over half of their monthly bill to support programs they seldom or never watch. Even if consumer interest in non-sports programming is sufficient to retain most or all of the 50\% of the subscribers who don’t watch sports, the premium they would be forced to pay is a substantial loss of consumer surplus. Some sports aficionados would also lose surplus. There are many who watch particular teams, particular sports, or college sports as opposed to professional sports (or vice versa). For these sports viewers, forcing them to buy a bundled package that includes many expensive channels that they would not watch is still a consumer welfare loss. Thus, even if Carlton and Waldman are correct that there are modest consumer surplus gains from offering a few “least-liked” channels in the bundled package, it is extremely unlikely that these small gains would offset the overall consumer welfare loss associated with the high price for the bundled sale.

The Carlton and Waldman example also assumed the ability of the distributor to price in a way that maximizes return without any loss of output. Each of the 1000 consumers in their example will continue to buy cable TV because the distributor is able to discern and then price in a manner that comes close to, but does not exceed, the reservation price for each viewer. In the real world, that is impossible. The forced bundles, in addition to reducing consumer subscriptions, will also alter the output of programming itself. The bundles may exclude channels

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{148} Id. at 4–5 ("perfect price discrimination means that the monopolist extracts all the potential surplus from consumers").
\item \textsuperscript{149} See supra note 24 and accompanying text.
\end{itemize}
\end{footnotesize}
that the viewer would prefer to watch.\textsuperscript{150} Because programmers want to include niche channels that are likely to increase the number of subscribers, they may exclude channels of interest to mainstream viewers who already subscribe.\textsuperscript{151}

Each of the hypothetical 1000 consumers will have differing preferences, varying financial capabilities, and highly differentiated information in making a purchase decision. For example, a consumer may be willing to pay $1 each for the non-preferred channels, but that willingness may be grudging. The consumer may vastly prefer not to be forced to buy them at all. As pointed out above, the concept of a reservation price, while a useful tool in modeling the one-time sale of a single item, breaks down when the complexities of the product tend to overwhelm the available information and absorption abilities of the average consumer and when there is a dynamic element (regular repeated purchases with content and price varying over time).

4. ABSENCE OF ANTICOMPETITIVE EFFECTS

Having ruled out the price discrimination theory of bundling as a cognizable injury to competition, Carlton and Waldman were unable to identify any other economic model that demonstrated anticompetitive injury from the forced bundling. That is unremarkable. The complexity of the bundled sale of television channels does not lend itself to easily understandable economic models susceptible to deductive proof. The \textit{Brantley} litigation, because it was dismissed before discovery was completed and before any summary judgment could be weighed, did not force either side to pin down economic theories of competitive or anticompetitive effects. The plaintiffs, however, in addition to relying on inter-product price discrimination, emphasized their willingness to show direct evidence of anticompetitive effects, including evidence of higher prices, reduced output, loss of consumer choice, and increased barriers to entry and reduced competition in the distribution market.

5. HOVENKAMP’S CRITIQUE

Addressing the \textit{Brantley} decision, Hovenkamp has argued that the forced bundling could have been justified by the efficiencies associated with bundled sales as compared to \textit{à la carte} sales.\textsuperscript{152} As ex-

\textsuperscript{150} FCC, \textit{FURTHER REPORT}, supra note 21, at 30–31: Amended Complaint, Cablevision, supra note 16, ¶¶ 135 et seq.
\textsuperscript{151} FCC, \textit{FURTHER REPORT}, supra note 21, at 31.
\textsuperscript{152} Hovenkamp, supra note 78, at 2.
plained in Part I.G., infra, there are undeniable efficiencies associated with bundled sales by distributors, but those efficiencies do not explain why programmers should be allowed to force bundling on the distributors, who should be allowed to freely decide when and what to bundle. Hovenkamp also observed that the Brantley complaint was dismissed because the plaintiffs “could not identify any independent program providers who were foreclosed or excluded by the arrangement.”¹⁵³ That is one possible reading of the opinion. The Ninth Circuit, however, affirmed dismissal despite the complaint’s emphatic allegations that there were substantial foreclosure effects at the distribution level. Hovenkamp does not address the important question whether tying law should be concerned only with upstream exclusionary effects while ignoring comparable effects in downstream distribution.

Hovenkamp concluded by observing that the “Brantley plaintiffs simply want the seller to offer a smaller product than it wants to offer.”¹⁵⁴ While the comment is superficially accurate, it views the competitive landscape solely through the eyes of the programmers and misses the core concerns with the forced bundling. The Brantley complaint alleged classic antitrust injuries including loss of consumer surplus, loss of total surplus, loss of consumer choice, and foreclosure injuries at the downstream distributor level. Smaller bundles and more consumer choice are the likely result of mitigating these very substantial injuries to competition. That’s what the Brantley plaintiffs sought.

C. The Future of the Price Discrimination Theory of Tying

Crane, as well as Carlton and Waldman, argued that price discrimination effected through tying arrangements should not be actionable unless there is additional competitive injury associated with the conduct. The loss of consumer surplus, they argued, is widespread and not sufficient to trigger antitrust intervention; they asserted without support that widely employed tying arrangements are usually efficient and that false positives are a major risk if price discrimination effected through tying were condemned.

In most cases, this debate may seem inconsequential. Most tying that effects inter-product price discrimination is likely to have foreclosure injuries. Indeed, notwithstanding the Ninth Circuit’s flawed reading of the complaint, downstream foreclosure injuries were amply pled in Brantley. The Cablevision complaint against Viacom alleges both

¹⁵³. Id. at 4.
¹⁵⁴. Id. at 12.
upstream and downstream foreclosure injury. That both downstream distributors and upstream programmers have now endorsed the Cablevision suit challenging Viacom’s bundling practices is one indication of the reality of these foreclosure injuries. It is difficult to find an example of a tie-in that implements inter-product price discrimination that does not have likely foreclosure injury at the upstream level, the downstream level, or both levels.

There are, however, compelling reasons to recognize the injury flowing from inter-product price discrimination as a valid and independent basis for condemning a tying arrangement. The primary allocative harm from such a tie is wealth transfer and deadweight loss to consumers, not the foreclosure injury to a rival programmer. While a foreclosure injury is more likely to suggest a drag on innovation, such a showing has never been required to demonstrate anticompetitive effects in other contexts (such as the law governing horizontal restraints or vertical restraints such as resale price maintenance). In addition, proof of the requisite foreclosure injury will not always be easy. In Brantley, the consumer plaintiffs and their attorneys had difficulty getting independent upstream programmers to speak for the record, perhaps because they did not wish to jeopardize their ability to find cooperative distributors, many of them integrated into programming. Recognizing that tie-ins can have anticompetitive effects through price discrimination would not open the floodgates that critics fear. Congress has singled out tying (but not most other conduct that can diminish consumer surplus) for antitrust scrutiny through enactment of Section 3 of the Clayton Act. Tying is a behavior that businesses and their counselors can easily identify. Where such tying is efficient, the defendant can make this showing as a defense in any tie-in case (an efficient tie is a basis for arguing that the tying and tied products should not be considered distinct, and that well-informed buyers are not forced to accept an anticompetitive bundling). Where, as in Brantley, the competitive injury to consumers is industry-wide and substantial, the case ought not to rise or fall based solely on whether the plaintiffs can show foreclosure effects on upstream competitors.

Ultimately, the Supreme Court has the last word on what constitutes unlawful tying. The Court has not addressed a block booking case

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156. Independent programmers may feel less constrained in openly supporting Cablevision in its suit against Viacom. A number of major distributors have already expressed support for this suit.
since Loew’s, but has expressly acknowledged that tie-ins “can increase the social costs of market power by facilitating price discrimination, thereby increasing monopoly profits over what they would be absent the tie.”\textsuperscript{157} The Court’s statement was and remains sound antitrust policy.

IV. Reflections on the Future of Pay-TV and Antitrust

\textit{Brantley} was a case of moment. It could potentially have restructured the marketing model for pay television channels and saved consumers tens of billions of dollars annually. Reading the “restraint of trade” language of Section 1 of the Sherman Act with a blank slate (without a century plus of complicating jurisprudence), it is difficult to see how one could exculpate this conduct, and even more difficult to comprehend a dismissal of the litigation on a motion to dismiss before the record could be fully developed. The Ninth Circuit’s decision in \textit{Brantley} was based on a transparent misreading of the complaint, muddled and incorrect principles of antitrust law, and incoherent or unexplained economic analysis.

The Chicago School’s enduring contribution to antitrust has been to establish the primacy of economic analysis. \textit{Brantley} violated that primacy. Although economists do not always agree on antitrust policy, under any credible definition of welfare, including the narrow total welfare definition, the \textit{Brantley} complaint alleged facts that would establish huge welfare losses for U.S. consumers. Part I uses the public record to describe the current state of television distribution, and shows that the forced bundles generate enormous overcharges, reduce output, deprive consumers of choice, and undermine opportunities for independent programmers and innovative distributors. In addition, that record is consistent with a conclusion that forced bundles have led to overinvestment in programming and other x-inefficiencies. The scale of these losses suggest yet another loss for antitrust. Had \textit{Brantley} been allowed to proceed, the case could have provided a seminal gain for consumers and proof that antitrust can still be relevant in people’s lives.

If antitrust law is moved to irrelevancy, society will nonetheless find ways of adjusting. The Federal Communications Commission may follow the lead of their Canadian counterpart and impose regulation that fosters genuine consumer choice. Congress could step in if support

mounts for a bill that would require à la carte programming. Failing all of this, although it may take a decade or more for this to happen, the marketplace may ultimately force greater consumer choice as more and more consumers cut the cord in favor of Internet options for television programming. The Sherman Act, however, provides a better answer.

The bilateral monopoly in television distribution that existed before the early 1990s was far from ideal for TV consumers. It did, however, provide one benefit. Powerful programmers with popular channels could not run roughshod over the local monopolist cable provider. The two needed each other and were likely to negotiate terms less harmful to consumer welfare than would occur with unchecked monopoly power. After 1992, competition in distribution that should have benefitted consumers worsened welfare outcomes. Now the monopoly power of a programmer with a must-have channel is employed to whipsaw competing distributors into submission to the pricing and bundling terms that serve the powerful programmer’s selfish interests.

If effectively employed, the Sherman Antitrust Act provides a very effective remedy for these negative welfare effects. By enjoining programmers’ bundling and tiering restrictions, the distributors would be free to make their own bundling and distribution decisions in a manner that responds to consumer demand. Distributors who were unresponsive to consumer interests would quickly lose market share. Consumers would be put back in driver’s seat without intrusive government regulation. That’s just as Senator Sherman would have intended.

158. See Flint, supra note 1 (describing the “Television Consumer Freedom Act of 2013,” which is the bill introduced by Senator John McCain).
Freedom of Expression-Based Restrictions on the Prosecution of Journalists Under State Secrets Laws: A Comparative Analysis

By Katharine Larsen and Julia C. Atcherley*

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1. Relevant Principles

2. Widespread Recognition of the Johannesburg Principles

I. Council of Europe

J. International Convention on Civil and Political Rights

K. African Charter on Human and Peoples’ Rights

III. Recognition of Substantial Free Expression-Based Restrictions on the Prosecution of Journalists under State Secrets Laws

Introduction

An inevitable tension exists between protecting national security interests and guarding the free flow of government information to the public. This tension has intensified as increased government efforts to prevent and prosecute leaks of protected state information have come into conflict with the public’s right to receive and impart information about all manner of government conduct, including matters touching on national security.

Earlier this year, the U.S. Department of Justice found reason to believe that Fox News national security reporter James Rosen aided and abetted a violation of the U.S. Espionage Act when he reported on classified information allegedly obtained from a State Department security advisor.1 In the United Kingdom, David Miranda, partner of Guardian columnist Glenn Greenwald, was detained for almost nine hours under the British Terrorism Act 2000 as he transited through Heathrow airport.2 The British government seized digital documents he was carrying that related to The Guardian’s reporting on govern-

1. See Ryan Lizza, The D.O.J. Versus James Rosen, New Yorker (May 20, 2013), http://www.newyorker.com/online/blogs/newsdesk/2013/05/the-doj-versus-journalist-gmail.html (embedding application for search warrant as to Rosen’s e-mail account, which contains a sworn statement from an agent of the Federal Bureau of Investigations “that there is probable cause to believe that the Reporter has committed or is committing a violation of [the Espionage Act], as an aider and abettor and/or co-conspirator”); Ann Marimow, A Rare Peak into a Justice Department Leak Probe, Wash. Post (May 19, 2013), http://www.washingtonpost.com/local/a-rare-peek-into-a-justice-department-leak-probe/2013/05/19/0bc473de-be5e-11e2-97d4-a479289a31f9_story.html.

2. See Alan Rusbridger, David Miranda, Schedule 7 and the Danger that All Reporters Now Face, Guardian (Aug. 19, 2013), http://www.theguardian.com/commentisfree/2013/aug/19/david-miranda-schedule7-danger-reporters (The Guardian editor describing Miranda’s detention and stating that it “rightly caused international dismay because it feeds into a perception that the U.S. and U.K. governments—while claiming to welcome the debate around state surveillance started by [Edward] Snowden—
ment surveillance activities. Soon thereafter, *The Guardian* revealed that British security agents had earlier required the physical destruction of hard drives containing materials received from Edward Snowden, a former contractor with the U.S. National Security Agency. On the other side of the Atlantic, a member of the U.S. Congress has called for the criminal prosecution of Greenwald. And, as this article went to press, South Africa’s Protection of State Information Bill was waiting on the desk of President Jacob Zuma, who may sign it into law or direct it to the Constitutional Court for review. Although a number of the bill’s most controversial provisions were removed or amended, it still proposes to impose severe criminal penalties for the unauthorized receipt, possession, and publication of broadly-defined national security information, penalties that would significantly restrict media rights and intimidate those reporting on sensitive government matters.

3. Id.


7. See, e.g., David Smith, *South African Activists Vow to Fight on after MPs Pass ‘Secrecy Bill’*, *Guardian* (Apr. 25, 2013), http://www.theguardian.co.uk/world/2013/apr/25/south-african-activists-secrecy-bill (“Freedom of speech activists acknowledge that the [Secrecy Bill] has been greatly improved and amended during five years of fierce national debate. But they warn that it still contains ambiguities and harsh penalties that could have a ‘chilling effect’ on those seeking to expose official corruption”); Pierre De Vos, *New Improved Secrecy Bill: Still Bad, Still Unconstitutional*, *Constitutionally Speaking* (May 7, 2013), http://constitutionallyspeaking.co.za/new-improved-secrecy-bill-still-bad-still-unconstitutional/ (“Because the definition is open-ended, it is conceivable that a cabinet minister or the owner of Nkandla could interpret ‘national security’ in a far broader manner than the examples mentioned in the definition of national security contained in the Bill to include almost anything that, in the mind of the classifier, would threaten ‘national security.’”); South Africa:
Unquestionably, national governments have a legitimate interest in maintaining the secrecy of information where there exists a substantial likelihood that its release to adversaries would put lives at risk and cause grave harm to public security. In the wake of acts of terrorism, alleged cyber-attacks, and related threats, many governments have tightened their hold on sensitive data and documents, and have pursued more aggressively those suspected of disclosing such information without authorization.

At the same time, modern democratic principles mandate that the state guarantee citizens’ ability to exercise fully their right to free expression, a right that encompasses the derivative rights to receive and impart information. Freedom of expression is a “cornerstone” of democratic society, enabling all members to participate in decision-making processes—and especially in the political processes. But true and meaningful participation requires an informed public, that is, one with the benefit of access to information about all types of government activities. In recognition of these principles, at least 93 countries have enacted national legal frameworks establishing the public’s right to request and receive official information, and in approximately two-thirds of these countries, the right finds its origins in the constitution itself.

Caught in the middle of this tension between security and transparency are members of the media—and national security reporters in particular. Broadly speaking, journalists work in service of the public, performing the essential tasks of collecting, synthesizing, and disseminating information on matters of public concern. When this informa-


tion concerns the activities of government and government officials, these tasks take on special meaning, as they enable individual citizens to exercise democratic control, including by monitoring government and demanding accountability.10

Government information may reach a journalist in myriad ways. A reporter may conduct interviews or submit official records requests, and, although less frequently, a reporter may receive information from confidential or anonymous government sources—individuals who believe that the public has a right to know about the information in question, despite an official position that the material is to be withheld from the public.

National security reporters work no differently—only, because of the subject matter of their newsgathering, they face the risk of violating laws that criminalize the disclosure of state secrets each time they question a government source or informally receive a government or military record. Yet these reporters’ activities are unquestionably critical to upholding the fundamental guarantee that, in a democratic society, the public is able to monitor, question, debate, and criticize all types of government conduct—even conduct involving military and national security affairs.

Examining the jurisprudence of domestic and international courts, as well as the policies and principles of intergovernmental entities, this article explores the constraints that the right to free expression—and the derivative rights to receive and impart government information—impose on the nature and scope of state secrets laws as applied to journalists.11 Section I offers an overview of the right to obtain government information and the growing international consensus on the burdens to be imposed on government bodies when they seek to prevent access to data or documents touching upon national security matters. Section II surveys the laws, policies, and practices of state governments and intergovernmental bodies applicable to journalists working at the intersection of the public’s right to receive sensitive state information on matters of public concern and the government’s efforts to prosecute the receipt and dissemination of that very same information.

10. See, e.g., Claude-Reyes, ¶ 87 (recognizing that “[d]emocratic control by society, through public opinion, fosters transparency in State activities and promotes the accountability of State officials in relation to their public activities.”); Sunday Times, ¶ 50(b) (“Not only does the press have the task of imparting . . . information and ideas [on matters of public interest]: the public also has a right to receive them. Were it otherwise, the press would be unable to play its vital role of ‘public watchdog.’”).

11. Although attempting to survey as many jurisdictions as possible, this article is far from exhaustive, due in part to challenges in assessing the existence of relevant decisions, laws, or standards in many countries.
Last, Section III identifies the free expression-based constraints that, in this modern constitutional era, guide the evaluation of the validity of state secrets laws as applied to the work routinely undertaken by national security reporters.

I. In the International Community, the Right to Access Sensitive Government Information is Well-Established

Across the globe, the public’s right to access government information is robustly protected. International and regional law, as well as established state practice, reflect the fundamental nature of the right to obtain, possess, and disseminate such information—even when public disclosure implicates national security concerns.

Transparency in government in the public interest is integral to the proper functioning of a representative democracy.12 Public disclosures are necessary, *inter alia*, to provide accountability for the conduct of public officials, to increase efficiency in public bodies, and to identify governmental wrongdoing or harm. Without access to government information, investigative journalists and watchdog organizations would be thwarted in their efforts to monitor government activities and, when necessary, to expose corruption or misconduct, including when the underlying activities involve sensitive governmental matters. Moreover, public disclosures of government-held information facilitate citizen involvement in areas of political, financial, and social decision-making; they are crucial for supporting informed and open debate at local and national levels.

In democratic states, access to information laws establish a presumption that all government-held information shall be available to the public unless specifically exempted.13 Simply put, a government record must be provided to a requestor unless and until the relevant government body demonstrates that the requested record is encompassed by a narrowly-drawn exception to disclosure. Substantial harm to national security certainly can provide a legitimate basis for constraining access to government-held information. However, unless


such a constraint is carefully drawn to effectuate its specific purpose, the exception may defeat legitimate access to information critical to democratic oversight. Moreover, a vague or overbroad exception likely would come into conflict with constitutionally-based protections for free expression, including the basic rights to receive and impart information on matters of public concern.

Thus, in jurisdictions committed to the protection of fundamental democratic principles, limitations on public access to information related to national security information must be subject to rigorous review. An examination of international and regional laws, together with established state practice, reflect a growing consensus on the nature of this analysis, which generally requires that a government body seeking to prevent access to information must satisfy the following burdens:14

First, the public body must demonstrate that the information relates to a “legitimate national security interest,” i.e., an interest with the genuine purpose and effect of protecting the country’s existence, stability, or its territorial integrity—and not for the purpose of avoiding loss of confidence in government, embarrassment, or weakened public trust.

Second, the public body must demonstrate that the disclosure of the information at issue poses a “serious threat,” i.e., that there is an actual and demonstrable—not just a theoretical—likelihood of “substantial harm” to the national security interest.

Third, the public body must demonstrate that the “serious threat” or “substantial harm” identified outweighs the public interest in access to the information.15

Fourth, the public body must demonstrate that the limitation on access is clearly defined and constitutes the least restrictive means available to protect the national security interest at issue.

Finally, even where these burdens can be satisfied, the government may nonetheless make the requested information publicly available upon consideration of the nature or significance of the public interest


15. Id. Principle 3.
in disclosure. This process is known as a “public interest override.” The override may be permissive or mandatory, that is, it may authorize discretionary disclosures or it may require the disclosure. In either case, the override authorizes, and immunizes, disclosure even where otherwise legally restricted, such as by a state secrets law.

The high bar to withholding public information reflects international recognition that the right to information is fundamental in a democratic society, and that a failure to protect this right in the face of “national security”—an amorphous and expansive concept—can result in the improper and abusive suppression of free expression.16

II. International and Regional Laws and State Practices Constrain Criminal Prosecutions of Journalists for the Unauthorized Disclosure of Sensitive Government Information

Although there exists a general international consensus as to the principles governing the right of access to sensitive state information,17 the laws, policies, and practices defining the permissible scope and nature of the prosecution of a journalist for receiving and disclosing national security information remain undeveloped. It is not uncommon to find that state secrets laws—many of which were enacted well before modern developments in free expression jurisprudence—have not been invoked in the newsgathering context, that no court has been tasked with examining whether the relevant law constitutes a valid restriction on rights to a free press, or that no legislature has considered the need for promulgating a public interest defense or similar provision to constrain the overbroad nature of many such laws. This Section explores the case law, statutes, and practical experiences of the limited number of jurisdictions where journalists’ rights to free expression—generally recognized to extend, in accordance with democratic principles, to the right to obtain and impart government information on matters of public concern—have come into actual conflict with statutes prohibiting the receipt, possession, and disclosure of certain classes of data and documents.18


18. In contrast, a larger number of countries have established legal and/or regulatory frameworks concerning protections for government whistleblowers, i.e., government employees who release protected information in the public interest.
A. Canada

Canada broadly supports the right of a free press and of access to information through constitutional and statutory law, and thereby imposes significant limitations on the validity of any criminal prosecution of a journalist for obtaining, possessing, or publishing protected state information. The Canadian Charter of Rights and Freedoms, the bill of rights embodied in Canada’s Constitution, was successfully invoked to invalidate portions of Canada’s Security of Information Act, provisions that made it a criminal offense to “communicate, possess and retain certain categories of government information without authorization.” These provisions—found defective in, inter alia, their vague and overbroad terms, lack of mens rea elements, and failure to include a public interest defense—have not been remedied through further legislation and, as of mid-2013, remain unenforceable.

1. THE CANADIAN CHARTER OF RIGHTS AND FREEDOMS, THE SECURITY OF INFORMATION ACT, AND O’NEILL V. CANADA (ATTORNEY GENERAL)

The Canadian courts have played a central role in guaranteeing the right to obtain and publish sensitive state information, including documents related to alleged terrorist activities. In O’Neill v. Canada (Attorney General), the Ontario Superior Court of Justice struck down the so-called “leakage” provisions of Canada’s Security of Information Act (“SOIA”), reasoning that they: (1) imposed impermissible restrictions on free expression in violation of section 2(b) of the Charter of Rights and Freedoms; (2) were impermissibly vague and overbroad in violation of the liberty rights guaranteed by section 7 of the Charter; and (3) failed to contain an element of fault as also required by section 7 of the Charter. The court concluded that these restrictions on fundamental rights could not be saved as a reasonable limit prescribed by law as can be demonstrably justified in a free and democratic society, and were not limited by any common law public interest defense or the specific defense provided elsewhere in the SOIA. Last, the court determined that the constitutional infirmities of the challenged SOIA provisions wrongfully enabled authorities to use allegations of criminal

20. Id. para. 84.
21. Id. paras. 65, 72.
22. Id. para. 80.
23. Id. para. 105.
24. Id. paras. 54–57.
activity to intimidate a member of the press into compromising her constitutionally-based right to protect the identity of her sources.25

The Charter of Rights and Freedoms establishes, in section 2(b), the fundamental right of freedom of expression and opinion, and, in section 7, an individual’s fundamental right to liberty.26 All Canadian laws—including laws criminalizing the unauthorized release of protected government information, such as the Canadian SOIA—must be consistent with the rights protected by the Charter or may be stricken,27 unless the restrictions on the right at issue can be saved as “reasonable limits prescribed by law as can be demonstrably justified in a free and democratic society.”28 While the government always bears the burden of overcoming this threshold, laws restricting the right to free expression by threat of criminal sanction are particularly suspect. In such cases, the government “bears a heavy burden”29 of demonstrating that the restriction is justified in the “‘clearest of circumstances.’”30

The case of O’Neill v. Canada arose from a November 2003 article authored by journalist Juliet O’Neill and published by the Ottawa Citizen newspaper. The article concerned Maher Arar, a Syrian-born Canadian citizen and a reported target of the United States’ extraordinary rendition program. Deported in September 2002 from the U.S. to Syria, “Arar was allegedly tortured, interrogated and forced to sign a false confession pertaining to his involvement in terrorist activities.”31 Upon his return to Canada in October 2003, the public generally viewed Arar as an innocent victim; many questioned whether Cana-

25. Id. paras. 154–59, 163.
26. Canadian Charter of Rights and Freedoms, Part I of the Constitution Act, 1982, being Schedule B to the Canada Act, 1982, c. 11 (U.K.) [hereinafter Charter of Rights and Freedoms], available at http://laws-lois.justice.gc.ca/eng/const/page-15.html; id. § 2 (“Everyone has the following fundamental freedoms: . . . (b) freedom of thought, belief, opinion and expression, including freedom of the press and other media of communication”); id. § 7 (“Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.”).
29. Id. para. 86 (“where a freedom guaranteed by the Charter is infringed by a criminal prohibition, the Crown bears a heavy burden of justifying that infringement”).
30. Id. paras. 91–94.
dian authorities were complicit in his deportation. In her article, O’Neill included classified information leaked to her by a confidential official source—information that, if believed, undermined Arar’s claim of innocence. Hers was not the only such news report, which led politicians and the public to call on the government to investigate the identity of the officials who, Arar’s supporters alleged, were disclosing information in an effort to turn public opinion against him.

In January 2004, the Royal Canadian Mounted Police (“RCMP”) executed search warrants at O’Neill’s home and the Ottawa Citizen office, searching for information that could identify the source of the classified information in her article. The warrants were issued pursuant to section 4 of the SOIA, which criminalized the unlawful receipt of so-called “secret official” information and the communication of such information to persons not authorized to receive it.

The recognized purpose of section 4 is to deter and protect against the “unauthorized release of government information that carries with it some element of harm to the national interest if released, causing it to be categorized as ‘secret official’ or ‘official.’” Its terms provide up to 14 years’ imprisonment for any person “who receives any secret official code word, password, sketch, plan, model, article, note, document or information,” who “has in his possession any official document or secret official code word of password issued for the use of a

34. O’Neill, 82 O.R. 3d para. 141(9).
35. Id. paras. 140(25), (27).
36. Security of Information Act, R.S.C. 1985, c. O-5, § 4 (Can.) [hereinafter Security of Information Act or SOIA], available at http://laws-lois.justice.gc.ca/PDF/O-5.pdf; O’Neill, 82 O.R. 3d paras. 14, 85, 110. The warrants were issued on the basis of an affidavit setting out that the RCMP already had conducted surveillance of O’Neill, had obtained records from her Internet service provider, had searched her garbage, and had interviewed at least one person who received an e-mail message from her. Id. para. 141(23).
37. O’Neill, 82 O.R. 3d para. 29 (explaining that section 4 of the SOIA was “intend[ed] to criminalize and, therefore, deter and protect against the unauthorized release of government information that carries with it some element of harm to the national interest if released.”).
person other than himself,”39 who fails to return it,40 or who “communicates” a “secret official” item.41

O’Neill never was charged under the SOIA, but the search warrants alleged she had violated section 4’s receipt and retention provisions.42 O’Neill, together with the Ottawa Citizen, challenged the validity of the searches authorized by the warrants and of the seizures of documents and computer information, asserting that section 4 formed an unjustified restriction on fundamental rights established by the Charter.43

The Ontario Superior Court of Justice nullified the challenged portions of section 4, concluding that they were facially invalid on multiple grounds. The court first found that section 4 restricted rights guaranteed by the Charter:

- The sections “constitute a prima facie violation of section 2(b) Charter rights. The sections restrict activity that attempts to convey meaning so that they restrict ‘expression’ . . . . Furthermore, their purpose is to restrict the free flow of government information and their effect is to limit freedom of expression including freedom of the press regarding the functioning of government institutions.”44

- They breach section 7 of the Charter in their breadth and vagueness: the law “fails to define in any way the scope of what it protects”45 and does “not sufficiently delineat[e] the risk zone for criminal sanction”46 by omitting definitions for terms such as “secret official,” terms that are not defined elsewhere under the law.47

- Two of the challenged subsections “impose criminal liability based solely on the prohibited act having been committed by the accused and as such . . . violate section 7 of the Charter,”48 which prohibits “the imposition of imprisonment in the absence of proof of an element of fault referred to as the mens rea.”49 Because the offenses impose a maximum penalty of 14 years’ impri-

39. Id. § 4(4)(b).
40. Id.
41. Id. § 4(1)(a).
42. O’Neill, 82 O.R. 3d para. 4. The newspaper was never alleged to have acted illegally. See id. para. 163.
43. Id. para. 5. O’Neill and the newspaper also asserted that the issuance and execution of the warrants constituted an abuse of judicial process. See id.
44. Id. para. 84 (citations omitted).
45. Id. para. 62.
46. Id. para. 72.
47. Id. paras. 36, 49.
48. Id. para. 82.
49. Id. para. 73.
sonment, they are considered “true crime” offenses that, as even the government agreed, “require proof of some blameworthy mental state.”

Next, the court determined that no other law constrained or “harmo-
nized” the challenged sections such that the constitutional values at issue were nonetheless promoted, rejecting in particular the government’s suggestion that the court recognize a “general common law public interest defense to justify the unauthorized disclosure.”

Last, the court concluded that the challenged portions were not “rea-
sonable and demonstrably justified, so as to balance the interests of so-
ciety with those of individuals and groups”—even though it found the purpose of the SOIA—deterring the unauthorized release of state secrets—as “pressing and substantial.” In this analysis, the court found that the broad language of section 4 “ha[s] not been well tai-
lored to suit” the purpose of the law and “ha[s] not been carefully lim-
ited to be a ‘measured and appropriate response’ to the harms” sought to be addressed. Among the defects, the court recognized that the challenged portions of section 4 “are able to criminalize a wide variety of conduct that should not be caught, for example, the communication, receipt or possession and retention of information that invokes no harm element to the national interest,” thus having a chilling effect on the exercise of freedom of expression. For these reasons, the court concluded that the “state has not proven . . . that its restriction [of] fundamental Charter right[s] is demonstrably justifiable in a free and democratic society,” and declared the challenged portions “of no force and effect.”

The court further concluded that the defects in section 4 allowed for abuse of the judicial process with regard to the RCMP’s investigation of O’Neill. It recognized that the RCMP, through the mere threat of criminal charges, was able to intimidate O’Neill and “gain ‘leverage’ against [her] in its quest to uncover the source of the leaks,” thereby infringing her constitutional right to “gather news and other informa-

50. Id. paras. 75–76, 80.
51. Id. paras. 54–55; see also id. paras. 41–53 (no limitation imposed by Canadian Access to Information Act); id. paras. 56 (no limitation imposed by the SOIA’s specific public interest defense); id. paras. 58–59 (no limitation imposed by prosecutorial discretion).
52. Id. paras. 95–98.
53. Id. paras. 99–102.
54. Id. para. 102.
55. Id. paras. 103–104.
56. Id. para. 110.
tion without undue governmental interference.”\(^{57}\) The Canadian Attorney General elected not to appeal the O’Neill decision.\(^ {58}\) This case represents the one known instance in which the Canadian SOIA has been invoked with regard to a journalist’s receipt or publication of sensitive government information.\(^ {59}\)

2. THE LIMITED PUBLIC INTEREST DEFENSE IN THE CANADIAN SOIA

The Canadian Security of Information Act contains an express public interest defense.\(^ {60}\) The defense does not apply to the leakage offenses contained in section 4, but only to offenses involving the communication of sensitive government information by government employees.\(^ {61}\) As discussed above, although advocated by the government, the O’Neill court refused to recognize a “general public interest defense” broadly applicable to the SOIA, finding instead that the existence of such a common law defense was “dubious and specula-

\(^{57}\) Id. paras. 159–160 (citation and internal quotation marks omitted); see also id. para. 137 (“Freedom of the press is intended to complement and give effect to freedom of expression. It includes the ‘right to transmit news and other information [and] also the right to gather this information’” (citation omitted)); id. paras. 154–165 (reasoning as to findings on abuse of process).


\(^{59}\) Indeed, since its enactment in 1985, only one individual has ever faced charges under the SOIA; a former official from the Canadian Navy pled guilty to selling state secrets between July 6, 2007, and January 10, 2012. See Ryan Van Horne, Navy Spy Jeffrey Delisle Sentenced to 20 Years in Prison, TORONTO SUN (Feb. 8, 2013), http://www.torontosun.com/2013/02/08/navy-spy-jeffrey-delisle-to-be-sentenced. Under a previous version of the law, the Canadian government unsuccessfully sought to prosecute a media company under the leakage provisions; the case was dismissed on the basis that the information in question already had entered into the public domain. R. v. Toronto Sun Publ’g Ltd. (1979), 24 O.R. 2d 621, paras. 45–46 (Can. Ont. Prov. Ct. J.) (criticizing the leakage offenses as “ambiguous and unwieldy,” such that a “complete redrafting of the [Act] seems appropriate and necessary”).

\(^{60}\) Security of Information Act, § 15(1). The defense provides that “[n]o person is guilty of an offence under section 13 or 14 if the person establishes that he or she acted in the public interest.” Id. The burden of proof rests on the defendant to demonstrate that she “act(ed) in the public interest,” which is narrowly defined as acting “for the purpose of disclosing an offence under an Act of Parliament that he or she reasonably believes has been, is being or is about to be committed by another person in the purported performance of that person’s duties and functions for, or on behalf of, the Government of Canada” where “the public interest in the disclosure outweighs the public interest in non-disclosure.” Id. § 15(2). Seven factors are to guide a court in determining whether the public interest in disclosure outweighs the public interest in non-disclosure. Id. § 15(4). The multi-factor analysis is to be disregarded if disclosure of the information “was necessary to avoid grievous bodily harm or death.” Id. § 15(6).

\(^{61}\) Id. §§ 13–14.
tive.‖62 In response to the O’Neill decision, a Special Senate Committee of the Canadian Parliament has suggested adding a public interest defense to section 4,63 and other commentators have recommended expansion of the application of the existing statutory defense.64 No amendments to the law are expected in the near future, however.

3. THE CANADIAN ACCESS TO INFORMATION ACT

Enacted in 1983, the Canadian Access to Information Act provides a broad right to information held by the federal government.65 Government information is presumed to be subject to access unless it falls within a specific exception—including the exception for national security records—which allows but does not mandate that the head of a government institution refuse disclosure.66 If a request for information is refused, the requestor may seek the assistance of an ombudsperson67 and thereafter may apply to the Federal Court of Canada.68 The Access to Information Act does contain a limited public interest override provision, but it is not applicable to the national security exception.69

B. India

In India, the public right of access to government information is rooted in Article 19(1)(a) of the Constitution of India, which expressly protects the fundamental right of all citizens “to freedom of speech

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66. Id. ¶ 4 (each citizen or permanent resident “has a right to and shall, on request, be given access to any record under the control of a government institution” subject to the Act’s exceptions and to other laws); id. ¶ 15 (exempting the disclosure of information “which could reasonably be expected to be injurious to” national security and related interests).
67. Id. ¶¶ 30–37.
68. Id. ¶ 41.
69. Id. ¶ 20(6) (applicable to the disclosure of, inter alia, emergency management plans and vulnerability of physical, communications, or other infrastructure).
and expression.” The courts have broadly interpreted this provision
to guarantee derivative free speech and free press rights, raising the
suggestion that it would impose considerable constraints on the coun-
try’s colonial-era state secrets law. Nonetheless, some journalists have
been charged under the law—although it appears that no prosecution
has been successful.

1. CONSTITUTIONAL PROTECTION FOR THE RIGHT TO KNOW

The Indian courts have affirmed that a “right to know”—that is, the
public’s right to obtain government-held information—is grounded in
Article 19(1)(a) of the Indian Constitution. In the seminal 1975 de-
cision of State of Uttar Pradesh v. Raj Narain, the Indian Supreme
Court not only recognized the constitutional basis of the public’s
right to know, but also described the wide net cast by this right:

In a government of responsibility like ours, where all the agents
of the public must be responsible for their conduct, there can be
but few secrets. The people of this country have a right to know
every public act, everything that is done in a public way, by their
public functionaries. They are entitled to know the particulars of
every public transaction in all its bearing. The right to know,
which is derived from the concept of freedom of speech, though
not absolute, is a factor which should make one wary, when se-
crecy is claimed for transactions which can, at any rate, have
no repercussion on public security. . . . The responsibility of of-
ficials to explain and to justify their acts is the chief safeguard
against oppression and corruption.

In 1981, the Indian Supreme Court further explained, “[t]his is the
new democratic culture of an open society towards which every liberal

70. INDIA CONST. art. 19, § 1, cl. a.
imgst.aspx?filename=21481; Secretary, Ministry of Info. & Broad. v. Cricket Ass’n of
Bengal, (1995) 2 S.C.C. 161, para. 44 (India) (“[t]he freedom of speech and expression
includes [the] right to acquire information and to disseminate it”); see also Right to In-
formation: India, National Level RTI, COMMONWEALTH HUMAN RIGHTS INITIATIVE, http://
www.humanrightsinitiative.org/programs/ai/rti/india/national.htm (last visited Sept. 20,
2013) (“the right to information is implicit in the right to freedom of speech and expres-
sion explicitly guaranteed in Article 19 of the Indian Constitution”).
72. U.P. at 360 (citing N.Y. Times Co. v. United States, 403 U.S. 713 (1971)). Be-
cause the free speech and expression rights found in Article 19 are “based on the pro-
visions in the First Amendment to the Constitution in the U.S.A.,” reference to deci-
sions of the U.S. Supreme Court is proper “to appreciate the true nature, scope and
extent of this right.” Reliance Petrochemicals Ltd., v. Proprietors of Indian Express
democracy is [evolving] and our country should be no exception. The concept of an open government is the direct emanation from the right to know which seems to be implicit in the right of free speech and expression guaranteed under Article 19(1)(a).”73 And additional support for the right to know is found in Article 21 of the Indian Constitution, which guarantees the right to life and personal liberty.74

Under Article 19 of the Constitution, Indian courts have enforced the public’s right to know—even where that right is alleged to cause harm to state interests—on the basis that “exposure to public gaze and scrutiny is one of the surest means of achieving a clean and healthy administration.”75 For example, in Gupta v. President of India, the Supreme Court rejected the government’s arguments that a standard policy of disclosure could be injurious to the state, explaining:

[D]isclosure of information in regard to the functioning of Government must be the rule and secrecy an exception justified only where the strictest requirement of public interest so demands. The approach of the court must be to attenuate the area of secrecy as much as possible consistently with the requirement of public interest, bearing in mind all the time that disclosure also serves an important aspect of public interest.76

The Gupta case arose from the efforts of petitioners to gain public disclosure of correspondence by the Law Minister, the Chief Justice of India, and the Chief Justice of Delhi regarding the non-appointment of a judge for an additional term and the transfer of a High Court judge.77 The government argued that the correspondence was protected from disclosure by Section 123 of the Indian Evidence Act, which prohibits giving evidence derived from unpublished official documents regarding affairs of state.78

The Supreme Court set out a balancing test for determining whether a document relating to internal state affairs could be disclosed in a ju-

73. Gupta v. President of India, 2 S.C.R. para. 66.
74. Reliance Petrochemicals, Supl. 3 S.C.R. at 235 (“Right to know is a basic right which citizens of a free country aspire in the broader horizon of the right to live”). The Reliance Petrochemicals decision involved the public’s right to know about the Controller of Capital Issues’ authorization of a public subscription of secured convertible debentures and the right of the press to publish a news article critical of the authorization, given that the judicial challenge to such authorization was pending before the courts.
75. Gupta v. President of India, 2 S.C.R. para. 65; see also id. (“an open government is . . . a powerful safeguard against political and administrative aberration and inefficiency”).
76. Id. para. 66.
77. Id. para. 55.
78. Id.
In a judicial proceeding, the court must consider and weigh two competing interests: (1) potential injury to the interest of the State or the proper functioning of the public service and (2) the proper administration of justice that might be frustrated by non-disclosure.79 In undertaking this exercise, the Gupta court determined that the production of the requested documents would not result in injury to the State and therefore ordered disclosure of the correspondence.80

The court emphasized that no category of documents is exempt from this analysis, as it “is a balancing task which has to be performed by the Court in all cases”—even where the records at issue would otherwise be protected by law.81 Although there does not appear to exist any judicial decision involving the requested disclosure of national security information, the touchstone of the analysis would be whether the disclosure likely would result in actual harm outweighing the public interest in access to the information.

Finally, the Supreme Court has stricken as unconstitutional laws incompatible with the public’s right to know. As one example, in People’s Union for Civil Liberties v. Union of India, the court determined that, because “the foundation of a healthy democracy is to have well-informed citizens-voters,” a statutory restriction on the personal information that political candidates could be required to provide could not withstand scrutiny under Article 19.82 The court reasoned that “[t]rue democracy cannot exist unless all citizens have a right to participate in the affairs of the polity of the country. The right to participate . . . is meaningless unless the citizens are well informed on all sides of the issues . . . .”83

2. THE RIGHT TO INFORMATION ACT

India also provides statutory support for a right of access to information through the Right to Information Act (“RTIA”), enacted in

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79. Id. para. 72.
80. Id. para. 85.
81. Gupta, 2 S.C.R. paras. 72–73 (“This balancing between two competing aspects of public interest has to be performed by the court even where an objection to the disclosure of the document is taken on the ground that it belongs to a class of documents which are protected irrespective of their contents”).
82. People’s Union for Civil Liberties v. Union of India, Writ Petition (civil) 490 of 2002, Writ Petition (civil) 509 of 2002, Writ Petition (civil) 515 of 2002 (India S.C. Mar. 13, 2003), available at http://www.judis.nic.in/supremecourt/imgs1.aspx?filename=19044 (“for survival of true democracy, the voter must be aware of the antecedents of his candidate . . . . That information to a voter, who is a citizen of this country, is one facet of the fundamental right under Article 19(1)(a).”)
83. Id. at 18 (quoting Secretary v. Cricket Ass’n, para. 82) (internal quotation marks omitted).
The RTIA permits citizens to request information—broadly defined as material in any form—from public authorities. The RTIA contains an explicit public interest override provision. Section 8 permits disclosure of information that would ordinarily be exempt—whether pursuant to the RTIA, the Official Secrets Act, or any other legislation—where the “public interest in disclosure outweighs the harm to the protected interests.” Section 22 of the RTIA is clear that this override “shall have effect notwithstanding anything inconsistent therewith contained in the Official Secrets Act . . . and any other law.”

3. ATTEMPTED PROSECUTION OF JOURNALISTS UNDER THE OFFICIAL SECRETS ACT 1923

The Official Secrets Act 1923 (“OSA”) is commonly described as a “colonial relic,” as it was enacted when India was under British rule and remains largely unchanged since that time. Section 5 of the OSA prohibits the “[w]rongful communication . . . of information.” It provides criminal sanctions for any person who “voluntarily receives any secret official code or pass word or any sketch, plan, model, article, note, document or information knowing or having reasonable ground to believe” it was communicated in violation of the OSA; who fails to return it; or who “willfully communicates” such an item to anyone not authorized to receive it. Notably, the language of the leakage provisions of the OSA is similar to those provisions of the Canadian SOIA that were found constitutionally defective in O’Neill v.
Canada; both find their origins in earlier versions of the British Official Secrets Act.

Although it does not appear that any journalist has been successfully prosecuted under the OSA for the receipt, retention, or publication of information touching upon matters of national security, journalists have been aggressively and—it appears—arbitrarily targeted under the law. Indeed, watchdog organizations have recognized that the OSA “continues to be a potent instrument in the hands of the State to browbeat the citizens and journalists and curb their fundamental rights, including the freedom of expression.”

The case against financial journalist Santanu Saikia is one such example. Saikia was arrested in 1999 for publishing the contents of a note from the Cabinet of India regarding divestment policy. Three years later, after an unsuccessful investigation into the identity of the individual who leaked the Cabinet note to him, Saikia was charged with violating the Official Secrets Act. The prosecution extended over seven years. Finally, in 2009, a criminal court judge dismissed the case on two grounds. First, the court found no actual harm to the state resulted from the disclosure of the document at issue—indeed, it was common for news outlets to report on Cabinet papers. Second, the court adopted a narrow interpretation of the law—following the Indian Supreme Court’s narrow interpretation of the OSA’s espionage provisions—in concluding that the OSA only provided sanctions for the unauthorized communication of a “secret official code or password,” not of a document bearing a “secret” designation.

Another is the detention of Iftikhar Gilani, New Delhi bureau chief for the Kashmir Times. Arrested and charged in June 2002 with the possession of classified documents in violation of the OSA, Gilani was jailed for seven months, until charges against him were dropped

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94. The Cabinet of India, formally known as the Council of Ministers, is a collective decision-making body of the government, consisting of the prime minister and the most senior government ministers. See, e.g., http://cabsec.nic.in/council_ministersofstate.php (listing members).
96. Garg, supra note 88. Media and watchdog reports do not identify the provision under which he was charged.
97. Id.
in January 2003, withdrawn “for administrative reasons and in the public interest.” Numerous sources explain that, while the documents at issue concerned military operations, they were readily available online and had been published in a Pakistani journal.

In contrast, in March 2012, when the contents of a letter to the Indian Prime Minister from the Army Chief describing the Army’s lack of preparedness were widely published by news entities, none was threatened with sanction.

C. European Court of Human Rights

The European Court of Human Rights (“ECtHR”) has recognized the importance of disseminating information that touches on matters of public concern, acknowledging that, in certain circumstances, even the disclosure of sensitive government information should be encouraged and protected. The ECtHR aims to strike a balance between the public interest implicated and any competing national security concerns by evaluating secrecy on a case-by-case basis.

1. ARTICLE 10 OF THE EUROPEAN CONVENTION

Article 10(1) of the European Convention for the Protection of Human Rights and Fundamental Freedoms (“ECHR”) establishes “the right to freedom of expression,” including the right to divulge


information on matters of public interest.

Article 10(2) requires that any “restrictions or penalties” on this right be “prescribed by law,” in pursuit of a legitimate interest, and “necessary in a democratic society.” The ECtHR has recognized that Article 10 imposes positive obligations on state governments, mandating that they affirmatively guarantee the existence of an environment in which the right to freedom of expression can be exercised.

2. THE SPYCATCHER CASES: SUNDAY TIMES AND OBSERVER AND GUARDIAN

In the Spycatcher cases—Observer & Guardian v. United Kingdom and Sunday Times v. United Kingdom (No. 2)—violations of Article 10 were found as a result of injunctions imposed by the English courts on newspapers the Observer, The Guardian and The Sunday Times, as to publication of the details of the book Spycatcher and information obtained by its author, former British Security Service (MI5) officer Peter Wright.

a. Background

Following his resignation from MI5 in 1976, Wright sought to publish his memoirs in Australia, where he resided. His book, Spycatcher, detailed MI5’s operational organization, its methods and personnel, as well

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103. The purpose of the ECHR is to “guarantee not rights that are theoretical or illusory but rights that are practical and effective.” Airey v. Ireland, App. No. 6289/73, 32 Eur. Ct. H.R. (ser. A) para. 24 (1979), available at http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-57420?{"itemid":"001-57420"}.

104. These include “the interests of national security, territorial integrity or public safety, [or] for the prevention of disorder or crime.” ECHR, art. 10(2).

105. Id.


109. Observer & Guardian, para. 9; Sunday Times, para. 9.

110. Observer & Guardian, para. 11; Sunday Times, para. 11.
as “an account of alleged illegal activities by the Security Service.”111

By mid-1984, part of the material in Wright’s manuscript had already been published in the United Kingdom in other books and television interviews.112 In 1985, the U.K. Attorney General unsuccessfully sought to restrain publication of Spycatcher in Australia.113 While the Australian proceedings were pending, however, short articles appeared in two U.K. newspapers—the Observer and The Guardian—which reported on the forthcoming hearing in Australia and gave details of some of the contents of Spycatcher, including allegations of improper conduct on the part of MI5 officers.114 The U.K. Attorney General instituted proceedings for breach of confidence against both newspapers in England,115 obtaining ex parte interim injunctions restraining the papers from any further publication of Spycatcher material,116 injunctions that were upheld by the Court of Appeals with minor modifications.117

In April 1987, a major summary of certain allegations in Spycatcher, allegedly based on a copy of the manuscript, appeared in numerous publications, both in the U.K. and abroad,118 and in July, the book was published in the United States.119 Also in July 1987, the U.K. newspaper The Sunday Times, which had purchased British serial-

111. Id. Specifically, Wright asserted that “MI5 conducted unlawful activities calculated to undermine the 1974–1979 Labour Government, burgled and ‘bugged’ the embassies of allied and hostile countries and planned and participated in other unlawful and covert activities at home and abroad, and that Sir Roger Hollis, who led MI5 during the latter part of Mr. Wright’s employment, was a Soviet agent.” Id.

112. Id. para. 12.

113. Attorney-General (U.K.) v Heinemann Publishers Austl. Pty. Ltd. (1988) 165 CLR 30 (Austl.), available at http://www.austlii.edu.au/au/cases/cth/HCA/1988/25. html. The High Court of Australia decided in favor of Wright and his publishers on the basis that the United Kingdom sought to indirectly enforce Wright’s obligations under the U.K. Official Secrets Act. The High Court declared that “the principle of law renders unenforceable actions . . . to enforce the governmental interests of a foreign state,” id. para. 39, even where the foreign government is a close ally, id. para. 37, and enforcement “was supported by the Australian Government as being in the Australian public interest,” id. para. 7.


115. Observer & Guardian, para. 15. The government submitted affidavits stating “that the publication of any narrative based on information available to Mr. Wright as a member of the Security Service would cause unquantifiable damage, both to the service itself and to its officers and other persons identified, by reason of the disclosures involved,” it would “undermine the confidence that friendly countries and other organizations and persons had in the Security Service,” and it would further “create a risk of other employees or former employees of that service seeking to publish similar information.” Id. para. 16.

116. Id. para. 17.

117. Id. para. 19.

118. Id. paras. 22–23.

119. Id. para. 28.
ization rights from Wright’s publishers, began publishing extracts from *Spycatcher*. The Attorney General immediately commenced proceedings against *The Sunday Times* for contempt of court, obtaining a temporary injunction restraining publication of further extracts, and in October instituted further proceedings for breach of confidence. The injunctions remained in force until October 13, 1988, when, at the conclusion of the proceedings on the merits, the House of Lords rejected the Attorney General’s claims for permanent injunctions against the *Observer*, *The Guardian* and *The Sunday Times*.  

b. House of Lords Decision

In its decision on the merits of the Attorney General’s actions against the applicants, the Appellate Committee of the House of Lords held that, “since the world-wide publication of *Spycatcher* had destroyed any secrecy as to its contents,” “continuation of the injunctions was not necessary,” and “should be discharged.” The House of Lords further held that the *Observer* and *The Guardian* articles “had not contained information damaging to the public interest,” “the *Observer* and *The Guardian* were not in breach of their duty of confidentiality when they published [those] articles,” and “the Crown would not have been entitled to a permanent injunction against both newspapers.” However, the House of Lords found that “*The Sunday Times* was in breach of its duty of confidence in publishing its first serialised extract from *Spycatcher* on 12 July 1987,” and therefore, “*The Sunday Times* was liable to account for the profits resulting from that breach.” Lastly, observing that “the information in *Spycatcher* was now in the public domain and no longer confidential,” the House of Lords held that, “no injunction should be granted against the *Observer* and *The Guardian* restraining them from reporting on the contents of

120. *Sunday Times*, para. 27.
121. *Id.* para. 27.
122. *Id.* para. 32. The Vice-Chancellor granted the temporary injunction to restrain publication, while he considered the application by the *Observer* and *The Guardian* for discharge of the injunctions against them, since they effectively bound *The Sunday Times* as well. *Id.* In a split decision, the House of Lords held that the injunctions against the *Observer* and *The Guardian* should continue until the commencement of the substantive trial in the breach of confidence actions. *Id.* para. 35.
123. *Id.* para. 39.
124. *Id.* para. 42.
125. *Id.* para. 42.
126. *Sunday Times*, para. 42.
127. *Id.* The House of Lords reasoned that *The Sunday Times* “was not protected by either the defence of prior publication or disclosure of iniquity,” concluding “that imminent publication of the book in the United States did not amount to a justification.” *Id.*
the book,” or against “The Sunday Times to restrain serialising of further extracts from the book.”

c. The ECtHR Decisions

The Observer and The Guardian brought an application before the ECtHR, alleging that the interlocutory injunctions against them had constituted an unjustified interference with their freedom of expression, as guaranteed by Article 10 of the ECHR.

In respect of the temporary injunctions imposed on the applicants for the period from July 11, 1986 to July 30, 1987, the ECtHR held that there had been an interference with the applicants’ Article 10 rights. Nevertheless, the Court found that the restrictions during this period fell within the exception under Article 10(2). The restrictions were “prescribed by law,” and according to the Court, had the legitimate aim under Article 10(2) of “maintaining the authority of the judiciary” by protecting “the rights of litigants” in the substantive trial, as well as the “aim of protecting national security.” Lastly, the ECtHR examined whether restrictions were “proportionate to the legitimate aim pursued,” and whether reasons to justify them were both “relevant and sufficient,” holding that the restrictions were indeed “necessary in a democratic society.” The restrictions were relevant given “credible evidence” that publication during this period would “be detrimental to the Security Service,” and refusal of the interlocutory injunctions “would effectively deprive the Attorney General, if successful on the merits, of his right to be granted a permanent injunction.” The restrictions were also “sufficient” where the English courts had identified conflicting public interests in preventing and allowing disclosure, and “resolved” that conflict “by a careful weighing of the relevant considerations on either side.” Finally, the injunctions did not prevent the applicants from engaging in “an independent inquiry” into the operation of the Security Service, and although lasting for “slightly more than a year,” the contents related to “events that had occurred several years previously [and] could not really be classi-

128. Id.
129. Observer & Guardian, para. 54.
130. Id. paras. 55–56. The ECtHR recognized that “considerations of national security featured prominently in all the judgments delivered by the English courts in this case,” although noting comments by the English courts “that the precise nature of the national security considerations involved varied over the course of time.” Id. para. 56.
131. Id. para. 59(d).
132. Id. para. 65.
133. Id. para. 62.
134. Id. para. 63.
fied as urgent.”135 The restrictions therefore were “proportionate” to the legitimate aims pursued.136

In respect of the period from July 30, 1987 to October 13, 1988, however, the ECtHR held that the temporary injunctions had violated Article 10,137 finding that “the interference complained of was no longer ‘necessary in a democratic society’ after July 30, 1987.”138

The Court observed that, although “the further publication of Spycatcher material could have been prejudicial to the trial of the Attorney General’s claims for permanent injunctions . . . it does not constitute a ‘sufficient’ reason for the purposes of Article 10 (art. 10).”139 The confidentiality of the material had been destroyed as a result of the publication of Spycatcher in the United States—“irrespective of whether any further disclosures were made by [the Observer and The Guardian]”—and thus, “the interest in maintaining the confidentiality of that material had . . . ceased to exist by 30 July 1987.”140 Neither were the interests of national security relied on by the United Kingdom “sufficient.”141 Although the restrictions were initially sought “to preserve the secret character of information that ought to be kept secret,” by July 30, 1987, “the information had lost that character,” and “the purpose of the injunctions had thus become confined to the promotion of the efficiency and reputation of the Security Service.”142 “Above all,” the ECtHR held, “continuation of the restrictions after July 1987 prevented newspapers from exercising their right and duty to purvey information, already available, on a matter of legitimate public concern.”143

In The Sunday Times case, the Court was again faced with an evolving situation—“a curious metamorphosis,” it explained—because the information at issue entered into the public domain during the course of litigation.144 The publication of Spycatcher in the United States compelled the United Kingdom to shift from its original position that the injunctions were justified by the need “to preserve the secret character of [national security] information” to the position that they were justified by “the promotion of the efficiency and reputation of

135. Id. para. 64.
136. Id. para. 65.
137. Id. para. 46.
138. Id. para. 70.
139. Id. para. 68.
140. Id.
141. Id. para. 69.
142. Id.
143. Id.
144. Sunday Times, para. 55.
the Security Service.”145 The Court again concluded that this latter motive was not “sufficient” to justify the injunctions.146 Thus—for the same reasons applied to the injunctions against the Observer and The Guardian from July 30, 1987 to October 13, 1988147—the interference with the Article 10 rights of The Sunday Times was “no longer ‘necessary in a democratic society.’”148

3. FURTHER ATTEMPTS TO RESTRAIN DISCLOSURES BY THE MEDIA: VERENIGING WEEKBLAD BLUF! V. NETHERLANDS

In Vereniging Weekblad Bluf! v. Netherlands,149 the ECtHR held that the Netherlands had breached its obligations under Article 10 of the ECHR by removing from circulation all copies of a journal issue that published a six-year-old “confidential” government report. The ECtHR recognized that, unlike the situation in Sunday Times v. United Kingdom (No. 2), here the information in the report could not be obtained by other means.150

The applicant was an Amsterdam-based association which at the material time published the weekly magazine Bluf!.151 In the spring of 1987, the applicant obtained an internal quarterly report by the Netherlands’ Internal Security Service, Binnenlandse Veiligheidsdienst (the “BVD”), describing the BVD’s activities.152 Dated 1981 and labeled “confidential,” the report demonstrated that the BVD had, at the time, been monitoring the Dutch Communist Party and the Anti-Nuclear-Power Movement.153 On April 29, 1987, the applicant sought to publish the report as a supplement to that date’s issue of Bluf!.154 Before the journal could be published, however, the BVD informed the public prosecutor that its dissemination would likely to infringe the state’s Criminal Code (Wetboek van Strafrecht).155 A preliminary judicial investigation was ordered that same day; the association’s

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145. Id.
146. Id.
147. Observer & Guardian, paras. 66–70.
148. Id. para. 70.
150. Id. para. 38.
151. Id. para. 7.
152. Id. para. 8.
153. Id.
154. Id.
155. Id. para. 9. The director of the BVD recognized that “the various contributions taken separately do not (or do not any longer) contain any State secrets,” but nevertheless suggested that “taken together and read in conjunction” they “amount to information whose confidentiality is necessary in the interests of the State or its allies.” Id.
premises were searched; all copies of the Bluf! issue, including the supplement, were seized; and three people were arrested—although released shortly thereafter.\textsuperscript{156} Despite this, during the evening of April 29, the staff of the association reprinted the issue and circulated it throughout Amsterdam the following day.\textsuperscript{157}

Finding no basis on which to continue the investigation, the presiding judge ordered that it be closed a few days later.\textsuperscript{158} Nevertheless, the Review Division of the Amsterdam Regional Court dismissed an application by the association seeking to have the confiscated copies returned for timely distribution to subscribers, finding that “it was not ‘highly unlikely’ that in the criminal proceedings an order would be made for the periodical’s withdrawal from circulation.”\textsuperscript{159} The Supreme Court dismissed appeals on all grounds.\textsuperscript{160} The Review Division also dismissed a second application by the association challenging the lawfulness of the seizure under Article 10 of the ECHR.\textsuperscript{161}

On March 25, 1988, the public prosecutor sought a court order that the issue of Bluf! be withdrawn from circulation,\textsuperscript{162} which the court permitted. Finding that the seized items were “designed to commit the offence set out in Article 98 and/or Article 98a” of the Criminal Code—provisions criminalizing the intentional and unauthorized communication of state secrets—the court concluded that “the unsupervised possession of them was contrary to the law and the public interest,” and the measure was justified under Article 10 of the ECHR “on the grounds of maintaining ‘national security.’”\textsuperscript{165} Dismissing an appeal by the association, the Supreme Court held that seizure and withdrawal from circulation was appropriate “even though neither the applicant association nor any other person had had to answer for their actions in the criminal proceedings,” and the fact that the issue had been reprinted and distributed “did not necessarily have the consequence that secrecy should not be preserved.”\textsuperscript{166} The court further found that, “the court below had clearly shown that what was in

\footnotesize{\textsuperscript{156} Id. para. 10.  
\textsuperscript{157} Id. para. 11.  
\textsuperscript{158} Id. para. 12.  
\textsuperscript{159} Id. para. 13.  
\textsuperscript{160} Id. para. 14.  
\textsuperscript{161} Id. para. 15 (the association also argued, unsuccessfully, that “as the judicial investigation had been terminated, the measure had ceased to be justified.”). Id.  
\textsuperscript{162} Id. para. 16.  
\textsuperscript{163} Id. para. 17.  
\textsuperscript{164} Id. para. 20.  
\textsuperscript{165} Id. para. 17.  
\textsuperscript{166} Id. para. 18.}
issue in the instant case was information whose secrecy was necessary in the interests of the State.”\textsuperscript{167}

The ECtHR concluded that the compelled withdrawal from circulation of the issue of Bluf! constituted a violation of Article 10 of the ECHR.\textsuperscript{168} It was not disputed that “the impugned measures amounted to interferences by a public authority in the applicant association’s exercise of its freedom to impart information and ideas.”\textsuperscript{169} However, the Netherlands claimed that the interferences were permitted under Article 10, as “prescribed by law,” pursuing a legitimate aim under Article 10, and “necessary in a democratic society.”\textsuperscript{170}

The ECtHR accepted the Netherlands’ argument that that the interferences were “prescribed by law,” where “Bluf! imparted information whose secrecy was necessary in the interests of the State,” an offence under the Criminal Code.\textsuperscript{171} Likewise, the Court agreed that “the interferences were unquestionably designed to protect national security, a legitimate aim under Article 10.”\textsuperscript{172}

However, regarding the third limb, the ECtHR found that the removal from circulation “was not necessary in a democratic society” to achieve the aim of national security.\textsuperscript{173} The Court observed that the report was “six years old at the time of the seizure,” “it was of a fairly general nature,” and it “was marked simply ‘Confidential,’ which represents a low degree of secrecy.”\textsuperscript{174} In particular, the ECtHR underscored the public nature of the information, where “the information in question had already been widely distributed when the journal was withdrawn from circulation,”\textsuperscript{175} and “[t]hat being so, the protection of the information as a State secret was no longer justified.”\textsuperscript{176} The withdrawal from circulation “no longer appeared necessary to achieve the legitimate aim pursued,”\textsuperscript{177} and therefore, the measure violated Article 10.

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{167} Id.
\item \textsuperscript{168} Id. para. 23.
\item \textsuperscript{169} Id. para. 27.
\item \textsuperscript{170} Id. para. 28.
\item \textsuperscript{171} Id. para. 29.
\item \textsuperscript{172} Id. para. 36.
\item \textsuperscript{173} Id. para. 46. The ECtHR recognized that while an institution such as the BVD “must enjoy a high degree of protection” from disclosure, it nevertheless remained “open to question whether the information in the report was sufficiently sensitive to justify preventing its distribution.” Id. paras. 40-41.
\item \textsuperscript{174} Id. para. 41.
\item \textsuperscript{175} Id. para. 43.
\item \textsuperscript{176} Id. para. 45.
\item \textsuperscript{177} Id. The ECtHR did “not consider that it must determine whether the seizure carried out on 29 April 1987, taken alone, could be regarded as ‘necessary.’” Id. para. 42.
\end{enumerate}
\end{footnotesize}
Although the ECtHR commented, without further explanation, that “[i]t would have been quite possible . . . to prosecute the offenders,” it has continued to vigorously enforce the protections afforded under Article 10 of the ECHR in connection with disclosures in the public interest of sensitive government information.

4. PERMISSIBILITY OF SANCTIONS FOR DISCLOSURES BY GOVERNMENT EMPLOYEES: GUJA V. MOLDOVA

In a decision issued several years after Blul!, the ECtHR examined the permissibility of imposing sanctions on government employees who disseminate information without authorization, under Article 10 of the ECHR.

In Guja v. Moldova, the Grand Chamber of the Court confirmed that Article 10 protects the disclosure in the public interest of secret internal information by a government employee. The ECtHR recognized that “[t]he interest which the public may have in particular information can sometimes be so strong as to override even a legally imposed duty of confidence.” The case concerned the former Head of the Press Department of the Moldovan Prosecutor General’s Office who leaked two letters to the press and was subsequently dismissed for failing to first notify his superiors in accordance with internal policies. The letters revealed that a senior politician had exercised undue pressure on the Public Prosecutor’s Office. The applicant, Iacob Guja, believed he had acted in line with the President’s anti-corruption drive and with the intention of creating a positive image of the Office. On appeal from Guja’s civil action against the Prosecutor General’s Office, which had been denied, the court held that, given the particular circumstances of the case—pressure by a high-ranking politician on pending criminal cases—the penalty of dismissal for external reporting to a newspaper “was not ‘necessary in a democratic society.’”

The ECtHR described as a “balancing exercise” the determination of whether a state restriction is reconcilable with freedom of expression as protected by Article 10. The Court explained that, “[i]n de-

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178. Id. para. 45.
180. Id. para. 74.
182. Guja v Moldova, para. 97.
183. Id. para. 75.
termining the proportionality of an interference with a civil servant’s freedom of expression in such a case the Court must also have regard to a number of other factors.”¹⁸⁴ Specifically:

- The first factor to be considered is “whether there was available to the applicant any other effective means of remedying the wrongdoing which he intended to uncover.”¹⁸⁵ The Court recognized that “[i]n the light of [a civil servant’s] duty of discretion . . . disclosure should be made in the first place to the person’s superior or other competent authority or body.”¹⁸⁶ It is only where such a course of action is “clearly impracticable” that internal or classified government information may, “as a last resort,” be legitimately disclosed to the public.¹⁸⁷

- Secondly, courts should give regard to “the public interest involved in the disclosed information,” taking into account the limited scope under Article 10(2) of the ECHR “for restrictions on debate on questions of public interest.”¹⁸⁸ The Court explained that an effective democratic system requires “close scrutiny” of a government’s acts and omissions, which encompasses oversight “not only of the legislative and judicial authorities but also of the media and public opinion.”¹⁸⁹

- The third factor is “the authenticity of the information disclosed.”¹⁹⁰ In this regard, “[i]t is open to the competent state authorities” to formulate appropriate measures for addressing “defamatory accusations devoid of foundation or formulated in bad faith.”¹⁹¹ Thus, individuals who elect to disclose sensitive information “must carefully verify, to the extent permitted by the circumstances, that it is accurate and reliable.”¹⁹²

- “On the other side of the scales,” the Court will consider “the damage, if any, suffered by the public authority as a result of the dis-

¹⁸⁴. Id. para. 74.
¹⁸⁵. Id. para. 73.
¹⁸⁶. Id.
¹⁸⁷. Id.
¹⁸⁸. Id. para. 74.
¹⁸⁹. Id.
¹⁹⁰. Id. para. 75.
¹⁹¹. Id.
¹⁹². Id.
This may involve an assessment of “the subject-matter of the disclosure,” such as the type of national security interest to which the information relates, and any harm, or threat of harm, to that interest affected by disclosure. The Court must determine “whether such damage outweighed the interest of the public in having the information revealed.”

- The “motive behind the actions of the reporting employee” may also be relevant. Disclosure must not be the product of “personal grievance or a personal antagonism or the expectation of personal advantage”; rather, the individual must be acting in “good faith and in the belief that the information was true, that it was in the public interest to disclose [the information].”

- Finally, “attentive analysis of the penalty imposed on the applicant and its consequences” is necessary, to evaluate “the proportionality of the interference in relation to the legitimate aim pursued.”

The ECtHR conceded that disclosure may have “strong negative effects on public confidence in the independence” of the Prosecutor General’s Office. Nevertheless, the public interest in revealing “improper conduct by a high-ranking politician and the Government’s attitude towards police brutality” was considered so important in a democratic society that it outweighed the interest in maintaining confidence in a State institution. Moreover, there was no “effective alternative channel to make the disclosure,” the letters were undisputedly genuine, and dismissal, “the heaviest sanction possible,” had been imposed. Finding that the interference with the applicant’s right to freedom of expression therefore was not “necessary in a democratic society,” the ECtHR held that there had indeed been a violation of Article 10 of the Convention.

The fact that the Court reached this outcome despite Guja’s duty of discretion to his employer, a duty inapplicable to a journalist, demon-
strates the significance the Court places on good faith dissemination of information—even national security information—in the public interest.

D. Denmark

With a view to striking an equitable balance between national security concerns and the disclosure of confidential information in the public interest, Denmark has codified a public interest defense to crimes associated with the publication of state secrets. This legislative protection has been rigorously implemented by the Danish judiciary, as demonstrated in the unsuccessful prosecution of journalists Jesper Larsen, Michael Bjerre, and Niels Lunde.

1. CONSTITUTIONAL RIGHT TO FREEDOM OF EXPRESSION

Denmark provides robust protection for freedom of speech and freedom of the press—rights that are firmly embedded in the Danish Constitution. Section 77 of the Constitutional Act of Denmark states that “[a]ny person shall be at liberty to publish his ideas in print, in writing, and in speech, subject to his being held responsible in a court of law. Censorship and other preventive measures shall never again be introduced.”

2. RIGHT OF ACCESS TO INFORMATION

There are two principal statutes providing express rights of access to documents maintained by government bodies. Under the Danish Access to Public Administration Files Act, which governs requests by any person for access to documents received or issued by a public administration authority, “the right of access applies to all documents relating to the matter in question,” subject to certain exceptions. For example, certain documents may not be subject to a right of access

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207. OSCE Report at 117 (citing DAPAF § 5(1)).

208. Id. (citing DAPAF §§ 7–14).
“because of their sensitive nature,”\textsuperscript{209} while the right of access to information concerning specified subject matter may be limited, “if the need for protection is essential.”\textsuperscript{210}

Similarly, the Danish Public Administration Act, which governs rights of access to documents for parties to a matter in which a decision has or will be made by a public administration authority, recognizes a general right of public access, subject again to certain exceptions.\textsuperscript{211} Documents that are exempt under the statute include materials concerning criminal proceedings,\textsuperscript{212} an authority’s internal case material,\textsuperscript{213} and “other particularly sensitive types of documents,” listed under the law.\textsuperscript{214} In addition, certain enumerated information relating to “sensitive subject matter” is exempt, provided that “the considerations for limiting access decisively outweigh the interests of the involved party.”\textsuperscript{215} However, aside from criminal proceedings, there remains a “duty to disclose factual information contained in the exempt document which is important to the making of a decision.”\textsuperscript{216}

The right to public access that flows from the foregoing legislation applies equally to foreigners and Danish citizens,\textsuperscript{217} and does not distinguish between the media and private individuals.\textsuperscript{218}

3. PROHIBITIONS ON THE UNAUTHORIZED DISCLOSURE OF STATE SECRETS

The Public Administration Act provides that

any person acting within the public administration is bound by professional secrecy [under] Section 152 and Sections 152c-152f of the Danish Criminal Code, whenever information is designated as confidential by statute or other legally binding provision or when-

\textsuperscript{209}. Id. (citing DAPAF § 10).
\textsuperscript{210}. Id. (citing DAPAF § 13(1)).
\textsuperscript{211}. Id. at 118 (citing DPAA § 10(1)).
\textsuperscript{212}. Id. (citing DPAA § 9(3)).
\textsuperscript{213}. Id. (citing DPAA § 12(1)).
\textsuperscript{214}. Id. (referencing DPAA § 14(1)).
\textsuperscript{215}. Id. (referencing DPAA § 15(1)).
\textsuperscript{216}. Id. (citing DPAA §§ 12(2), 14(2)).
\textsuperscript{217}. The Access to Public Administration Files Act permits “any person” the right to “demand to be apprised of documents received or issued by an administration authority in the course of its activity.” OSCE Report at 118 (citing DAPAF § 4(1)). The Public Administration Act permits “any party to a matter in which a decision has or will be made by an administration authority” the right to “demand to be apprised of the documents of the matter.” Id. (citing DAPAF § 4(1) and DPAA §9(1)).
\textsuperscript{218}. “However . . . Section 4(1) of the Access to Public Administration Files Act provides that an administration authority may grant wider access to documents unless this is not allowed under the rules on secrecy etc. This rule is according to practice of particular relevance to journalists and media organizations.” Id. at 118.
ever it is otherwise necessary to keep the information secret to protect material public or private interests, including in particular . . . 1) the security of the State and the defence of the realm[; and] 2) Danish foreign policy and Danish external economic interests . . . .

In addition, under section 152(1) of the Danish Criminal Code (Straffeloven), any current or former public official “who unlawfully passes on or exploits confidential information” obtained by him or her in connection with their office or function, “shall be liable to a fine or to imprisonment for any term not exceeding six months.”

Private individuals are not subject to the statutory rules on professional secrecy. However, although the media are permitted to “publish information which originates from unauthorised disclosure,” such immunity may be revoked where “the information is strictly private or confidential because of its importance to the safety of the state or to the protection of the state defence.”

4. THE CODIFIED PUBLIC INTEREST DEFENSE TO THE DISCLOSURE OF STATE SECRETS AND DENMARK V. LARSEN

To safeguard disclosures on matters of public concern, the Danish Criminal Code contains an express public interest defense, which can be invoked to avoid sanction if a person is charged with disseminating confidential information. Section 152e of the Code states, “The provisions of sections 152–152d [penalizing publication of state secrets] do not include cases where the person . . . is acting in the legitimate exercise of obvious public interest or for his own or others’ best interests.”

Danish courts actively enforce the public interest defense to prevent prosecution for publishing confidential information where there is a clear public interest supporting disclosure. In 2006, charges were brought against the Editor-in-Chief of the Berlingske Tidende, Niels Lunde, and journalists Michael Bjerre and Jesper Larsen, for publishing state secrets in two 2004 articles. The articles disclosed classi-
fied intelligence reports that questioned the existence of weapons of mass destruction in Iraq. In December of that year, the Copenhagen City Court unanimously acquitted Lunde, Bjerre, and Larsen.

The question before the court was whether the defendants’ dissemination of confidential information could be characterized as “unjust,” or whether it was clear that the defendants acted “in the legitimate exercise of obvious public interest or for his own or others’ best interests,” consistent with section 152e of the Danish Criminal Code. The court held that the relevant provisions of the Criminal Code must be read in light of the free expression protections established by Article 10 of the ECHR and by the jurisprudence of the ECtHR. In so doing, the court balanced several factors, including (1) the national security interest to which the information relates, (2) the degree of actual harm to that interest caused by unauthorized disclosure, and (3) the significance of the public interest in knowing the information and facilitating debate on the issues raised.

During these proceedings, the Government underscored the harm to national security flowing from the newspaper articles, arguing that publication of names of specific foreign partners posed a serious risk to the Defense Intelligence’s ability to receive information from partners in the future. The court rejected this position, noting that there was no indication that the leak had in fact caused a real strain on relationships with partners. Moreover, several former foreign ministers and academics supported the defendants’ statement that, at the time of publication, there was a significant public interest in knowing the basis for the political decision for Denmark’s participation in the military action in Iraq. The court also found persuasive the witnesses’ opinion that the articles had a significant impact on this debate and the understanding of the intelligence service’s role. In balancing the foregoing considerations, the court held that the “considerable public interest” surrounding the decision by Denmark to take part in

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226. See U.S. State Dep’t Summary.
227. Id.
228. See Denmark v. Larsen.
229. Id.
230. Id.
231. Id.
232. Id.
233. Id.
the Iraq war, "outweighed the government’s fears for its intelligence operations." The court concluded that the defendants acted in justified preservation of the interest of the general public at the time it decided to publish classified information.

E. United Kingdom

Although the domestic law of the United Kingdom is generally considered weak in its protections for speech and expression, the country’s Human Rights Act of 1998 incorporates the European Convention on Human Rights into domestic law, thereby requiring secrecy legislation in the U.K.—including the country’s Official Secrets Act 1989 ("OSA")—to be interpreted consistently with Article 10 of the ECHR. Although the government has invoked the OSA with regard to the publications of national security reporters and authors, recent investigations and prosecutions have been abandoned prior to judicial review of the validity of proposed or actual charges.

1. THE HUMAN RIGHTS ACT AND ARTICLE 10 OF THE ECHR

The United Kingdom does not have one single constitutional document. Instead, guarantees for fundamental rights—such as the right to free expression—are embodied in a range of written documents. For example, the European Convention on Human Rights has been incorporated into U.K. law through the Human Rights Act of 1998, which requires, inter alia, that the domestic courts follow the decisions of the European Court of Human Rights when "determining a question which has arisen in connection with a Convention right," including Article 10, and that any statutory offenses implicating Convention rights "must be read and given effect in a way which is compatible with Convention rights."

Moreover, the Crown Prosecution Service ("CPS") is bound by the principles of the ECHR in determining whether to move forward with

\[\text{235. See Denmark v. Larsen; see also U.S. State Dep’t Summary.}\]
\[\text{238. See Section III.C.1, supra.}\]
\[\text{239. Human Rights Act, § 2(1).}\]
\[\text{240. See Section III.C.1, supra (describing the free expression rights guaranteed by Article 10 of the ECHR).}\]
\[\text{241. Human Rights Act, § 3(1).}\]
any prosecution. In a statement to the Leveson Inquiry—the commission established to investigate the culture, ethics, and practices of the press in the aftermath of the phone-hacking scandals involving the *News of the World* and other British print media—CPS Director Keir Starmer affirmed that “section 3 of the *Human Rights Act* 1998 requires all statutory offences which engage Convention rights to be read and given effect in a way which is compatible with those rights.” Because the common law and the Human Rights Act of 1998 recognize and protect the right to receive and convey information in the United Kingdom, he stated, any interference with those rights must be “necessary and proportionate.”

2. FREEDOM OF INFORMATION ACT

The United Kingdom has enacted right of access laws, including the Freedom of Information Act, which provide a general right to request and receive information held by public authorities, subject to express exemptions. Sections 23 and 24 provide exemptions from disclosure where the information “was directly or indirectly supplied to the public authority by” bodies dealing with security matters or where “required for the purpose of safeguarding national security.” These national security exemptions are “based on the effect that disclosure would have, not on the content or source of the information,” and “[i]nformation is not automatically exempt because it relates to national security matters.”


245. **Id. ¶ 14.**


247. **Id. § 1(1).**

248. **Id. §§ 21–44.**

249. **Id. §§ 23(1), (3), 24(1).**

Information is also exempt from public access rights where disclosure “would, or would be likely to, prejudice” the “defence of the British Islands or of any colony, or . . . the capability, effectiveness or security of any relevant forces”;\(^\text{251}\) the United Kingdom’s “[i]nternational relations”;\(^\text{252}\) or “relations between any administration in the United Kingdom and any other such administration.”\(^\text{253}\)

3. THE OFFICIAL SECRETS ACT 1989

The Official Secrets Act 1989 is the key statute prohibiting the unauthorized disclosure of government information in the United Kingdom. Section 5 of the OSA expressly criminalizes so-called “secondary disclosures,” that is, the publication by journalists or members of the public of protected information received from government employees in contravention of the law.\(^\text{254}\) While this section is subject to actual and objective harm tests, there is no express public interest defense. It provides that a secondary discloser “is guilty of an offence” if he or she receives protected information, including information relating to “security or intelligence, defence or international relations,”\(^\text{255}\) “without lawful authority” from a government representative\(^\text{256}\) and then discloses that information “without lawful authority knowing, or having reasonable cause to believe, that it is protected against disclosure”\(^\text{257}\) where “the disclosure by him is damaging” and he or she “kn[ew], or ha[d] reasonable cause to believe, that it would be damaging.”\(^\text{258}\)

4. LIMITS ON THE DISCRETION OF THE CROWN PROSECUTION SERVICE

Prosecutions pursued by the Crown Prosecution Service are restricted by administrative guidelines imposing a public interest analysis that examines the propriety of any proceeding charging an individual with violating secrecy and data protection laws. The Code for Crown Prosecutors explicitly obligates prosecutors to “swiftly stop cases . . . where the public interest clearly does not require a prosecution.”\(^\text{259}\)

\(^{251}\) Freedom of Information Act, § 26(1).

\(^{252}\) Id. § 27.

\(^{253}\) Id. § 28(1).

\(^{254}\) Official Secrets Act 1989, § 5.

\(^{255}\) Id. § 5(5)(a).

\(^{256}\) Id. § 5(1)(a)(i), (iii).

\(^{257}\) Id. § 5(2).

\(^{258}\) Id. § 5(3).

\(^{259}\) CPS Code for Crown Prosecutors § 3.3.
A determination to prosecute must pass the two-step process embodied in the CPS’s “Full Code Test.”\textsuperscript{260} First, at the Evidential Stage, the CPS must determine whether there is sufficient evidence to provide a “realistic prospect of conviction.”\textsuperscript{261} Second, the case passes to the Public Interest Stage, where the prosecutor must determine “whether a prosecution is required in the public interest.”\textsuperscript{262} Alternately stated, the case should not proceed where “there are public interest factors tending against prosecution which outweigh those tending in favour.”\textsuperscript{263} These factors include the seriousness of the offense, the suspect’s level of involvement, the impact of the alleged crime, the proportionality of prosecution as a response, and whether there are sources of information to be protected.\textsuperscript{264} Each case must be considered on its own facts and merits\textsuperscript{265} and should involve an “overall assessment of the public interest.”\textsuperscript{266}

CPS Director Starmer confirmed to the Leveson Inquiry that the CPS engaged in a public interest analysis in reaching the decision not to prosecute either a Home Office civil servant or a Member of Parliament for leaking confidential government information to a national newspaper.\textsuperscript{267} In that decision, CPS acknowledged that Article 10 of the ECHR strongly protects the “right of everyone to receive and impart information and ideas without interference.”\textsuperscript{268} While acknowledging that the right is not absolute, CPS stated that “any criminal proceedings which restrict the ability of the press to publish information and ideas on matters of public interest calls for the closest scrutiny.”\textsuperscript{269}

The CPS is in the process of drafting a policy that would provide guidance regarding the prosecution of journalists engaged in news-gathering, recognizing that “the law affords a wide measure of protection to journalists where a publication is in the public interest.”\textsuperscript{270} Ac-
According to Director Starmer, the draft policy would likely “bring together and reflect more clearly existing CPS policy and guidance” and would be subject to a consultation period.271

5. ABORTED INVESTIGATIONS AND PROSECUTIONS OF NEWSGATHERING ACTIVITIES UNDER THE OFFICIAL SECRETS ACT 1989

Despite these substantive and procedural hurdles, prosecutions against journalists and authors have been commenced in recent years—although none has been successful. For example, former Sunday Times reporter Tony Geraghty was arrested in December 1998 for the alleged violation of section five of the OSA, which criminalizes the unauthorized disclosure of protected government information; he was thereafter charged for having published a book that highlighted extensive British surveillance of the residents of Northern Ireland.272 A year later, a new attorney general elected to drop the charges.273 Additionally, an editor of The Sunday Times, Liam Clarke, was detained and threatened with prosecution in 1999 for articles that included allegations of wrongdoing by an undercover military unit operating in Northern Ireland, and a volunteer researcher for a comedy program, Julie-Ann Davies, was arrested in 2000 and questioned regarding her communications with an exiled former MI5 officer.274 Neither was ever charged with wrongdoing.275

F. Inter-American Court of Human Rights

Across the Atlantic, the Inter-American Court of Human Rights, in its interpretation and application of the right to freedom of thought and expression guaranteed by the American Convention on Human Rights, has recognized both a broad public right of access to information that includes information related to military activities and limits on the

271. Id. ¶ 31.
273. Id.
274. ARTICLE 19 AND LIBERTY § 4.3; Student Arrested Over Shayler Link, GUARDIAN (Mar. 7, 2000), http://www.theguardian.co.uk/politics/2000/mar/07/freedomofinformation.uk.
275. For a discussion of the Spycatcher cases, in which the U.K. Attorney General sought to enjoin the publication, by various media entities, of information provided by a former State Security officer, see Section II.C.2., which describes the proceedings in the English courts as well as the judgments ultimately issued by the ECHR.
criminal prosecutions for expression touching upon matters of national security.276

1. ARTICLE 13 OF THE AMERICAN CONVENTION ON HUMAN RIGHTS

Article 13.1 of the Convention broadly guarantees the right to free expression. It provides that “[e]veryone has the right to freedom of thought and expression,”277 and explains that “[t]his right includes freedom to seek, receive, and impart information and ideas of all kinds, regardless of frontiers, either orally, in writing, in print, in the form of art, or through any other medium of one’s choice.”278

2. THE RIGHT TO INFORMATION

In Claude-Reyes v. Chile, the Inter-American Court first established that Article 13 embodies a public right of access to state-held information.279 This case arose from a records request filed with the Chilean Foreign Investment Committee, which sought information about the Rio Condor Project, a “forestry exploitation project that caused considerable public debate owing to its potential environmental impact.”280 The request was denied in part, which denial was upheld by the Chilean Supreme Court, and the matter eventually reached the Inter-American Court of Human Rights.281

In its judgment, the Inter-American Court reconfirmed that “the right to freedom of thought and expression includes . . . ‘the right and freedom to seek, receive and impart information and ideas of all kinds,’” which is viewed as a “positive right.”282 From this foundation, the court expressly recognized:

Article 13 of the Convention protects the right of all individuals to request access to State-held information, with the exceptions

276. International advocacy organizations have recognized the Inter-American system as a “global leader” in the area of access law, given the broad guarantees provided by the American Convention for the right to seek and receive information. See Amicus Curiae Submission in the Case of Gomes Lund v. Brazil of Amici Curiae Open Society Justice Initiative, et al., OPEN SO’Y FOUND. (June 2010), available at http://www.opensocietyfoundations.org/sites/default/files/araguaia-amicus-english-20100601.pdf.
278. Id. note 8.
279. Claude-Reyes v. Chile, supra note 8.
281. Claude-Reyes, ¶¶ 1–2, 57(31).
282. Id. ¶ 76.
permitted by the restrictions established in the Convention. Consequently, this article protects the right of the individual to receive such information and the positive obligation of the State to provide it, so that the individual may have access to such information or receive an answer that includes a justification when, for any reason permitted by the Convention, the State is allowed to restrict access to the information in a specific case.283

In this, the court held that democratic societies are “governed by the principle of maximum disclosure, which establishes the presumption that all information is accessible” and the burden rests on the state to demonstrate that any information withheld fits into Article 13’s “limited system of exceptions.”284 Alternately stated, the state is under a positive obligation to either provide the information requested or, if it restricts access on a basis permitted by the Convention, provide a response that justifies the restriction.285

The court set out a three-part test for evaluating the legitimacy of restrictions on access rights. First, any restriction must be “expressly established by law” to ensure that it is not employed “at the discretion of public authorities.”286 Second, the restriction must correspond to a purpose identified in Article 13.2, which limits permissible restrictions to those that are “necessary to ensure ‘respect for the rights or reputations of others’ or ‘the protection of national security, public order, or public health or morals.’”287 Third, the restriction must be “necessary in a democratic society” and designed “to satisfy a compelling public interest.”288 To fulfill this requirement, “the restriction must be proportionate to the [justifying] interest” as well as “appropriate for accomplishing this legitimate purpose, interfering as little as possible with the effective exercise of the right.”289

283. Id. ¶ 77.
284. Id. ¶¶ 92–93.
285. Id. ¶¶ 77, 92–93. In recognizing this right, the court noted the “regional consensus” as to “the importance of access to public information and the need to protect it,” id. ¶ 78, a consensus reflected in resolutions issued by the General Assembly of the Organization of American States, the provisions of the Inter-American Democratic Charter, and the provisions of the Nueva Leon Charter, id. ¶¶ 78–80. A concise overview of the right to information in Latin America can be found in The Latin American Approach to Transparency and Access to Information, ELLA (May 2012), available at http://ella.practicalaction.org/sites/default/files/120424_GOV_TraAcclnff_GUIDE.pdf.
286. Claude-Reyes, ¶¶ 58(f), 89.
287. Id. ¶ 90 (quoting Article 13.2).
288. Id. ¶ 91.
289. Id. In this case, the court concluded that the denial of access failed the very first prong of this test, as it was not “based on law,” that is, at the relevant time, “there was no legislation in Chile that regulated the issue of restrictions to access to State-held information.” Id. ¶ 94.
Therefore, in *Gomes Lund v. Brazil*, the Inter-American Court struck down, as incompatible with the Convention, a 1979 Brazilian law granting amnesty for offenses committed during Brazil’s military dictatorship.\(^{290}\) One aspect of this case involved the denial by the government of access to information and records regarding military operations in the 1970s against a leftist movement known as *Guerrilla do Araguaia*, access requested by the family members of those killed during the operations in support of judicial proceedings alleging human rights violations by the former regime.\(^{291}\)

The court reaffirmed that the right to seek, receive, and impart ideas of all kinds is encompassed in Article 13’s guarantees for freedom of thought and expression,\(^{292}\) and that the state governments have a positive obligation to provide requested information under their control,\(^{293}\) subject only to limited exceptions.\(^{294}\) The right to access to information includes the right to know the truth, seen here as the right of “the next of kin of the victims of gross human rights violations . . . to know the truth . . . in cases of enforced disappearance.”\(^{295}\)

Moreover, given the positive obligation of the state, the court determined that “authorities cannot resort to mechanisms such as official secret or confidentiality of the information, or reasons of public interest or national security, to refuse to supply the information.”\(^{296}\)

Because Article 13 prohibits a state from withholding information—even classified military information and documents—pertaining to human rights violations, the Inter-American Court specifically held that those provisions of the Brazilian amnesty law “that prevent the investigation . . . of serious human rights violations are not compatible with the American Convention, lack legal effect, and cannot continue as obstacles for the investigation of the facts” underlying human rights abuses.\(^{297}\)


\(^{291}\) *Id.* ¶¶ 1–2.

\(^{292}\) *Id.* ¶¶ 196, 228, 230.

\(^{293}\) *Id.* ¶¶ 197, 228.

\(^{294}\) *Id.* ¶¶ 199, 229.

\(^{295}\) *Id.* ¶ 200–01.

\(^{296}\) *Id.* ¶ 202 (further concluding that, “when it comes to the investigation of punishable facts, the decision to qualify the information as secretive or to refuse to hand it over cannot stem solely from a State organ whose members are charged with committing the wrongful acts. In the same sense, the final decision on the existence of the requested documentation cannot be left to its discretion”).

\(^{297}\) *Id.* ¶ 325(3).
3. LIMITS ON CRIMINAL PROSECUTIONS FOR EXPRESSION RELATED TO NATIONAL SECURITY

Although the Inter-American Court has not yet been confronted with any case in which a journalist has been charged for, or enjoined from, publication on national security matters, in Palamara-Iribarne v. Chile, it invalidated the criminal convictions of a retired Chilean Navy officer who attempted to publish a book allegedly disclosing “secret or confidential information without prior written authorization from the relevant authorities” and who held a press conference where he “criticized the actions taken by the Office of the Naval Prosecutor in the proceedings against him.”

In March 1993, the Deputy Naval Prosecutor issued a seizure order and entered the home of Humberto Palamara-Iribarne, where 874 copies of his book were seized. For unauthorized publication of the book, the retired officer thereafter “was prosecuted for two counts of disobedience and correspondingly convicted.”

On application to the Inter-American Court, the Inter-American Commission on Human Rights alleged that that the acts of searching the officer’s home, seizing copies of the book and related materials, and banning future publication were “incompatible with Article 13.” Representatives for Palamara-Iribarne further argued that the charges and conviction for disobedience and breach of military duties, “constituted a direct attempt to prevent the publication of the book.” The representatives urged that “[e]ven ‘if the argument by the State were to be accepted’ regarding the determination of subsequent liability to protect national security, the book written by Mr. Palamara-Iribarne did not reveal any military secrets, nor did it affect national secur-

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300. Id. ¶ 269(12).
301. Id. ¶ 66(e).
302. Id. ¶ 63(72).
303. Id. ¶ 63(20).
304. Id. ¶ 2. In addition, Palamara-Iribarne was charged with “contempt of authority” for the statements he made at the press conference, and a guilty verdict was returned. Id.
305. Id. ¶ 64(a). The Commission further asserted that the conviction for contempt of authority “grounded on his criticism of public officials conduct,” also violated Article 13, because it “constitutes an imposition of subsequent liability on the exercise of the freedom of expression that is unnecessary in a democratic society.” Id. ¶ 64(c).
306. Id. ¶ 65(c).
ity.” In response, the Government of Chile claimed that Palamara-Iribarne “was not subject to prior censorship, but to subsequent liability, which is explicitly provided by law” and “grounded on the urgent need to ensure protection of national security.” It further asserted that, as a Navy officer, Palamara-Iribarne “was not allowed to disclose secret or confidential information without prior written authorization from the relevant authorities,” and the publication was banned as a result of “the author’s negligence to request authorization for publication in a timely manner.”

The Court concluded that the officer’s freedom of thought and expression under Article 13 had been violated. The Court considered it “logical” that Palamara-Iribarne’s “training and professional and military experience helped him write the book and that it does not entail *per se* an abuse of his right to freedom of thought and expression.” In addition, the “duty of confidentiality” owed by “employees or officers of an institution,” is “not applicable to information related to the institution or the duties performed by it that is already in the public domain,” and therefore, the content of the duty “w[as] not . . . examined insofar as it has been established that Mr. Palamara-Iribarne used information from ‘open sources.’” The Court therefore held that the “measures adopted by the State to prevent the distribution of the book”—including “instituting [criminal] proceedings against Mr. Palamara-Iribarne for disobedience and breach of military duties,” prohibiting “Palamara-Iribarne from publishing his book,” and “seiz[ing] the copies thereof”—“constituted acts of prior censorship that are incompatible with the parameters” of Article 13 of the American Convention.

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307. *Id.* ¶ 65(b).
308. *Id.* ¶ 66(b).
309. *Id.* ¶ 66(e).
310. *Id.* ¶ 78.
311. *Id.* ¶ 76. The court explained that “[a]ny interpretation to the contrary would prevent individuals from using their education or professional training to enrich the expression of their ideas and opinion.” *Id.*
312. *Id.* ¶ 77.
313. *Id.* ¶ 78.
314. *Id.* ¶ 70.
315. *Id.* ¶ 78. This court also held that the contempt charges stemming from the statements made at the press conference violated Article 13; specifically, the Court found that the comments concerned a matter of public interest—the conduct of the naval prosecutor and the criminal military proceedings involving Palamara-Iribarne, *id.* ¶ 82—and that the related charges and potential sanctions “were disproportionate to the criticism leveled at government institutions and their members, thus suppressing debate, which is essential for the functioning of a truly democratic system, and unnecessarily restricting the right to freedom of thought and expression.” *Id.* ¶ 88.
G. United States

Freedom of expression enjoys robust protection under the U.S. Constitution and statutory law. It is well established that the First Amendment to the federal constitution protects the dissemination of sensitive government information in the public interest. And U.S. courts repeatedly have expressed doubts that the prosecution of a member of the press or any private individual for publishing protected government information would be constitutionally permissible, in a general recognition that “[a] statutory scheme that purports to criminalize such activity, without both specifying and cabining its reach, would be unlikely to survive a constitutional challenge.” Thus, although unsettled—because the U.S. government has not attempted to pursue the prosecution of a journalist under any such law—there likely exists an extraordinary threshold that the government must overcome to pursue a constitutionally-valid prosecution of a member of the media for the publication of state secrets in the public interest.

1. THE FIRST AMENDMENT AND THE PENTAGON PAPERS CASE

The First Amendment to the Constitution of the United States provides that “Congress shall make no law . . . abridging the freedom of speech or of the press.” Pursuant to this constitutional right, the U.S. Supreme Court, in

New York Times Co. v. Sullivan,

condemned the Sedition Act of 1798—a law having the practical effect of criminalizing criticism of the government during times of unrest—as unconstitutional, effectively discrediting the notion that the government may prosecute its detractors on national security grounds. However,
it was not until 1971, in the Pentagon Papers Case, that the right of the government to restrain the press from publishing state secrets was tested in the Supreme Court. The federal government sought to enjoin two newspapers from publishing the contents of a classified historical study of the United States’ involvement in the Vietnam War, claiming that the exposure would threaten the government’s ability to conduct that war and would endanger American lives. A split majority rejected the government’s position, holding that “‘[a]ny system of prior restraints of expression comes to this Court bearing a ‘heavy presumption against its constitutional validity.’”

A separate concurring opinion by Justice Hugo Black explained that, “[b]oth the history and language of the First Amendment support the view that the press must be left free to publish news, whatever the source, without censorship, injunctions or prior restraints.” Recognizing that “[t]he word ‘security’ is a broad, vague generality whose contours should not be invoked to abrogate the fundamental law embodied in the First Amendment,” Justice Black concluded:

The greater the importance of safeguarding the community from incitements to the overthrow of our institutions by force and violence, the more imperative is the need to preserve inviolate the constitutional rights of free speech, free press and free assembly in order to maintain the opportunity for free political discussion, to the end that government may be responsive to the will of the people and that changes, if desired, may be obtained by peaceful means. Therein lies the security of the Republic, the very foundation of constitutional government.

posed upon criticism of government and public officials, was inconsistent with the First Amendment” (footnote omitted). For an overview of the potential liability of journalists for receiving and reporting information that may endanger national security in the United States, and the historical backdrop against which this has played out, see Lee Levine & Julia Atcherley, The First Amendment and National Security, in National Security Law in the News: A Guide for Journalists, Scholars and Policy-Makers 13–24 (Paul Rosensweig et al. eds., 2012).

322. Id. at 718 (government arguing that “[t]here are other parts of the Constitution that grant powers and responsibilities to the Executive, and . . . the First Amendment was not intended to make it impossible for the Executive to function or to protect the security of the United States.” (alterations in original) (citations and internal quotation marks omitted)).
323. Id. at 714 (Black J. & Douglas J., concurring) (citation omitted) (unsigned opinion speaking for six of the nine justices).
324. Id. at 717 (“Only a free and unrestrained press can effectively expose deception in government.”).
325. Id. at 719-20.
In the wake of *New York Times Co. v. Sullivan* and the Pentagon Papers Case, the freedom of the press to report on sensitive national security information is firmly established in the United States.

2. RIGHT OF ACCESS TO INFORMATION

State and federal jurisdictions in the United States have enacted statutes establishing the right of members of the public, including the media, to request and receive government information. The federal Freedom of Information Act ("FOIA") provides that every government agency must make all of its records available for public inspection, unless a record falls within one of the Act's nine exemptions. One exemption is classified information—"matters that are . . . specifically authorized under criteria established by an Executive order to be kept secret in the interest of national defense or foreign policy"—but only to the extent the records "are in fact properly classified."

For the exemption to apply, the government must demonstrate both that it properly classified the information procedurally and that there is "a logical connection" between public access to the information and some likely harm to national security. To satisfy this burden, the government must identify the potential harm to national security with "reasonable specificity" through declarations and other admissible evidence. While courts "accord substantial weight to an agency's" submissions, they have an independent responsibility to "review de novo the agency's use of a FOIA exemption to withhold documents."

In determining whether a FOIA exemption applies, the court considers "whether on the whole record the [a]gency's judgment

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327. 5 U.S.C. § 552(b)(1)-(9).
328. 5 U.S.C. § 552(b)(1). Various federal statutes provide the U.S. government authority to classify national security information, and regulate the access to such information. See, e.g., 50 U.S.C. § 426 (definition of "classified information"); 50 U.S.C. § 435 (authority for "Executive order[s] or regulation[s] . . . govern[ing] access to classified information").
330. Amnesty Int’l USA v. C.I.A., 728 F. Supp. 2d 479, 517 (S.D.N.Y. 2010). "The requirement of reasonable specificity . . . forces the government to analyze carefully any material withheld, it enables the trial court to fulfill its duty of ruling on the applicability of the exemption, and it enables the adversary system to operate by giving the requester as much information as possible, on the basis of which he can present his case to the trial court." *Id.* (internal citations and quotations omitted). See also Rosenfeld v. U.S. DOJ, 57 F.3d 803, 807 (9th Cir. 1995).
objectively survives the test of reasonableness, good faith, specificity, and plausibility.”

3. THE ESPIONAGE ACT OF 1917, UNITED STATES V. MORISON, AND UNITED STATES V. ROSEN

Despite the broad protection afforded the press under the First Amendment and relevant Supreme Court jurisprudence, some have asserted that certain provisions of the Espionage Act of 1917, in theory, could give rise to criminal liability for the publication by the press of state secrets. Section 793(d) of the Act prohibits anyone lawfully having possession of any document, writing, or photograph, among other tangible materials, or any other information “relating to the national defense”—which “the possessor has reason to believe could be used to the injury of the United States or to the advantage of any foreign nation”—from “willfully” communicating or transmitting it to anyone not entitled to receive it. Section 793(e) prohibits the unauthorized possession, retention (and failure to return) or communication of documents or, other tangible materials, or any other information “relating to the national defense”—again, when the recipient has reason to believe that the document or information could be used to the injury of the United States or to the advantage of any foreign nation.

In the 1988 decision of United States v. Morison, the U.S. Fourth Circuit Court of Appeals reflected on whether a member of the press may be prosecuted under the Espionage Act for disseminating national security-related information. Former naval intelligence employee Samuel Loring Morison was convicted under the Act for the unauthorized possession of satellite secured photographs of Soviet naval preparations and for the transmittal of those photographs to the British publication Jane’s Defence Weekly. On appeal, the Fourth Circuit affirmed the conviction, holding that sections 793(d) and (e) of the Act prohibit the willful communication of information “to a person not entitled to receive it” and that the press was not entitled “to receive” the classified photographs. However, charges were never

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334. Id. § 793(e).
335. 844 F.2d 1057 (4th Cir. 1988).
336. Id. at 1060.
337. Id. at 1065–66 (“It seems abundantly clear from [the] legislative history that sections 793(d) and (e) . . . were intended to criminalize the disclosure to anyone ‘not entitled to receive it.’”).
338. Id. at 1078 (“the decisive point is that . . . Jane’s Defence Weekly, the ones to whom the defendant transmitted the secret material in this case, did not have a
brought against journalists with *Jane’s Defence Weekly*, and two of the three judges on the appellate panel questioned whether such a prosecution would be constitutional, observing that “Morison as a source would raise newsgathering rights on behalf of press organizations that are not being, and probably could not be, prosecuted under the espionage statute” and that Morison’s conviction should not be understood as “threatening the vital newsgathering functions of the press.”

In *United States v. Rosen*, apparently for the first time, the government sought to impose criminal liability on private citizens for receiving and communicating information acquired from an individual who may have unlawfully obtained or disclosed the information. Private lobbyists, Steven J. Rosen and Keith Weissman, were indicted by a federal grand jury and charged under sections 793(d) and (e) of the Espionage Act with conspiring unlawfully to receive classified information from a government official, and with transmitting that information to the press and other third parties.

Rosen and Weissman argued that prosecution under the Act for receiving classified information from a source and publishing it violated the First Amendment. The federal trial judge ruled that the prosecution of an ordinary citizen who was not a public official was permitted under the Espionage Act and was not wholly inconsistent with the First Amendment. Nevertheless, the judge held that the statute must be “narrowly and sensibly tailored to serve the government’s legitimate interest in protecting the national security” in order to survive First Amendment scrutiny. As a result, a prosecution under the Espionage Act required the government to demonstrate

1. “that the information relates to the nation’s military activities, intelligence gathering or foreign policy” and is “closely held” by the government;
2. that disclosure of the information “could cause injury to the nation’s security”;
3. that the defendant’s violation of the statute was willful, i.e., he or she “knew the nature of the information, knew that the person

“Secret” clearance and were thus, to the knowledge of the defendant, not qualified to receive the information.”

339. *Id.* at 1081 (Wilkinson, J., concurring).
340. *Id.* at 1086 (Phillips, J., concurring).
341. 445 F. Supp. 2d 602 (E.D. Va. 2006), aff’d, 557 F.3d 192 (4th Cir. 2009). This case is often called the AIPAC prosecution, as the defendants were former employees of the American Israel Public Affairs Committee.
342. *Id.* at 643.
343. *Id.*
with whom they were communicating was not entitled to the in-
formation, and knew that such communication was illegal, but
proceeded nonetheless”; and

4. where the information is intangible, as opposed to in physical
form, that the defendant demonstrated “bad faith,” i.e., “the de-
fendant had a reason to believe that the disclosure of the infor-
mation could harm the United States or aid a foreign nation.”344

The government abandoned its prosecution of Rosen and Weiss-
man, effectively conceding that it could not meet the heightened intent
requirement the court had imposed.345

Thus, although not yet tested in the courts, First Amendment-
based principles well-established in U.S. law “suggest that, at a
minimum, the solicitation, receipt, and publication of information
by the press can constitutionally be deemed to violate such statutes
only if their scope is cabined, by legislative amendment or judicial
decision, in material ways.”346 Specifically, legal commenters have concluded

[At a minimum, the application of such statutes to the press . . .
can survive First Amendment scrutiny only if construed to re-
quire that (1) the press conduct at issue be unrelated to commu-
nicative acts involving the transmission of information, or (2) the
defendant evince some bad-faith purpose other than and beyond
the intent to obtain information for the purpose of reporting it
to the public.347

Any broader interpretation would run afoul of the constitutional
protections that “the Supreme Court has recognized on several occa-
sions” as applying to a “range of press conduct that involves ‘solicit-
ing, inquiring, requesting, and persuading’ sources ‘to engage in the
unauthorized and unlawful disclosure of information.’”348

H. The Johannesburg Principles on National Security, Freedom
of Expression, and Access to Information

The Johannesburg Principles349 were adopted in 1995 by a group of
experts in international law and human rights convened by the interna-

344. *Id.*
345. Levine et al., *supra* note 320, at 1016.
346. *Id.* at 1036.
347. *Id.*
348. *Id.* (citing Nicholson v. McClatchy Newspapers, 223 Cal. Rptr. 58, 64 (Ct.
App. 1986)).
tional advocacy organization Article 19 and the Centre for Applied Legal Studies of the University of the Witwatersrand.\textsuperscript{350}

Drawing on international and regional law, applicable standards, and evolving state practice, the Johannesburg Principles address the extent to which governments may legitimately suppress freedom of expression and access to information in order to safeguard national security. The Principles “set a high standard of respect for freedom of expression, confining claims based on national security to what States can legitimately justify.”\textsuperscript{351} Thus, while recognizing that restrictions on the right to seek, receive, and disclose information are permitted in certain circumstances, the Principles conclude that national security cannot not be a catchall category for prohibiting access to information.

1. RELEVANT PRINCIPLES

Under the Johannesburg Principles, “the public interest in knowing the information shall be a primary consideration” in all laws touching on rights to access and disclose information.\textsuperscript{352} They expressly cite a number of illegitimate grounds for claiming a national security interest, such as protecting the government from embarrassment and entrenching a particular ideology.\textsuperscript{353}

Punishment for disseminating information is prohibited in cases where disclosure does not result in actual harm or likelihood thereof, or where the overall public interest is served by disclosure.\textsuperscript{354} Moreover, where a state seeks to justify a restriction on the disclosure of information “on grounds of national security,” the government

- “must have the genuine purpose and demonstrable effect of protecting a legitimate national security interest”;\textsuperscript{355}
- must establish that the restriction is “necessary to protect a legitimate national security interest,” by evidencing that


\textsuperscript{351}. Mendel, \textit{supra} note 350, at 1.

\textsuperscript{352}. \textit{JOHANNESBURG PRINCIPLES}, \textit{supra} note 13, at 11 (Principle 13).

\textsuperscript{353}. \textit{Id.} at 8 (Principle 2).

\textsuperscript{354}. \textit{Id.} at 11–12 (Principle 15).

\textsuperscript{355}. \textit{Id.} at 8 (Principle 1.2).
• the information “poses a serious threat to a legitimate national security interest”;
• “the restriction imposed is the least restrictive means possible for protecting that interest”; and
• “the restriction is compatible with democratic principles.”

The Principles acknowledge that, even where effective freedom of information legislation is in place, there may still be situations where disclosure is refused and it is only through an unauthorized leak that important information—such as exposure of government corruption or wrongdoing—may become public. Thus, prohibitions on prosecution extend not only to situations where the media publishes classified information, but also to protect the civil servant responsible for the primary disclosure to the media.

2. WIDESPREAD RECOGNITION OF THE JOHANNESBURG PRINCIPLES

The Johannesburg Principles have been “widely endorsed by international law scholars and UN experts,” and referenced by courts around the world. They have been relied upon by “judges, lawyers, civil society actors, academics, journalists and others, all in the name of freedom of expression.” The core conclusion of the Principles—that no person may be punished for the disclosure of information on national security grounds if “the public interest in knowing the information outweighs the harm from disclosure”—has been endorsed by the UN Special Rapporteur, the OSCE Representative on Freedom of the Media, and the OAS Special Rapporteur in a Joint Declaration on Freedom of Information and Secrecy Legislation.

I. Council of Europe

Through committee and parliamentary assembly resolutions and recommendations, the Council of Europe has repeatedly recognized

356. Id. (Principle 1.3).
357. Coliver, supra note 350, at 7.
360. JOHANNESBURG PRINCIPLES, supra note 13, at 11–12 (Principle 15).
the importance of protecting and encouraging public access to sensitive government information.

On October 6, 2010, the Council of Europe’s Committee on Culture, Science, and Education unanimously adopted a Draft Recommendation advocating protection for public interest disclosures based in free expression rights:

Insofar as Article 10 of the Convention protects the right of the public to be informed on matters of public concern, anyone who has knowledge or information about facts of public concern should be able to either post it confidentially on third-party media, including Internet networks, or submit it confidentially to journalists.362

This followed the position taken by the Council of Europe Parliamentary Assembly, through the adoption of Resolution 1729,363 that member states should enact comprehensive legislation protecting whistleblowers who speak up in the public interest. The Assembly also recommended that the CoE Committee of Ministers “look into ways and means of enhancing the protection of . . . journalists, who expose corruption, human rights violations, environmental destruction or other abuses of public authority, in all Council of Europe member states.”364

Endorsing the need for a public interest override in legislation governing access to government information, the Council of Europe has taken a formal position that the existence of “an overriding public interest in disclosure” prevails over other concerns, including potential risks to national security.365

Previously, the Committee of Ministers of the Council of Europe recognized the threat to the press in times of crisis, adopting Guidelines related to balancing the freedom of expression and national se-

365. See Convention on Access to Official Documents, art. 3(2), Nov. 27, 2008, CETS No.: 205, available at http://conventions.coe.int/Treaty/en/Treaties/html/205.htm. Article 3 of the Convention on Access to Official Documents states that, “unless there is an overriding public interest in disclosure,” id., art. 3(2), “[a]ccess to information contained in an official document may be refused if its disclosure would or would be likely to harm” interests including “national security, defence and international relations,” id., art. 3(1)(a), and “public safety,” id., art. 3(1)(b).
curity interests. The Guidelines urged member states to “protect the right of journalists not to disclose their sources of information” and not require journalists “to hand over information or material . . . gathered in the context of covering crisis situations nor should such material be liable to seizure for use in legal proceedings.”

Emphasizing the practical and effective implementation of Article 10 of the ECHR, relevant ECtHR jurisprudence, and other Council of Europe texts, the Guidelines state, “There is no need to amend these standards or to elaborate new ones. Instead, we should focus on the practical problems linked to their implementation. At the very least, national governments and parliaments should incorporate these standards into their national regulatory frameworks and implement them rigorously.”

Observing the importance of investigative journalism on matters of public concern, the guidelines also incorporate a warning from the Committee that crisis situations, such as wars and terrorist attacks, may tempt governments to unduly restrict these rights of media professionals.

J. International Convention on Civil and Political Rights

Article 19 of the International Convention on Civil and Political Rights (“ICCPR”) guarantees the right to freedom of expression, which encompasses the “freedom to seek, receive and impart information and ideas of all kinds, regardless of frontiers, either orally, in writing or in print, in the form of art, or through any other media of his choice.” The ICCPR states these rights are “subject to certain restrictions, but

368. 2007 Committee of Ministers Guidelines, supra note 366, ¶ 1, 3, 17–19.
370. ICCPR, supra note 369, art. 19, ¶ 2.
these shall only be such as are provided by law and are necessary . . . [f]or respect of the rights or reputations of others [or] [f]or the protection of national security or of public order or of public health or morals.”371 The General Comments on Article 19 prepared by the Human Rights Committee, Office of the United Nations High Commissioner for Human Rights,372 are instructive in understanding the intended implementation of this provision, and what qualifies as compliance.

When a state party invokes a legitimate ground for restriction of freedom of expression, such as public welfare or national security, that State “must demonstrate in specific and individualized fashion the precise nature of the threat, and the necessity and proportionality of the specific action taken, in particular by establishing a direct and immediate connection between the expression and the threat.”373 Constraints on the dissemination of information must be directly related and narrowly tailored to the specific need upon which they are predicated, that is, “[r]estricions must not be overbroad.”374 The Committee provides further guidance in this respect, requiring that restrictive measures “conform to the principle of proportionality,” and be both “appropriate” and “the least intrusive instrument” for achieving their protective function.375 The form of expression at issue is also relevant, with greater protection afforded to matters of public debate.376

Finally, when a state party imposes restrictions on the exercise of freedom of expression, “these may not put in jeopardy the right itself.”377 State parties should avoid state secrets laws that disregard the potential public interest in disclosing confidential government information in a particular case, or adopting catch-all provisions that risk encompassing unrelated, legitimate forms of expression. Thus, the Committee cautions against overly restrictive domestic secrecy legislation; such provisions must be “crafted and applied in a manner that conforms to the strict requirements of paragraph 3 [of Article 19].”378

371. Id., art. 19, ¶ 3.
373. See id. ¶ 35.
374. Id. ¶¶ 22, 34.
375. Id. ¶ 34.
376. Id.
377. Id. ¶ 21. See also ICCPR, supra note 369, art. 5, ¶ 1 (“nothing in the present Covenant may be interpreted as implying for any State, group or person any right to engage in any activity or perform any act aimed at the destruction of any of the rights and freedoms recognized herein or at their limitation to a greater extent than is provided for in the present Covenant.”).
378. General Comment No. 34, supra note 372, ¶ 30.
Any restriction on expression or the dissemination of information constitutes a serious curtailment of human rights, which is amplified in the context of disclosures on matters of public concern. Thus, under the framework of the ICCPR, state secrecy laws should be narrowly tailored to the protection of national security, and proportionate to that aim, taking into account any potential public interests favoring disclosure.

K. African Charter on Human and Peoples’ Rights

The Organization of African Unity, now the African Union, adopted the African Charter on Human and Peoples’ Rights in 1981. Also called the Banjul Charter, this instrument was created to protect an array of individual and community rights and freedoms across the African continent. The Charter has been ratified by 53 member states of the African Union.379

Article 9 of the Charter protects the individual’s right to receive and disseminate information, providing that “[e]very individual shall have the right to receive information” and “shall have the right to express and disseminate his opinions within the law.”380

The Charter established the African Commission on Human and Peoples’ Rights, which is charged with interpreting the Charter and protecting and promoting human and peoples’ rights.381 In order to address “in a holistic and comprehensive manner the major threats to freedom of expression and information” in Africa and to “serve as a benchmark to evaluate states[’] compliance with Article 9” of the Charter,382 the Commission adopted the Declaration of Principles on Freedom of Expression in Africa.383


The Declaration contains express protections for freedom of information that specifically recognize a right of information stemming from the principle that public bodies hold information “not for themselves but as custodians of the public good.”\textsuperscript{384} The Declaration further provides that

- the right to information “shall be guaranteed by law”;
- no one shall be subject to any sanction for releasing in good faith information on wrongdoing, or that which would disclose a serious threat to health, safety or the environment save where the imposition of sanctions serves a legitimate interest and is necessary in a democratic society”; and
- “secrecy laws shall be amended as necessary to comply with freedom of information principles.”\textsuperscript{385}

III. Recognition of Substantial Free Expression-Based Restrictions on the Prosecution of Journalists under State Secrets Laws

As the forgoing discussion demonstrates, in the international community, principles of free expression are widely recognized as imposing significant constraints on the validity of any prosecution of a journalist for obtaining, possessing, or publishing protected state information in violation of a state secrets or similar law. The jurisprudence surveyed evidences that the constraints emanate from four primarily limitations. As such, despite the weighty interests in protecting public security and deterring the unauthorized dissemination of information believed to be detrimental to such security, when the state secrets law is applied to newsgathering activities, that law must, at a minimum, be circumscribed in the following ways:\textsuperscript{386}

First, the law may not be vague, but must expressly and clearly define the scope of information that is protected, such that the zone of risk for criminal sanction is plainly delineated and the terms of the law are sufficiently specific to prevent arbitrary or discriminatory enforcement.

\textsuperscript{384.} Declaration of Principles, \textit{supra} note 383, § IV.1, 2 (“everyone has the right to access information held by public bodies”).

\textsuperscript{385.} \textit{Id.} § IV.2.

\textsuperscript{386.} These restrictions apply equally to provisions that would allow the prosecution of a journalist for aiding and abetting, conspiring, or inducing a violation of a state secrets law.
Second, the law may not be overly broad in its terms or application, but must be narrowly tailored to prohibit only that conduct necessary to accomplish its objective.

Third, the law must incorporate a *mens rea* element or a full public interest defense. Any fault element contained in the law should reflect a subjective intent requirement, that is, should obligate the state to prove that the journalist’s actual purpose was something other than obtaining the information to share it with the general public. Alternately, the law should contain a public interest defense applicable to all provisions of the law that prohibits the imposition of any sanction on one who establishes that he or she acted in furtherance of the public interest with regard to information disclosed.

Fourth, the law must incorporate an actual harm test, obliging the government to prove that the information is confidential in nature and that either its receipt or publication by the journalist caused an actual and substantial breach in the secrecy and security of the state. This requirement may be addressed in part by the inclusion of a public domain defense, which prohibits the imposition of any sanction where the information at issue had already lost its confidential character because it was publicly available at the time of it was received or published by the journalist.

Taken together, these restrictions impose formidable obstacles to drafting a state secrets law that would comport with the international principles of free expression at stake in this context.\(^{387}\) Therefore, as this area of the law develops—and as courts, legislatures, and international bodies examine the validity of applying existing state secrets laws to the work of national security reporters—it is likely that the leakage provisions of such laws either will be invalidated as in violation of fundamental free expression rights or substantially limited in their permissible scope. Moreover, because the prosecution of members of the press under state secrets laws is incompatible with free expression principles under all but the most extreme circumstances, the invocation of such laws to investigate, but not charge, a journalist, or to press charges but dismiss the case prior to judicial scrutiny, may well constitute an independent violation of free expression rights.

\(^{387}\) Indeed, the consensus of the international experts convened in preparation of the Tshwane Principles was nearly absolute, concluding that a “person who is not a public servant may not be sanctioned for the receipt, possession, or disclosure to the public of classified information,” unless that person engaged in “other crimes, such as burglary or blackmail, committed in the course of seeking or obtaining the information.” *See The Tshwane Principles, supra* note 14 (Principle 47).
Exhaustion and Software Resale Rights in Light of Recent EU Case Law

By Lazaros G. Grigoriadis, Ph.D.*

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Introduction

On July 3, 2012, the Court of Justice of the European Union (CJEU) handed down its decision on UsedSoft GmbH v. Oracle Int’l Corp. (“UsedSoft”), ruling on the then-undecided copyright distribution issue of reselling copies of computer programs downloaded from the Internet without the rightholders’ consent.

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I. The Legal Framework

Pursuant to Art. 4(2) of Directive 2009/24/EC, “The first sale in the Community of a copy of a program by the rightholder or with his consent shall exhaust the distribution right within the Community of that copy, with the exception of the right to control further rental of the program or a copy thereof.”

In light of this provision, which established the principle of EU-wide exhaustion of the right to distribute computer program copies, and what is accepted in legal doctrine with regard to the right to distribute works, it is unquestionable that a computer program copyright owner cannot oppose the resale of a program copy manufactured in any media format (e.g., CD-ROM, DVD) and sold in the European Union by himself or with his consent.

But, does the above provision also apply to permanent copies of a computer program that have been downloaded via the Internet and stored on a material medium by virtue of the buyer’s online purchase?

Three issues drive this inquiry. First, circulating a work through digital networks does not fall within the distribution concept of Art. 4(1)


of Directive 2009/24/EC, according to the legal literature. Second, the contract terms accompanying a downloaded computer program copy describe the purchase as a license agreement, not a sale, and Art. 4(2) of Directive 2009/24/EC presupposes the sale of a copy of a computer program. Third, the online sale of a work constitutes a service, and the question of exhaustion of rights does not arise, according to the recitals in the preambles to Directives 2001/29/EC and 96/9/EC in the case of services and online services, in particular. In UsedSoft, the CJEU answered the above question.

II. The Facts

The CJEU based its decision on the following facts: Oracle developed and distributed to clients via Internet downloads, computer programs functioning as “client-server software.” The customer downloaded a copy of the program directly onto his computer from Oracle’s website. The accompanying license agreement included the right to store permanently a copy of the program on a server and to allow a specific number of users to access the server copy and install it on their workstation computers. The license agreement granted the customer a non-transferable and exclusive user right for an unlimited


5. According to the recital 33 in the preamble to Directive 96/9/EEC:

Whereas the question of exhaustion of the right of distribution does not arise in the case of on-line databases, which come within the field of provision of services; whereas this also applies with regard to a material copy of such a database made by the user of such a service with the consent of the rightholder; whereas, unlike CD-ROM or CD-i, where the intellectual property is incorporated in a material medium, namely an item of goods, every on-line service is in fact an act which will have to be subject to authorization where the copyright so provides.

Furthermore, according to the recital 29 in the preamble to Directive 2001/29/EC:

The question of exhaustion does not arise in the case of services and on-line services in particular. This also applies with regard to a material copy of a work or other subject-matter made by a user of such a service with the consent of the rightholder. Therefore, the same applies to rental and lending of the original and copies of works or other subject-matter which are services by nature. Unlike CD-ROM or CD-i, where the intellectual property is incorporated in a material medium, namely an item of goods, every on-line service is in fact an act which should be subject to authorization where the copyright or related right so provides.

period. A maintenance agreement provided for downloads from Oracle’s website of software updates ("updates") and programs for correcting faults ("patches").

UsedSoft marketed and resold licenses acquired from Oracle’s customers. UsedSoft’s customers who did not yet possess the software downloaded it directly from Oracle’s website after acquiring a "used" license. Customers who already held licenses for the software but purchased additional licenses to accommodate additional users were induced by UsedSoft to install the program on those users’ workstation computers.

Oracle brought proceedings against UsedSoft in the German courts, seeking an order instructing UsedSoft to cease those practices. The Bundesgerichtshof (Federal Court of Justice, Germany), which had to rule on the dispute as a court of final instance, referred some questions to the CJEU regarding the interpretation of Arts. 4(2) and 5(1) of Directive 2009/24/EC.7

III. The CJEU’s Findings

To settle the dispute, the CJEU clarified that, pursuant to Art. 4(2) of Directive 2009/24/EC, a “sale” is an agreement by which a person, in return for payment, transfers to another person his rights of ownership in an item of tangible or intangible property belonging to him.8 Based on this definition, it judged that the application of the above provision must involve a transfer of the right of ownership in a specific copy of a computer program.9 Such a transfer also takes place, according to the CJEU, when the computer program’s manufacturer executes a user license agreement with its client relating to the right to use a copy of the program concerned. The client then downloads the program for free from the manufacturer’s website and retains it for an unlimited period in return for a fee payment corresponding to the copy’s economic value.10

Moreover, the CJEU said that when applying Art. 4(2) of Directive 2009/24/EC, it makes no difference whether a copy of a computer program was made available by means of a material medium, such as a CD-ROM or DVD, or by means of a download from the right-

7. Id. ¶¶ 20–34.
8. Id. ¶ 42.
9. Id.
The CJEU justified this opinion on seven arguments. Firstly, based on Art. 1(2)(a) of Directive 2001/29/EC, the provisions of Directive 2009/24/EC constitute a *lex specialis* in relation to the provisions of Directive 2001/29/EC. Therefore, even if the digital transmission of a computer program copy falls within the scope of “communication to the public,” as defined in Art. 3(1) of Directive 2001/29/EC, so that there is no exhaustion of the right to distribute the copy concerned under Art. 3(3) of Directive 2001/29/EC, this cannot affect the scope of Art. 4(2) of Directive 2009/24/EC.12

Secondly, it follows from Art. 6(1) of the WIPO Copyright Treaty (WCT) that Directives 2001/29/EC and 2009/24/EC, to the greatest extent possible, must be interpreted to mean that the transfer of the right of ownership of a computer program copy always leads to the application of Art. 4(2) of Directive 2009/24/EC.13

Thirdly, Art. 4(2) of Directive 2009/24/EC makes no distinction with respect to the tangible or intangible form of the copy in question.14

Fourthly, according to Art. 1(2) of Directive 2009/24/EC, “protection in accordance with this Directive shall apply to the expression in any form of a computer program.”15

Fifthly, Recital 7 in the preamble to Directive 2009/24/EC specifies that the “computer programs” the Directive aims to protect “include programs in any form, including those that are incorporated into hardware.”16

Sixthly, from an economic point of view, the sale of a computer program on CD-ROM or DVD and the sale of a program downloaded via the Internet are similar.17

Seventhly, not applying the principle of exhaustion of the distribution right under Art. 4(2) of Directive 2009/24/EC in relation to a computer program copy that has been downloaded via the Internet would allow the copyright holder to control the resale of such a copy. Moreover, the copyright holder could demand further remuneration for each new sale, even though the first sale of the copy had already enabled the copyright holder to obtain appropriate remuneration. Restricting the

11. *UsedSoft GmbH*, ¶ 47. See also Opinion of Advocate General Yves Bot, point 84.
13. *Id.*, ¶ 52. See also Opinion of Advocate General Yves Bot, point 73.
15. *Id.*, ¶ 57.
16. *Id.*
17. *Id.*, ¶ 61.
resale of such computer program copies would go beyond what is necessary to safeguard the specific subject matter of the copyright.\textsuperscript{18}

Furthermore, as the CJEU highlighted after putting forward the above arguments, the application of the exhaustion rule under Art. 4(2) of Directive 2009/24/EC to a computer program copy that was downloaded from the Internet is not affected by the fact that the seller and the first user of that copy also formed a contract for services (i.e., a maintenance agreement). According to the CJEU, the functionalities corrected, altered, or added based on such an agreement form an integral part of the copy originally downloaded, and they can be used by the acquirer of the copy for an unlimited period, even in the event that the acquirer subsequently decides not to renew the maintenance agreement. The user of such a copy is a proprietor not only of the copy concerned, but also of its functionalities. Thus, even if the computer program copy that the user resells is not identified with the one that was downloaded to his computer, this does not affect the legality of the above resale in light of Art. 4(2) of Directive 2009/24/EC.\textsuperscript{19}

In addition, one of the legal consequences of the exhaustion doctrine under Art. 4(2) of Directive 2009/24/EC is that the user of a computer program copy downloaded from the Internet may legally resell that copy to another. Therefore, under UsedSoft, the second acquirer, and any subsequent acquirer, of that copy are “lawful acquirers” of it within the meaning of Art. 5(1) of Directive 2009/24/EC.\textsuperscript{20} Also, if the second acquirer obtained the copy concerned via Internet download, such a download must be regarded as a reproduction of the computer program that is necessary for the new acquirer to use the program in accordance with its intended purpose.\textsuperscript{21}

However, these legal consequences do not permit the acquirer to resell just the right to use the copy to a number of users determined by him\textsuperscript{22} without the license. In order to avoid infringing the exclusive right of reproduction held by the author of a computer program as delineated in Art. 4(1)(a) of Directive 2009/24/EC, the CJEU stressed that after reselling a computer program copy first obtained via Internet download and installed on the first acquirer’s server, the first acquirer

\textsuperscript{18} Id. ¶ 63. See also Opinion of Advocate General Yves Bot, points 78–83.
\textsuperscript{19} UsedSoft GmbH, ¶¶ 64–68.
\textsuperscript{20} Id. ¶ 80. Contra Opinion of Advocate General Yves Bot, points 95–99.
\textsuperscript{21} UsedSoft GmbH, ¶ 81. Contra Opinion of Advocate General Yves Bot, points 95–99 (does not accept any extension of the principle of exhaustion to the right of reproduction of a copy of a computer program).
\textsuperscript{22} UsedSoft GmbH, ¶ 69.
must no longer be able to use that copy. Moreover, the CJEU entitled the computer program manufacturer to render unusable by all technical means at its disposal the copy obtained via Internet download but still in the reseller’s hands.

IV. Comment

*UsedSoft*, a leading decision, gives rise to new data regarding the right of distribution of a computer program copy and the issue of exhaustion of that right. Furthermore, it is a decision that is expected to affect radically the functioning of the EU computer program market.

A. *UsedSoft is a Landmark: The CJEU Rules the Resale of Used Software Licenses Legal*

*UsedSoft* revises the issue of distinguishing between the right to distribute the original or copies of a work and the author’s right to make his work available to the public in a specific way, which is a specific expression of the right to communicate a work to the public. Heretofore, the right to distribute an original work or its copies did not include the digital transmission of that work. Nonetheless, according to *UsedSoft* and Advocate General Yves Bot, a transfer of ownership changes, in light of Art. 6(1) of the WIPO Copyright Treaty (WCT), an “act of communication to the public” within the meaning of Art. 3(1) of Directive 2001/29/EC into an act of distribution within the meaning of Art. 4 of Directive 2009/24/EC. Thus, according to the CJEU, the online transmission of a work falls within the distribution right, provided that the transmission results in the transfer of the right of ownership of a permanent copy of the work that was created with the copyright holder’s consent on a data carrier by the receiver of the transmission.

At this point, the CJEU’s effort to extend the scope of the right to distribute a work and to subsume an additional form of exercise of

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23. *Id.* ¶ 70. Thus, the first acquirer is not authorized to divide the license and resell only the user right for the computer program concerned corresponding to a number of users determined by him (*Id.* ¶ 69).

24. *Id.* ¶ 87.

25. See Marinos, *supra* note 2, at 44.

26. See *supra* note 3.

27. As already acknowledged by the CJEU in a previous decision, the provisions of Directives in European copyright law must be interpreted, to the extent possible, in the light of the rules of International Agreements reached by the European Community (now EU). *See* Case C-456/06, Peek & Cloppenburg KG v. Cassina SpA. (2008) ECR -2731, ¶ 30.

the author’s right to the rule of exhaustion of rights, which expresses the fundamental principle of free movement of goods in EU copyright law, is particularly evident. Indeed, if the CJEU regarded the above digital transmission as one form of exercising the right of communicating a work to the public and, more specifically, the right of the author to make his work available to the public in a specific way (Art. 3(1) of Directive 2001/29/EC), there would not be room for applying the rule of exhaustion of rights since the above right is explicitly excluded from the scope of that rule (Art. 3(3) of Directive 2001/29/EC). Nonetheless, if the above digital transmission is regarded as a form of exercise of the distribution right for a work (Art. 4(1) of Directive 2001/29/EC), it is possible to apply Art. 4(2) of Directive 2001/29/EC (exhaustion of rights rule covering works other than computer program copies and copies of databases) to the above transmission.

Moreover, based on the above decision and regardless of the qualification given by the computer program manufacturer in the relevant contract, the grant of a right to use a copy of the program for an unlimited period and in return for payment of a fee corresponding to the economic value of the program copy is equal to a sale of the copy within the meaning of Art. 4(2) of Directive 2009/24/EC. As a result, a computer program copy made available to a specific user based on a “shrink-wrap” license or a “click-wrap” license—or any license with terms that were not negotiated by the contracting parties—invalidates the application of the provision of Art. 4(2) of Directive 2009/24/EC unless it is found that a right was granted to use the copy for an unlimited period in return for fee payment corresponding to its economic value. The CJEU’s position must be praised because, if the application of Art. 4(2) of Directive 2009/24/EC were to depend on the contractual language granting a right to use a computer program copy, the risk of circumvention of the above provision would be quite high, as pointed out by Advocate General Yves Bot. 29

Finally, in light of the above decision, the rule of exhaustion of the distribution right for a computer program also applies to copies of computer programs installed on data carriers (e.g., on a computer’s hard disk) via an online service by the service user, if the copyright holder provided a right of use of the copy concerned for an unlimited period in return for a fee corresponding to the economic value of the copy concerned. Therefore, according to the CJEU’s view, there must

29. See Opinion of Advocate General Yves Bot, point 59. Cf. even prior to Used-Soft, Christopher Stothers, PARALLEL TRADE IN EUROPE, INTELLECTUAL PROPERTY, COMPETITION AND REGULATORY LAW 51 (2007).
be a distinction between an online sale—which, according to recital 18 in the preamble to Directive 2000/31/EC, constitutes an information society service and is not subject to the rule of exhaustion of rights—and a permanent copy of a computer program that is created on a specific material medium under an online sale by the acquirer and with the consent of the copyright holder. The latter should be subject to the rule established in Art. 4(2) of Directive 2009/24/EC. The CJEU clarifies that the downloading necessary for reselling such a copy does not breach the exclusive right of reproduction of a computer program (Art. 4(1)(a) of Directive 2009/24/EC). Thus, the rightholder cannot prohibit the resale because the resale constitutes a reproduction, which is necessary for the lawful acquirer to use the computer program in accordance with its intended purpose. On the other hand, in order to avoid infringing the above right, the user who resold such a copy must no longer have the ability to use it and the rightholder may ensure by all technical means at its disposal that the copy concerned is made unusable.

The CJEU’s approach described above seems correct from the perspective of what is generally accepted regarding the distinction between products and services. Indeed, a permanent copy of a computer program created on a material medium via an online sale by the acquirer and with the consent of the rightholder does not have all the characteristics of a service.30 Contrary to a service, whose use by its recipient requires the involvement of its provider, the copy concerned may be used by its acquirer without the seller’s involvement. Moreover, the creation and use of the copy concerned do not happen concurrently, as in the case of the provision and use of a service. Nevertheless, the above approach of the CJEU clashes with the view expressed by the European Commission within the framework of Directives 96/9/EEC and 2001/29/EC on permanent database copies and permanent copies of any other works created on material media by users of online services with the rightholders’ consent. More specifically, pursuant to recital 33 in the preamble to Directive 96/9/EEC and recital 29 in the preamble to Directive 2001/29/EC,31 the exhaustion of rights rules of those Directives (Art. 5(c), second sentence of Directive 96/9/EEC and Art. 4(2) of Directive 2001/29/EC) are not applied to such copies. Finally, regarding the CJEU’s clarification of the legality of the reproduction (downloading) necessary for the resale of a perma-

30. For the characteristics of a service, according to the economic theory, see Raymond P. Fisk, Stephen W. Brown & Mary Jo Bitner, Tracking the Evolution of the Services Marketing Literature, 69 J. OF RETAILING 61 (1993).
31. See for the text of the above recitals, supra note 6.
nent copy of a computer program created on a material medium via an online sale by the acquirer and with the rightholder’s consent, this was necessary to guarantee, from a technical point of view, the effectiveness of Art. 4(2) of Directive 2009/24/EC.

B. Consequences of the UsedSoft Decision for the EU Computer Program Market

1. INTRODUCTION

The UsedSoft decision is expected to have a great impact on the EU computer program market. The decision’s main and direct consequence is that it provides users of online services with an option, the legality of which has been controversial to date (i.e., the possibility of users reselling permanent copies of computer programs that were created on material media by the users in question with the rightholders’ consent). Still, the benefits of the decision for computer program users likely will not apply to computer programs that will be released in the near future. This is because the decision is expected to lead computer program manufacturers to revise established methods as well as adopt new methods of software distribution with a view to reducing radically the computer program copies covered by the rule of Art. 4(2) of Directive 2009/24/EC.

2. USEDSOFT CONSEQUENCES FOR USERS OF COMPUTER PROGRAM COPIES

Regarding users of computer program copies, UsedSoft makes it clear that a computer program user who created a copy of the program within the framework of an online sale with the consent of the rightholder has the same rights as the user who acquired a copy of the same program on a material medium (e.g., CD-ROM, DVD). That means that the first of the above users is able to resell the copy he acquired without the consent of the rightholder being necessary for the resale. This also paves the way for intra-brand market competition\footnote{In a copyright context, intra-brand competition has the meaning of competition between copies of the same copyrighted product. GLOSSARY OF TERMS USED IN EU COMPETITION POLICY (2002).} between computer program copies that are made available online through digital networks. More specifically, UsedSoft “abolishes” rightholders’ monopolies on digital transmissions that create permanent copies of computer programs on material media because such copies may now be resold at lower prices than the rightholders’ prices. Furthermore, there is no longer any doubt about the possibility of reselling media holding permanent copies of computer programs that were created
by users of online services with the consent of the rightholders. Pursuant to UsedSoft, reselling such copies is legal, so the resale of media holding such copies should also be considered legal.

3. USEDSOFTWARE CONSEQUENCES FOR COMPUTER PROGRAM MANUFACTURERS

On the other hand, regarding computer program manufacturers, UsedSoftware will likely incentivize them to establish new software distribution methods. In order for manufacturers to deny the benefits accorded by UsedSoftware to users of computer program copies, it is very likely that they will renounce, to a great extent, the sale and the grant of a right to use a program copy for an unlimited period in return for payment of a fee corresponding to the copy’s economic value as software distribution methods. Even if some computer program manufacturers continue to apply the above software distribution methods, it is almost certain that those methods will not be applied on the basis of the current contract terms of the software market. In fact, following UsedSoftware, computer program manufacturers are expected to use the following software distribution models:

a) Grant of a right to use a computer program copy for a limited period (“subscription-based model”). According to UsedSoftware, application of the rule in Art. 4(2) of Directive 2009/24/EC requires the grant of a right to use the copy of a computer program for an unlimited period. However, a use right of an extremely long duration (e.g., fifty or seventy years) does not seem to invalidate the application of the above rule since it is obvious that the time restriction aims at circumventing the said rule.

b) Use of the model “Software as a Service (SaaS)” (also known as “on-demand software”). Based on UsedSoftware, application of the rule in Art. 4(2) of Directive 2009/24/EC requires the transfer of the right of ownership in a copy of a computer program. If the transfer of the ownership right is not ascertainable, the above provision cannot be applied regardless of whether a user gained access to the functions of a computer program with the consent of the rightholder. Therefore, in order to avoid the possibility of applying the above provision to copies of computer programs that are distributed digitally, the solution for the manufacturers of computer programs could be the “Software as a Service (SaaS)” model, which is already being increasingly used.

Within the framework of the aforementioned model, the rights to use the applications are not bought, but the user acquires the right to use software by paying a fee, which depends on either the duration of its use (time-based) or on the subscription that the user chose for his access to that software. The user has access through the Internet and a common web browser.\textsuperscript{34} It is evident that the “Software as a Service (SaaS)” model does not entail transfer of the right of ownership and, as a result, in light of this method of software distribution, the issue of applying the rule in Art. 4(2) of Directive 2009/24/EC does not arise.

c) Grant of a right to use a computer program copy for an unlimited period to a large number of users (“enterprise/block licensing”). According to \textit{UsedSoft}, the buyer who acquired the right to use the copy of a computer program for an unlimited period and for a determined number of users is not entitled to divide the right of use he acquired by reselling that right to a number of users determined by him. Based on this clarification, it is obvious that the resale of the right to use a permanent copy of a computer program for more users is more difficult than reselling the right to use a permanent copy of the same program for one user. This is because the first resale requires that the acquirer needs a right to use covering the same number of users. Therefore, the grant of rights to use computer program copies for an unlimited period for a large number of users rather than a single user constitutes another option for computer program manufacturers in their attempts to restrict the application of Art. 4(2) of Directive 2009/24/EC.

d) Grant of a right to use a computer program copy for an unlimited period and use of anti-piracy protection technical means (“technical solution”). Following \textit{UsedSoft}, it is almost certain that the use of technical protection means, which will significantly in-
crease the likeliness that the reseller of a computer program copy acquired via Internet download can no longer use his copy. It is clear in UsedSoft that the CJEU favors the use of such technical means by rightholders. Nevertheless, employing anti-piracy protection might result in price increases for the rights to use computer program copies for an unlimited period. Thus, a possible decrease in demand for such rights and a reduction of cases covered by the exhaustion of the distribution right provision under Directive 2009/24/EC could occur.

V. The situation in the United States

In the U.S., the “first sale” doctrine, which is a similar principle to the European exhaustion of rights rule, applies.

According to section 109(a) of the U.S. Copyright Act, Title 17 U.S. Code, “notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord. . . .”

Simply put, the “first sale” doctrine can be defined as a legal principle that allows the purchaser of a copy of a protected work to lend, give away, or resell that particular copy without violating the copyright. Copyright owners cannot use their monopolies to control the resale of particular copies of works that they originally sold or to prevent purchasers from selling them to others. The “first sale” doctrine also allows customers to destroy their particular copies or phonorecords and applies to all kinds of works (i.e., music, books, computer programs, etc.).

However, the “first sale” doctrine is subject to some limitations. First, it applies only to copies that were lawfully made. Second, it applies only to particular copies. Therefore, if the customer owns a copy of a work or a phonorecord and reproduces that copy or phonorecord in order to sell it, he infringes the copyright. However, if a copy of a work or phonorecord was “lawfully made” by the customer under the Copyright Act, the person is allowed to sell that reproduced copy or phonorecord under the “first sale” doctrine, as it is not limited to copies made or authorized by the rightholder. This is despite the fact that the “first sale” doctrine applies only to the distribution right and does not apply to the reproduction right or any of the other four rightholders’ rights.

The “first sale” doctrine was codified in 1976, “to give effect to the early common law rule against restraints on the alienation of tangible property,” as stated in the legislative history of section 109. The congressional reports refer to the ability of the owner of a material copy to dispose of that copy as he sees fit.

The term “first sale” doctrine dates back to 1908 case law in which the doctrine applied to copies that had been sold. Upon codification in the U.S. Copyright Act of 1976, the doctrine applied to any

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39. See Bobbs-Merrill Co. v. Strauss, 210 U.S. 339 (1908). The U.S. Supreme Court held that the scope of the exclusive right to sell copyrighted works is limited to the first sale of a copyrighted work, and the exclusive right to distribute a work may be used by the holder of the copyright in relation to a particular copy of the work only until the first sale of that particular copy.
lawfully transferred copy, regardless of whether it had been sold. In 1978, the U.S.’s National Commission on New Technical Uses of Copyrighted Works (CONTU) recommended that “computer program” be explicitly referred to in the copyright legislation, and the U.S. Congress adopted this amendment in the Computer Software Copyright Act of 1980. In 1990, Congress again amended section 109 by adopting the Computer Software Rental Amendments Act of 1990. This limited the “first sale” doctrine by stating that a “person in possession of a particular copy of a computer program” is not permitted to transfer that copy “by rental, lease, or lending” for commercial purposes.

In addition to section 109 of the U.S. Copyright Act, section 117 provides for other limitations on the exclusive rights of the copyright owner. Section 117 allows the owner of a computer program copy to make copies for any purpose associated with the use of the copy by the authorized owner. That provision relates to copies that are essential for the utilization of the software or that are solely made for back-up or archive purposes. Section 117 of the U.S. Copyright Act is quite similar to Art. 5(1) of Directive 2009/24/EC. However, there is an essential difference: section 117 of the U.S. Copyright Act can only be invoked by the owner of a copy of software, while Art. 5(1) of Directive 2009/24/EC can be invoked by the lawful acquirer, who may be a purchaser, licensee, renter, or a person authorized to use the program on behalf of one of the aforementioned.

In the United States, a few judgments have been issued on the applicability of the “first sale” doctrine in relation to software licenses. The main question is whether the acquisition of a software license is a sale transaction or merely a license.

In *SoftMan Products Co. v. Adobe Systems Inc.*, the U.S. District Court for the Central District of California held that acquiring an Adobe license should be qualified as a sale transaction, making the software subject to the “first sale” doctrine. The court reasoned that (i) the purchaser paid a single price for unlimited use without obligation

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41. Id.
to return the software, and (ii) the business environment suggested that Adobe sold its products to those who then resold the products. The court also referred to several earlier judgments, which held that the sale of software is a sale of a good within the meaning of Uniform Commercial Code.44

However, in Davidson & Assocs. v. Internet Gateway, Inc.,45 the District Court of Missouri found that “when defendants purchased the games, they bought a license to use the software, but did not buy the software.” The court concluded, “Defendants do not produce sufficient evidence demonstrating that title and ownership of the games passed to them. Therefore, the court finds that the first sale doctrine is inapplicable here.”

More recently, in Vernor v. Autodesk, Inc.,46 the United States Court of Appeals for the Ninth Circuit held that “a software user is a licensee rather than an owner of a copy where the copyright owner (1) specifies that the user is granted a license; (2) significantly restricts the user’s ability to transfer the software; and (3) imposes notable use restrictions.” The same reasoning was subsequently applied in MDY Indus. v. Blizzard Entm’t.47

Accordingly, U.S. courts seem to accept that restrictive end user license agreements may lead to the “first sale” doctrine not being applicable.

Conclusion

In UsedSoft, the CJEU made it clear that the distinction between the rights of digital dissemination and the distribution of a computer program copy must be based on the transfer of ownership. UsedSoft fur-

44. Id. According to the court, “in determining whether a transaction is a sale, a lease, or a license, courts look to the economic realities of the exchange.” Judges also cited many cases in which the courts found that the software was actually sold rather than licensed. The court concluded that “the circumstances surrounding the transaction strongly suggest that the transaction is in fact a sale rather than a license.” Those circumstances were the facts that the defendant “commonly obtained a single copy of the software, with documentation, for a single price, which was paid at the time of the transaction, and which constituted the entire payment for the ‘license’. The ‘license’ ran for an indefinite term without provisions for renewal.” The court said that “in light of these indicia, many courts and commentators conclude that a ‘shrink-wrap license’ transaction is a sale of goods rather than a license.”


46. Vernor v. Autodesk, Inc., 621 F.3d 1102 (9th Cir. 2010).

47. MDY Indus., LLC v. Blizzard Entm’t, Inc., 629 F.3d 928 (9th Cir. 2010), opinion amended and superseded on denial of rehearing, 2011 WL 538748 (9th Cir. Feb. 17, 2011).
ther clarified that the rule of exhaustion of the distribution right established in Art. 4(2) of Directive 2009/24/EC is applied to every permanent copy of a computer program for which a right to use for an unlimited period was granted either by the rightholder or with the rightholder’s consent regardless of whether the copy was distributed on a data carrier (offline) or via Internet download. *UsedSoft* directly benefits users of computer program copies. Yet, in the medium-to-long term, computer program manufacturers will likely try to deny those benefits—they are expected to adopt new software distribution methods or revise existing methods (to the extent that those will continue to be used) with a view to reducing the number of copies of computer programs subject to Art. 4(2) of Directive 2009/24/EC. Finally, contrary to the CJEU, U.S. courts seem to strengthen software vendors’ legal position by accepting that restrictive end user license agreements may lead to the “first sale” doctrine not being applicable.
A Fistful of Dynamite:¹
How Independent Film’s Cowboy Culture Creates Unstable Sales Agency Agreements
By Grace Clements*

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Introduction: Death Rides a Horse

Sam A. 3 has had a good run. In ten years, he has built his sales agency, Silver Dollar Cinema (“SDC”), from the proverbial desk, chair, and telephone into an entertainment powerhouse, selling international rights to $20–50 million motion pictures territory by territory. Major and smaller distributors around the world depend on him as a source of theatrical-level product. 4 Producers admire the size of the minimum guarantees he is able to extract from territories they barely knew existed (“They want my film in Bulgaria? Why?”), although some resent the 10–15% fees that SDC takes off the top.

Sam hates the title “sales agent” because he does so much more for his films. He puts together investors and guides his projects creatively to increase their international value. Sam has decided to shed his “sales agent” label and direct, develop, and produce his own pictures. That way, when they hit big—as many of his projects have done over the years—he and SDC will be able to keep much more than a 15%

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2. DEATH RIDES A HORSE (United Artists 1967).
3. Sam A. is purely fictional. This hypothetical was suggested by Steve Monas. Interview with Steve Monas, Entm’t Attorney & CEO of Bus. Affairs, Inc. (“BAI”), in L.A., Cal. (Feb. 17, 2013). BAI is a transactional law firm based in Santa Monica, California that represents filmmakers, sales agents, distributors, financiers, and others involved in the making of independent film. “Before founding BAI, Steve served as Executive Vice President and Head of Business Affairs for MDP Worldwide, President of Vision International, Vice President of Business Affairs with Vestron Pictures, and as an associate with New York law firms Frankfurt Garbus Klein & Selz, Pavia and Harcourt, and Brown & Wood.” BUS. AFF. INC., http://www.bizaffairs.com/attorneys.html (last visited Mar. 8, 2013).
4. Compare “Distributor: The owner or licensee of motion picture rights that licenses such rights to third parties,” SCHUYLER MOORE, THE BIZ: THE BASIC BUSINESS, LEGAL AND FINANCIAL ASPECTS OF THE FILM INDUSTRY 6 (4th ed. 2011), with “Sales Agent: A party that acts as agent for the owner of the rights in arranging for distribution or [exploitation of a motion picture.” Id. at 9; see also infra Part I.C.
sales agency fee. To transform into a production company, Sam will need a credit line.\(^5\)

The good news is that over the past ten years, SDC has built a substantial library of films. The sales agency agreements that SDC enters into with producers typically have terms of fifteen to twenty-five years, and the distribution agreements that SDC then secures with territorial distributors are typically also for fifteen to twenty-five years, with exceptions for some major territories. When the initial distribution agreements expire, as some have already, SDC is in a position to re-license the films for yet more minimum guarantees. In the interim, digital rights of various kinds—TVOD, SVOD, AVOD and more—have actually become worth something,\(^6\) so there are additional rights to sell on existing pictures, especially internationally.\(^7\) Sam figures SDC’s share of the digital rights must be worth at least $50 million. This is more than enough to support the credit line he is looking for, so he calls his friendly banker to start the paperwork.

But it turns out Sam has a problem: SDC doesn’t own any of the distribution rights in its library. Worse than that, the bank’s lawyers say those fifteen to twenty-five-year sales agency agreements that Sam has spent so much time and money negotiating could be terminated by the producers on the other side at any time. Why? Because SDC is merely an agent, a frail legal creature that exists at the pleasure of its principals under common law and statutes in many states—including California, where SDC and the vast majority of its sales

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\(^{5}\) What may be financed, and by whom, is in constant evolution. Interview with Steve Monas, Entm’t Attorney & CEO of BAI, in L.A., Cal. (Jun. 16, 2013). Most credit lines cover production, and although less common, development may be funded in this way as well. Interview with Steve Krone, Dir. Biederman Entm’t and Media Law Inst., Sw. Law Sch., in L.A., Cal. (May 22, 2013). Overhead is sometimes covered by a development fund but rarely by a production fund, except as a fee on a “go movie,” as opposed to ongoing funding of overhead as it is incurred. \(I d\).

\(^{6}\) The ever-expanding Video on Demand (VOD) platforms currently include TVOD: Transactional Video on Demand, formerly known as pay per view; SVOD: Subscription Video on Demand, such as Amazon and Hulu and emerging “TV Everywhere” platforms; and AVOD (Ad Supported/Free to User Video on Demand), such as YouTube. Wendy Bernfeld, Brave New World: Digital Distribution Beyond the Old World, SUNDANCE INSTITUTE (Apr. 23, 2012, 9:04 PM), http://www.sundance.org/artist services/distribution/article/brave-new-world-digital-distribution-beyond-the-old-world/.

\(^{7}\) SVOD (Subscription Video on Demand) has been financially negligible on the domestic front except for libraries, because studios are not able to license pictures until after the second pay window, some eight years out. Ken Ziffren, Co-Founder and Partner of Ziffren Brittenham LLP, Presentation at the Beverly Hills Bar Association Entertainment Law Section: “Features and TV 5.0—Developments and Trends for Entertainment Lawyers, Fifth Edition” (Aug. 21, 2013). Internationally, studios have been able to pick up extra money with one to two-year licenses for SVOD, and these short term deals give the studios more leverage and bargaining position against basic cable or pay TV, with whom the subscription services compete. \(I d\).
agency cohort do business. SDC’s library, according to the bank lawyers, is a mirage that could disappear tomorrow; certainly not something on which the bank should take a $50 million risk.

How did this happen? Sam found out the hard way that sales agency agreements may be revocable, even if they include a provision purporting to make them “irrevocable.” This is because in California, as in many other states, “[u]nless the power of an agent is coupled with an interest in the subject of the agency, it is terminated by . . . [i]ts revocation by the principal.” Although “a revocation of authority within the designated period renders the principal liable for damages for the violation of a legal right of the agent, just as in the case of any other breach of contract,” the remedy is limited to money damages, which may be too speculative to support a full recovery. Further, whether agents may successfully sue for a breached term on individual pictures is beside the point for poor Sam, who, regardless of any small individual victories he may win only after lengthy and costly litigation, is unable to obtain credit now, when he needs it, because of a cloud on a film library that he believed to be marketable.

As the international appetite for independent film grows, both in mainstream consumption and within niche markets, potentially unstable sales agency agreements may threaten a critical component of a multi-billion dollar industry. Because most sales agency disputes are arbitrated instead of litigated, the number of actual sales agents cur-

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8. Agency agreements are always revocable at will unless there is a “power coupled with an interest.” Thus the principal retains the power to revoke, even when she has otherwise contracted away her right. CAL. CIV. CODE § 2356(a)(1) (West 1985 & Supp. 2013). See also, infra Parts II.B, IV.
9. CAL. CIV. CODE § 2356(a)(1).
11. See infra Part IV.
rently facing revocation by producers is unknown. Yet, the legal and practical components of this issue are sneakily volatile, and they have spontaneously combusted for other industries, to great impact. This article identifies the potential dangers, and helps defuse them before they explode in possible revocation or litigation.

The sales agent plays a key role in the film industry’s future. Because the strength of an industry is built on its contracts, and the strength of a contract is built on its stability, potential fissures in the sales agency agreement must be sealed in order for the industry to advance. Part I begins with a current snapshot of the independent film business—with its increased focus on foreign markets, new media, and digital distribution channels—and highlights the sales agent’s contributions toward this new frontier. We then travel back to the original frontier of American independent film, when the pioneering sales agent laid the foundation for many of the practices employed today. Part I concludes by exploring the difference between an “agent” as defined by agency law and a “sales agent” according to the film business; dispelling in the process the prevalent confusion about the seemingly similar, but fundamentally different roles of “sales agent” and “distributor.”

Part II asks the question: Is an agency revocable at will even when it contractually claims to be irrevocable? The answer, to the chagrin of agents, is yes; unless the agency creates a “power coupled with an interest.” Unfortunately, what this term means and how to achieve the critical coupling has stymied lawyers for two hundred years, since Chief Justice Marshall first coined it in the 1800s.

16. However, the Independent Film and Television Alliance [hereinafter IFTA], a trade organization devoted to the production, distribution and finance of independent film and television, provides arbitration services to its members, and lists on its website empirical data by year about the types of awards granted. In 2010, there were nine awards involving sales agents. Arbitration Award Summaries, IFTA, available at http://www.ifta-online.org/sites/default/files/2010%20Arbitral%20Award%20Summaries_final%20posted_0.pdf (last visited Jan. 25, 2014). In 2011, there were three awards. Arbitration Award Summaries, IFTA available at http://www.ifta-online.org/sites/default/files/2011%20Arbitral%20Award%20Summaries_entire%20year%20final.pdf (last visited Jan. 25, 2014).

17. The hotel industry was the subject of tumultuous litigation in the 1990s, when, to everyone’s surprise, multi-million dollar hotel management (agency) contracts were permitted to be revoked because there was no “power coupled with an interest.” See infra Part III.

18. See infra Part I.
19. See infra Part III (for an example of an industry that did not address its contractual flaws until after it experienced loss).

20. See infra Part I.
21. See infra Part I.A.
22. See infra Part I.B–C.
23. See infra Part II.
24. See infra Part II.B.
Clues to resolve this conundrum may be found in Part III, in case law from the hotel industry, where large management companies were shocked to find their agency agreements revoked by hotel owners. Part IV explains why foreign sales agents, should they find themselves in the unfortunate position of their hotel management counterparts, will likely discover that the remedies available for their revoked agreements may be inadequate. Finally, Part V proposes potential business solutions to the foreign sales agent in contemporary practice. Armed with the knowledge of his profession’s history, and with lessons learned from a neighboring industry, Sam and his fellow sales agents may confidently ride into the future of foreign film distribution.

I. Great Treasure Hunt: Fortunes in Foreign

Domestic box office used to be all that mattered. But since the foreign box office first pulled ahead of domestic theatrical revenues in 1994, the global market has dramatically increased in importance. The foreign marketplace for theatrical motion pictures is now more than triple that of the U.S. domestic market, at $34.7 billion in 2012, compared to $10.8 billion domestically. Foreign distribution has become integral to the success of the movie business, and the extent of that success for independent films hinges on the sales agent.

The economic downturn has led to a shrinking studio slate, that in turn has created additional opportunities for independently financed

25. See infra Part III.
26. See infra Part V.
27. GREAT TREASURE HUNT (Continental Industrial Production 1972). Mark Damon, who starred in this film, was later to help create the template for foreign sales agents. Discussed infra Part I.A.
29. Id.
30. Id.
32. DANIELS ET AL., supra note 28, at 52 (“As go-betweens, sales agents fulfill an invaluable role, since a producer will seldom maintain relationships with distributors in any of the several hundred national marketplaces that make up the various foreign territories.”). Sales agents can broker domestic deals as well as international, but these deals tend to be less complex, as the U.S. is considered one territory and does not require the same web of specialized relationships as foreign. Interview with Steve Monas, supra note 5.
movies, and therefore, for the sales agents who broker those deals. New sales agencies have been quick to capitalize on the changing landscape and attract bigger stars and better material than were previously available to the indies. Many of these companies have evolved with the times and diversified their offerings, becoming more than “mere sales agents,” yet, in some cases, retaining the “sales agent” moniker. While sales agents have always participated in the financing and distribution, and even the creative guidance of their pictures, these hybrid entities have become the norm. The modern focus on foreign box office, combined with the new need for more independent product to fill the holes left by the majors, and the emerging viability of VOD and other digital distribution channels, puts the sales agent at the center of the vortex.

Contrary to popular belief, what makes a film “independent” is not its creative sensibility or the size of its budget, but how the film is

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33. See Dave McNary, FilmNation: Art, Commerce, and Staying Alive, VARIETY (May 13, 2013, 8:00 AM), available at http://www.variety.com/2013/film/features/filmnation-at-5-1200465888/#/1/aaron-ryder/ (“[T]he movie business has undergone deep changes, with Hollywood majors focusing more on tentpoles, opening up screen doors to the indie sector, which has seen a steady growth in sales-financing-producing shingles.”).

34. Id. (“Those outfits have also seen a greater ability to nab stars and material—once the domain of the studios—and to finance, make and sell serious worldwide hits such as ‘The Hunger Games,’ ‘The Best Exotic Marigold Hotel,’ ‘Taken’ and, of course, the ‘Twilight’ films.”).

35. Id. (explaining how FilmNation, like many burgeoning new “super agencies” “can now board a project as a producer, financier, sales agent, international distributor or marketer and at any stage, including development.”).

36. Telephone Interview with Alison Cohen, EVP Bus. & Legal Affairs, FilmNation Entr’m’t (Mar. 14, 2013). “Alison runs the business and legal affairs department for FilmNation. She works on . . . distribution agreements and bank financings for FilmNation’s international sales division, and development, production and financing agreements for the company’s production division. Prior to joining FilmNation, Alison . . . work[ed] in private practice, representing producers, production companies and film financiers and provid[ed] the production legal on more than 80 movies.” FILM NATION, http://www.weakofilmnation.com/the-citizens/alison-cohen.html (last visited Sept. 10, 2013). See also Telephone Interview with Robbie Little, Co-President, The Little Film Co. (Mar 18, 2013). Robbie and Ellen Little co-founded Overseas Media Group in 1980, then First Look Media, and remain shareholders of First Look Studio. Founding members of IFTA, the Littles represented Oscar winning films TSOTSI (Miramax Films 2005) and ANTONIA’S LINE (First Look International 1995), and have represented, as sales agent, distributor, or executive producer, many other prestigious films. LITTLE FILM CO., http://www.thelittlefilmcompany.com/About.aspx (last visited Mar. 24, 2013).

37. See, e.g., Dave McNary & Rachel Abrams, Indies Prep for Big Landing in Cannes, VARIETY (Mar. 9, 2013, 4:00 AM), available at http://www.variety.com/2013/film/international/indies-prep-for-big-landing-in-cannes-1200005926/ (“The indie sector has become populated with success stories such as IM Global, FilmNation, Exclusive Media and Sierra/Affinity, which have all greatly expanded far beyond the role of traditional sales agents and into production and financing.”).

financed and distributed. Films that are not independently financed are generally produced by a movie studio that finances the film and owns the “worldwide distribution rights to the film in all media.” Therefore, “financing done by means other than total studio financing of a motion picture” is generally referred to as “independent financing,” even when there is partial studio involvement. While studios have the internal infrastructure to distribute their motion pictures internationally, the independent film business does not, so it relies on foreign distribution deals that are largely brokered by sales agents.

While sales agents may sell films after completion with no foreign pre-sales, typically a sales agent helps a production obtain financing before the picture is made, by pre-selling territories to foreign distributors. In fact, independent films are financed primarily, and at times, exclusively, by this process of “banking pre-sales.” Once the sales agents enter into agreements with foreign distributors on behalf of their producer principals, they assign these agreements to the bank as collateral for the bank’s loan of funding to produce the film. Because the bank will not be repaid until the distributors’ payments are triggered, usually by delivery of the film to these foreign territories, the bank requires the producer to obtain a completion bond to ensure that the film is delivered on-time, on-budget and to delivery specifications.

Today’s market requires ever more complicated financing deals, including “gap” and “bridge” loans. Now that pre-sales are generally not covering the entire amount needed for production, a “gap loan,”

morning-poll-what-makes-a-film-a-real-indie-film/ (reporting that many people believe that an “indie” film must be low budget); but see Film Submission Information 2013, FILM INDEPENDENT SPIRIT AWARDS 4, https://s3.amazonaws.com/SpiritAwards/2013+Spirit+Awards+Rules+%26+Regs.pdf (considering films with budgets as high as $20 million dollars for eligibility to receive the only national award exclusively meant for “independent” films).

41. Id.
42. Id.
43. Id.
44. DANIELS ET AL., supra note 28, at 51–52.
45. MOORE, supra note 4, at 23.
46. Id. (noting that at the time of publication in 2011, “the level of average worldwide pre-sales has shrunk from about 100% of a film’s budget in the heyday to less than 70% today[].”)
47. Id.
48. Id.
49. Id. at 81.
50. See McNary & Abrams, supra note 37.
where available, will fund the difference of the amount of money pledged in the distribution agreements, and the amount of money needed to fund production. The only basis for this loan is what the sales agent estimates the not-yet-secured future sales to be on the picture.51 The sales agent’s reputation and relationship with the lenders is therefore of utmost importance.52 “Since gap loans are more risky than pre-sale loans, the costs go up, typically with up-front fees equal to 10–12% of the loan and interest at three to five points over LIBOR.”53

Because these funds don’t kick in until close to the start of production, and preproduction funding is often needed to secure talent and pay for other expenses before the start of production, a “bridge” loan may also be required.54 These loans are extremely risky, as they are only predicated on “being paid off by the pre-sale or gap lender when the completion bond closes.”55 To compensate for the risk, these loans charge the highest up-front fees.56 This house of cards is all built on Sam’s secured agreements, his estimates, his good name, and his relationships with the distributors and lenders, not to mention the producer. Sam and his sales agent cohort are members of a rare breed that is of critical importance to the success of the independent film business.

A. Pistol Packin’ Preacher:57 The Sales Agent Comes to Town

Dino De Laurentiis, “the early wizard of independent film production,”58 and Mark Damon, the “nearly legendary international sales agent,”59 have both been credited with inventing the pre-sale model.60

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51. Moore, supra note 4, at 24.
52. Adam Dawtrey, Superheroes of Sales to the Rescue: Dealmakers Impact Report 2012, Variety (Dec. 10, 2012, 2:00 PM), available at http://www.variety.com/2012/scene/news/superheroes-of-sales-to-the-rescue-1118063167 (“For the sales companies, the key is to prove they can be trusted to deliver on their promises—to the talent, the buyers, the banks and the equity players.”).
53. Moore, supra note 4, at 24. Keep in mind that financing and interest rates are constantly changing. Mr. Moore’s report reflects the time of the book’s publication in 2011.
54. Id.
55. Id.
56. Id. (typically charging 10% of the loan and interest as high as 1% each week, as of 2011).
58. Kopelson, supra note 40, at 5.
Well before their “international financing innovations,” they were already industry cowboys. De Laurentiis, who was a “pivotal figure in postwar Italian New Wave cinema,” built his business from nothing:

After the war, there was no industry. We lost the war. We had our whole city destroyed. No money. No studio. No film. No camera. No equipment. We would shoot in the street. We had no actors. Nothing . . . . But we wanted to do movies. And we did the best movies in the world.

When his studio, Dinocitta, went bankrupt in the 1970s, De Laurentiis headed to the United States. There, he started over, breaking new ground with his American productions.

While De Laurentiis was creating the Italian New Wave in the 1950s, Mark Damon was busy staking his claim on Hollywood. After he won the Golden Globe for “New Star of the Year” in Roger Corman’s House of Usher, Damon was lured to Italy by the promise of a role that he did not ultimately attain. But by the
1970s, Damon had become a bona fide “Spaghetti Western” star in Italy. When the roles dried up, Damon “knew [he] had to do something serious in order to keep [his wife] in the style to which [he] knew she wanted to become accustomed.” So he became a distributor.

Like the cowboys of the American and the Spaghetti Westerns, Damon and De Laurentiis reinvented themselves after each adversity they faced. Perhaps because of the literal borders they crossed, they were able to build “a bridge between [the] old school film business and today’s version of the film business.” Damon saw that “[i]n the 1970s the most popular films in Europe were American[,] [b]ut the only American films that were available to independent overseas distributors . . . were ‘B’ or ‘C’ movies[,]” since “[a]ll the ‘A’ American movies, the biggest money makers, went to distribution wings of major studio chains . . . .” Yet, in spite of this monopoly, the studios failed to maximize foreign profit, because their marketing campaigns were homogenous and reflective of their audience’s cultural diversity. Furthermore, “the majors had a certain power in what they called the key cities, but the independents went all through the provinces as well . . . They got a movie to show up everywhere, while the majors never bothered with the provinces, giving up about a third of their potential revenues.”

Damon’s plan to nab “A” movies for his bosses first took flight with One Flew Over the Cuckoo’s Nest, a sure thing, he thought, since he and Jack Nicholson were friends and former roommates. Sadly, his

71. Damon’s Italian films include JOHNNY ORO (MGM 1966); JOHNNY YUMA (Atlantic Releasing Corp. 1966); DEATH DOES NOT COUNT THE DOLLARS (a.k.a. DEATH AT OHELL ROCK AND NO KILLING WITHOUT DOLLARS) (Koch Media 1967), PISTOL PACKIN’ PREACHER (Agata Films 1971); and GREAT TREASURE HUNT (Continental Industrial Producing 1972). Sergio Corbucci’s classic film, DJANGO (Horse Man 1966), was written for Damon, but when Damon was held up by another film, Corbucci “cast a guy with piercing blue eyes, whom they discovered working at a gas station . . . . His name was Franco Nero.” COWBOY, supra note 67, at 361.

72. Id. at 403.
73. Id. at 407.
74. Id. at 404 (“Years later, Mark would tell the New York Times, ‘after I produced a film that wasn’t even distributed I decided to become a distributor. And that was so fascinating I left acting.’ In reality, it was not quite so easy.”). Cf. Telephone Interview with Mark Damon, CEO and Chairman, Foresight Unlimited (Mar. 20, 2013) (describing his position after he left acting as more of a sales agent than a distributor).
75. Levine, supra note 59.
76. COWBOY, supra note 67, at 407.
77. Telephone Interview with Mark Damon, supra note 74; cf. Telephone Interview with Robbie Little, supra note 36 (arguing that the the modern Internet age has led to less finely tuned campaigns, because the film’s title and look and feel are now expected to be the same across global markets).
78. COWBOY, supra note 67, at 410 (emphasis added).
79. Id. at 411.
80. Id.
hopes were grounded when the producer, Saul Zaentz, revoked their oral agreement “[b]ecause I thought about it and doubted I’d ever see a dime from a small foreign distributor that I don’t know. While if I sell the foreign rights to a major studio at least I’ll see my money.”81 This failure provided the impetus for Damon to organize a network of independent distributors, with a plan: “Next time we’ll buy in force. We’ll make an offer that represents six, seven, eight different countries and I’ll assure Hollywood producers that we all know how to report like the studios.”82

Like Damon, De Laurentiis also “established a network of independent film distributors in every country,”83 but to a different end. De Laurentiis wanted to pre-sell “to these distributors the rights to distribute his films in their territories. This enabled him to assemble a package of contracts from distributors in foreign territories, from which he gained cash to make his films.”84 De Laurentiis’s marketing savvy was a key component in his successful sales strategy.85 He appealed to the cultural differences of each territory, and created excitement “by wooing the press, throwing splashy events at international festivals such as Cannes, and relentlessly beating the PR drum.”86

The trails blazed by Damon and De Laurentiis are still followed by modern sales agents worldwide to secure billions of dollars annually.87 Although neither man was technically a sales agent at the time of his innovations,88 both men made major contributions to the way independent films are marketed and sold.89 Sales agents may still at times be “regarded as a bunch of renegades dragging a suitcase of garish posters from one market to the next.”90 Yet in part because of this dynamic duo,

81. Id.
82. Id. at 413.
83. Kopelson, supra note 40, at 5.
84. Id.
85. Natale, supra note 61.
86. Id.
87. Telephone Interview with Roman Kopelevich, CEO and Founder, Red Sea Media (Mar. 14, 2013) (confirming the influence that both men continue to have on sales agents and the industry). Prior to founding Red Sea Media, Roman worked with Mark Damon as Director of Distributor Services at Media 8 Entertainment. Id. Roman was also “Director of International Sales at Morgan Creek . . . , SVP of Worldwide Sales[,] and oversaw Bleiberg Entertainment’s international sales slate and film library . . . .” RED SEA MEDIA, http://www.redseamediainc.com/romansbio.aspx (last visited Jan. 8, 2014); see also What is an Independent?, IFTA, http://www.ifta-online.org/what-independent (last visited Mar. 24, 2013) (estimating the revenue from independent film sales at $4 billion a year).
88. Cf. Telephone Interview with Mark Damon, supra note 74 (describing his first position in distribution as more of a sales agent than a distributor).
89. Interview with Steve Monas, supra note 3; Telephone Interview with Roman Kopelevich, supra note 87.
90. Dawtrey, supra note 52; accord Telephone Interview with Mark Damon, supra note 74; Telephone Interview with Roman Kopelevich, supra note 87; Telephone
sales agents are increasingly viewed as “production powerbrokers, with
the right combination of creative skills, financial ingenuity and interna-
tional relationships to make serious movies happen.”91 The sales agent
has evolved into a “foreign sales mogul.”92

B. They Call Him Veritas:93 The Agent as Fiduciary

As renegade as the Sales Agent may otherwise be,94 if he is acting
as an agent as that term is meant under agency law,95 then he is also a
fiduciary.96 Under agency law, “the fiduciary relationship . . . arises
when one person (a “principal”) manifests assent to another person
(an “agent”) that the agent shall act on the principal’s behalf and sub-
ject to the principal’s control, and the agent manifests assent or other-
wise consents so to act.”97 Justice Cardozo most memorably defined
the fiduciary duty, in language that could itself be dialogue from a spa-
ghetti western: “[N]ot honesty alone, but the punctilio of an honor the
most sensitive.”98

In California, every contract contains an implied duty of good faith
and fair dealing,99 but this contractual duty does not require Cardozo’s
“punctilio of honor.”100 A fiduciary relationship exists only “between
parties to a transaction wherein one of the parties is in duty bound to
act with the utmost good faith for the benefit of the other party.”101

Interview with Robbie Little, supra note 36. However, the “renegade” Mark Damon
famously needed only one such poster to pre-sell WILD ORCHID (Triumph Releasing
Corp. 1989) in Cannes, after conceiving the concept for the film, writing a three-
page synopsis and securing a commitment from Mickey Rourke, all within 48 hours.
See COWBOY, supra note 67, at 453–54.
91. Dawtrey, supra note 52.
92. See id. (“As the major studios focus on making fewer, bigger tentpoles, thus
reducing their title output, foreign sales moguls are moving into the void and playing
an increasingly central role in Hollywood dealmaking.”) (emphasis added).
93. THEY CALL HIM VERITAS (Medusa Distribuzione 1972).
94. Dawtrey, supra note 52.
95. Batzel v. Smith, 333 F.3d 1018, 1035 (9th Cir. 2003) (citing RESTATEMENT
(THIRD) OF AGENCY § 1.01 (2006)); accord United States v. Bonds, 608 F.3d 495,
506 (9th Cir. 2010).
of fiduciary relationships in the commercial context include . . . agent/principal.”).
97. Batzel at 1035; accord Bonds at 506. See also RESTATEMENT (SECOND) OF
AGENCY § 1 (1958) (“(1) Agency is the fiduciary relation which results from the man-
ifestation of consent by one person to another that the other shall act on his behalf and
subject to his control, and consent by the other so to act. (2) The one for whom action
is to be taken is the principal. (3) The one who is to act is the agent.”).
99. See Wolf, 130 Cal. Rptr. 2d at 864 (citing, e.g., Nelson v. Abraham, 177 P.2d
931, 934 (Cal. 1947)).
100. See id. at 864 (quoting Meinhard, 164 N.E. at 546 (emphasis added)).
101. See id. at 863 (quoting Herbert v. Lankershim, 71 P.2d 220, 257 (Cal. 1937)).
While agents owe a fiduciary duty to their principals, parties to a contract without an agency relationship owe no such heightened duty to each other.

The fiduciary relationship was further examined in the context of the film business in *Wolf v. Superior Court*. There, the writer of the underlying novel for *Who Framed Roger Rabbit* unsuccessfully sued Disney for breach of an alleged fiduciary duty to him to account for merchandising royalties. The court held that neither contingent compensation nor distribution agreements give rise to a fiduciary relationship, but are instead merely examples of contractual relations. Although the claim was not based on an agency theory, the court’s definition of the fiduciary relation in the context of the film industry is applicable to the sales agent:

[A] “fiduciary relation” in law is ordinarily synonymous with a “confidential relation.” It is founded upon the trust or confidence reposed by one person in the integrity and fidelity of another, and likewise precludes the idea of profit or advantage resulting from the dealings of the parties and the person in whom the confidence is reposed.

*Wolf* further clarified that “[t]raditional examples of fiduciary relationships in the commercial context include trustee/beneficiary, directors and majority shareholders of a corporation, business partners, joint adventurers, and agent/principal.” Therefore, by *Wolf*’s definition, sales agents hold traditional fiduciary duties.

However, in a recent unpublished decision by the California Court of Appeals, the question of whether a sales agent is actually an agent according to agency law, or a unique industry term sharing none of the legal qualities of its name, appears to be far from settled: “In the film industry, the term ‘sales agent’ typically describes an entity that sells movies to distributors. It does not mean that the entity operates as an actual agent.” This case did not deal with fiduciary

102. See id. at 863.  
103. See id. at 866.  
104. 130 Cal. Rptr. 2d 860 (2003).  
106. *Wolf*, 130 Cal. Rptr. 2d at 864 (“The contractual right to contingent compensation in the control of another has never, by itself, been sufficient to create a fiduciary relationship where one would not otherwise exist.”).  
107. See id. at 866.  
108. Id. at 863 (citation omitted).  
109. Id. (citations omitted).  
111. Id. at *1.
duties, but it follows that a sales agent in film who is not an “actual agent” would also not be a fiduciary. While this case holds no precedential value because it is unpublished, it nevertheless provides insight into the ongoing confusion about the indiscriminate manner in which this term is used, and the problems this use may cause. After all, if “an entity that sells movies to distributors” is doing so on the principal’s behalf and subject to the principal’s control, it is still an agent under agency law.

C. Face to Face: Sales Agent vs. Distributor

When a sales agent is not an agent, it may be a distributor. “It is important to distinguish between a distributor and a foreign sales agent. If a . . . company is granted the rights to the film for the foreign markets, that company is the distributor.” The distributor owns the copyright for a specified period, in the territories and media conveyed in the exclusive license or distribution agreement. What it means to own the copyright is that the distributor actually owns one or more of the exclusive rights in the Copyright Act’s divisible bundle of rights.

112. This was a breach of contract claim, in which the sales agent, Syndicate Films (SFI), was unable to disclaim liability for a contractually owed refund by claiming that it was signing as an agent of a disclosed principal. Id. at *1, *4–5. The determination that the appellant was not an agent and thus was principally liable on the contract was due to many factors, including the interpretation of the term “sales agent” as it relates to film, as well as evidence of multiple corporate fictions that were erected to avoid liability, and parol evidence showing that the appellant did not intend to enter into the agreements as an agent. Id.

113. Id. at *1.

114. Batzel v. Smith, 333 F.3d 1018, 1035 (9th Cir. 2003) (citing RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006)); accord United States v. Bonds, 608 F.3d 495, 506 (9th Cir. 2010); see also RESTATEMENT (SECOND) OF AGENCY § 1 (1958) (“(1) Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act. (2) The one for whom action is to be taken is the principal. (3) The one who is to act is the agent.”).

115. FACE TO FACE (Explosive-Media 1967).


117. 17 U.S.C. § 101 (“Copyright owner,” with respect to any one of the exclusive rights comprised in a copyright, refers to the owner of that particular right.)

118. 17 U.S.C. § 106 (“Subject to sections 107 through 122, the owner of copyright under this title has the exclusive rights to do and to authorize any of the following: (1) to reproduce the copyrighted work in copies or phonorecords; (2) to prepare derivative works based upon the copyrighted work; (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending; (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly; (5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the
The advantages of copyright ownership are many. First, there is a presumption of copyright validity, when the copyright is properly registered with the Copyright Office.119 Second, when the action is copyright-based, and not merely an action for a breach of contract, the copyright holder may bring suit in federal court.120 The availability of statutory damages for copyright infringement is another major benefit121 because actual damages are often too speculative to recover on breaches of contract for future sales.122 Finally, as Sam discovered when he tried to obtain a credit line, banks lend to copyright owners because the banks can perfect a security interest against the copyright to hold as collateral for the loan.123

Sam may have been a victim of the prevailing confusion about the difference between sales agents and distributors.124 The Independent Film and Television Alliance (“IFTA”) strongly warns its members that “the IFTA Sales Agency Forms are representation agreements for a sales agency of a Picture and are not distribution agreements, nor do they grant or convey any ownership in and to the Picture.”125 Yet others, in an attempt to simplify the concepts, conflate the terms.126 For example, one online resource for independent filmmakers advises its members that typical sales agents are “more like intermediary distrib-

119. 17 U.S.C. § 410(c) (“[R]egistration made before or within five years after first publication of the work shall constitute prima facie evidence of the validity of the copyright. . . .”).

120. See Scholastic Entm’t, Inc. v. Fox Entm’t Grp., Inc., 336 F.3d 982, 985–89 (9th Cir. 2003).

121. 17 U.S.C. § 504(c) ($750–$30,000 per infringement, or up to $150,000 per willful infringement). However, statutory damages are only available if the copyright is timely registered. See John Tehranian, The Emperor Has No Copyright: Registration, Cultural Hierarchy and the Myth of American Copyright Militancy, 24 BERKELEY TECH. L. J. 1397–1457 (2009), available at http://ssrn.com/abstract=1558981.

122. See infra Part IV.B.

123. See Moore, supra note 4, at 74 (“A security interest gives the secured party a claim to specific property . . . in order to enforce a contractual obligation of another party. Security interests are not just for loans—any contractual obligation can be secured.”); see also In re Peregrine Entm’t, Ltd., 116 B.R. 194, 198–99 (Bankr. C.D. Cal. 1990) (requiring recordation with the Copyright Office to perfect a security interest in copyright, and preempts any state recordation system under the Copyright Act).


125. Guide to IFTA Model Sales Agency Agreements 3 (emphasis omitted).

126. See, e.g., Ravid, supra note 124; Litwak, supra note 124, at 187.
utors” that “license all the rights” themselves “and then re-license them per territory or in a worldwide deal.” An IFTA arbitrator and expert further commented that “[a] foreign sales agent is essentially a distributor that licenses a picture to other distributors.” Another California decision mixed the terms when it discussed one entity granting another “the exclusive right to distribute the film under an ‘International Sales Agency Agreement.’”

Contributing to the unclarity, the issue of ownership or distributorship versus agency is not necessarily binary. A party can have dual roles, owning part of a project but also acting as a sales agent with respect to that project. However, there are several distinctions that can be drawn between sales agents and distributors, and between different types of sales agents. The first distinction involves rights. The classic “middleman” sales agent has contractual rights, which are not ownership rights, but are rights nonetheless. On the other hand, the distributor has more substantial rights, including copyright protection.

The economic structure of the relationship also creates a distinction. A party may choose to just take a fee, which is closer to the strict “agent” model, with no rights in the picture. Or, a party may take an “equity” stake in the film—which may be true copyright ownership, as with a distributor, or a contractual right, as with an agent. “The indie sector has become populated with success stories” about a supposedly new breed of sales agent that has “greatly expanded be-
yond the role of traditional sales agents and into production and finan-
cancing.”141 It is more desirable to many sales agents to “invest and help producers make their projects”142 than to just “get[ ] a fee,”143 because of the perception that sales agents “don’t have any rights.”144

Although “[o]wning a slice of the production pie”145 may be “key to surviving today’s tough film market[,]”146 ownership interest goes against the traditional definition of agency.147 This is because an owner has the ability to control one’s ownership interests directly,148 no longer “on the principal’s behalf and subject to the principal’s control.”149 The determination in _E1 Films Canada_—that Syndicate Films acted on its own behalf—led in part to the conclusion that it must not have acted as an “agent” under agency law.150

Finally, some people use the term “distributor” to mean someone who has actual “on the ground” distribution capability.151 Others who own rights but must sub-distribute to those with actual distribution capability can be thought of as “rights traders.”152 These rights traders are distributors and not sales agents in the sense that they own the rights. However, they are sales agents (though not technically) and not distributors, in the sense that they have to resell to effect actual distribution.153

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141. McNary & Adams, supra note 37.
144. Id. (emphasis added).
145. Id.
146. Id.
147. _Restatement (Third) of Agency_ § 1.01 cmt. g (2006) (“A purchaser is not ‘acting on behalf of’ a supplier in a distribution relationship in which goods are purchased from the supplier for resale. A purchaser who resells goods supplied by another is acting as a principal, not an agent.”).
148. See id.
149. Id.
151. Interview with Steve Krone, supra note 5.
152. Id.
153. Id.
Ownership/distribution may confer privileges, but it also creates obligations. For example, under the Digital Millennium Copyright Act ("DMCA"), distributors and licensees are responsible for assuming residuals payments for films under collective bargaining agreements such as the Screen Actors Guild, while sales agents are not. Further, the Copyright Act requires transfers of copyright ownership, or exclusive licenses, to be in writing but it does not require the transfer to include any "magic words." The result is that an agreement may be titled a “Sales Agency Agreement” but still contain language that sounds like a grant of rights, and thus require compliance with the DMCA. This type of hybrid agreement may also have tax consequences, because the agent’s citizenship will not be considered for purposes of complying with a foreign tax treaty, but a distributor’s will.

Professional preferences go both ways. Some people that are known as sales agents prefer to take rights to the films that they rep-

154. Distributors with copyright ownership hold exclusive licenses. See 17 U.S.C. § 101 ("A ‘transfer of copyright ownership’ is an assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation of a copyright or of any of the exclusive rights comprised in a copyright, whether or not it is limited in time or place of effect, but not including a nonexclusive license.") (emphasis added). Distributors are copyright owners of one or more of the exclusive rights comprised in a copyright. See id. at §§ 101, 106.


156. Id.

157. Id. ("In the case of a transfer of copyright ownership . . . in a motion picture . . . that is produced subject to 1 or more collective bargaining agreements . . . the transfer instrument shall be deemed to incorporate the assumption agreements applicable to the copyright ownership being transferred that are required by the applicable collective bargaining agreement, and the transferee shall be subject to the obligations under each such assumption agreement to make residual payments . . . ").

158. 17 U.S.C. § 204(a) ("A transfer of copyright ownership, other than by operation of law, is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing and signed by the owner of the rights conveyed or such owner’s duly authorized agent.").

159. Radio Television Española S.A. v. New World Entm’t, Ltd., 183 F.3d 922, 927 (9th Cir. 1999).


163. Telephone Interview with Mark Damon, supra note 74 (prefers distributor); Telephone Interview with Robbie Little, supra note 36 (no preference, depends on
resent, and therefore actually act as distributors. Others prefer not to take rights, because these rights may come with added responsibilities, such as residuals assumptions, minimum guarantee payments to the filmmaker (“MGs”), and increased exposure to liability from potential claims involving the film. Some sales agents have operated as distributors in the past and are now technically sales agents without rights in their films, yet consider themselves “Distr-Agents,” because they perform functions for their films that might have previously been the provenance of the distributor, such as organizing theatrical release, festival participation, and direct contact with the audience. Many operations offer both distribution and sales agency deals. And others, aware that they are “middlemen who could be cut out at any time,” are moving toward more ownership of their projects.

II. The Big Gundown: Irrevocable or Revocable at Will?

Sam discovered that he is indeed a middleman that can be cut out at any time. Even an agency agreement that purports to be irrevocable is nevertheless revocable at the will of the principal, if the the agent does not have a power coupled with an interest in the agency to protect it from revocation. While performance clauses specify what is expected of Sam under the agreement and set forth events that would trigger the principal’s legal right to terminate, the principal retains the power to terminate the contract for any reason whatsoever. Sam

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164. Telephone Interview with Mark Damon, supra note 74.
165. Telephone Interview with Alison Cohen, supra note 36. While residuals assumptions are typically contracted back to the producer, the ultimate duty remains with the distributor, per the DMCA, should the producer default or go bankrupt. Interview with Steve Monas, supra note 3. In addition, sales agencies sometimes pay MGs, though this is relatively rare; and distributors sometimes do not, though they more commonly do. Interview with Steve Krone, supra note 5.
166. Telephone Interview with Robbie Little, supra note 36.
167. Telephone Interview with Michael Meyer, supra note 140.
168. Telephone Interview with Roman Kopelovich, supra note 87.
169. Id.
170. THE BIG GUNDOWN (Box Office Spectaculars (II) 1966).
172. Telephone Interview with Alison Cohen, supra note 36; accord Telephone Interview with Robbie Little, supra note 36.
may attempt to sue his principal for breach of contract if she revokes against an irrevocable provision, but remedies are likely to be inadequate. Sam may not, however, stop his principal from terminating or revoking their ostensibly irrevocable agreement.

A. Once Upon a Time in the West: Custom and Practice

The entertainment industry is notorious for invoking “custom and practice” when confronted with a legal or contractual dilemma. But “just because studios and networks follow certain practices does not make those practices legal.” Business practices that have not been defined and tested in the courts may face surprising results once they do enter the fray. For example, as recently as 1997, a California District Court questioned the validity of the “negative pickup agreement,” one of the more common types of distribution deals available to independent film, because the parties were unable to “cite any case authority recognizing or discussing such an arrangement.”

This tension between business and legal practice plays out in foreign sales agency agreements. In the early days, when Dino De Laurentiis and Mark Damon were creating a new model for film distribution and sales, they were mostly just “making it up as we went along.” At that time, there were no lawyers involved with structuring these agreements. The involvement of lawyers is a more recent development, and possibly more American. According to one international “Distr-Agent,” the United States is still more “lawyered-up”
than Europe. The common perception is that while lawyers may provide “finesse” to an agreement, “if you listen to your lawyer, you’ll never do a deal.” This attitude epitomizes Judge Kozinski’s characterization of the film business in Effects Associates, that “Moviemakers do lunch, not contracts.”

The custom and practice of an industry may help determine the meaning of its contracts, but it does not override the law. Contracts are important in business dealings, but the freedom to contract is subject to regulation. A contractual provision to which both parties freely agreed is nevertheless invalid “if legislation provides that it is unenforceable.” One example of such legislation, California Civil Code Section 2356, states that “[u]nless the power of an agent is coupled with an interest in the subject of the agency, it is terminated by . . . [i]ts revocation by the principal.” Therefore, in California, an agency agreement’s “irrevocable” term is made unenforceable by statute as well as proscribed by common law. While the principal retains the power to revoke at will, if the parties have agreed to an irrevocable contract, then the contractual right to revoke has been waived:

Save in the case of an agency coupled with an interest, a principal has the power to revoke an agent’s authority at any time before the agent has completed performance. A principal may, however, curtail his right of revocation by contracting not to revoke the authority for a definite time. If the principal does so contract, he still retains the power to terminate the agency, and the termination

184. Id.
185. Telephone Interview with Mark Damon, supra note 74.
186. Telephone Interview with Robbie Little, supra note 36.
188. Id.
189. Boehm v. Spreckels, 191 P. 5, 7 (Cal. 1920) (“The allegation that it was the custom and usage of the publishers . . . amounts to nothing more than a statement that it was the opinion of such publishers . . . .” But “[t]he question . . . is to be determined by the principles of law and not by the opinions or customs of persons who deal with such matters.”).
190. See Chicago, B. & Q.R. Co. v. McGuire, 219 U.S. 549, 567 (1911) (“[F]reedom of contract is a qualified, and not an absolute, right. There is no absolute freedom to do as one wills or to contract as one chooses. The guaranty of liberty does not withdraw from legislative supervision that wide department of activity which consists of the making of contracts, or deny to government the power to provide restrictive safeguards.”); Holden v. Hardy, 169 U.S. 366, 391 (1898) (“This right of contract . . . is . . . subject to certain limitations which the state may lawfully impose in the exercise of its police powers.”).
191. RESTATEMENT (SECOND) OF CONTRACTS § 178(1).
193. Id.
cannot be prevented by the agent, but a revocation of authority
within the designated period renders the principal liable for dam-
ages for the violation of a legal right of the agent, just as in the
case of any other breach of contract. 195

Therefore, unless the agency is a power coupled with an interest, the
power to revoke remains with the principal, regardless of whether the
right to revoke has been waived by a contractual clause designating
the agreement as irrevocable. 196 Since specific performance is not
available for personal services contracts such as agency agreements,
a breach of this contractual right is only recoverable in monetary dam-
ages. 197 At times, sales agency damages may be easily ascertainable,
and at others, they may be subject to acceptable uncertainty. 198 How-
ever, damages stemming from projected sales may also be deemed too
speculative to award. 199 Ironically, because most sales agents are care-
ful to not promote reliance on their projected estimates in case of
shortfalls, 200 this self-protection may preclude them from recovering
on the basis of those same vague figures. 201

B. Compañeros: 202 Power Coupled With an Interest

“The problem of what constitutes a ‘power coupled with an inter-
est’” 203 has plagued lawyers for almost 200 years, since Chief Justice
Marshall first attempted to define the term in the landmark Supreme
Court decision Hunt v. Rousmanier’s Administrators. 204 One hundred
years later, the courts were still trying to decipher his meaning. 205

It is most difficult to frame an all embracing definition of a power
coupled with an interest. Most of the authorities on the subject

195. Roth, 197 P. at 63–64 (emphasis added) (citations omitted).
196. Id.
197. See infra Part IV.A.
198. Interview with Steve Krone, supra note 5.
199. See infra Part IV.B.
200. Jeffrey Sipe, Indies Embrace Small World: Sales Agents Face Environment
that Rewards Volume, Expertise, VARIETY (Feb. 7, 2011, 4:00 AM), available at http://
www.variety.com/article/VR1118031223?refcatid=3534 (“If you give big numbers be-
fore going to market and then don’t reach them, it leaves you with some very unhappy
producers.”); accord Complaint ¶ 14, Mime Investments, LLC v. GK Films, LLC, No.
fraudulently misrepresented projected estimates).
201. Projections remain speculative even when the sales agent is specific about the
estimates. See infra IV.B.
[hereinafter Yale Note].
204. Hunt v. Rousmanier’s Adm’rs, 21 U.S. 174 (1823).
205. See Lane Mortg. Co. v. Crenshaw, 269 P. 672, 679 (Cal. 1928).
seem to conclude that such a power is recognized by the law, and when found to exist in any given case it is not revocable at the will of any principal and even survives his death. The question ever present is as to when such a power exists, and what conditions must be shown to manifest its existence. Many of the authorities approach the subject as though it were a thesis, and treat it in such an academic way as to be confusing. Much is said concerning what is not a power coupled with an interest, with little attempt at exactness concerning what actually constitutes the same. 206

Fast forward another hundred years to the present day, and lawyers are still confused. 207 If lawyers do not understand what it means to have a power coupled with an interest, what hope is there for Sam, or for filmmakers with whom he contracts? 208

Justice Marshall, in Hunt, 209 the first case known to deal with the power coupled with an interest conundrum, described “the interest which can protect a power” 210 as “an interest in the thing itself . . . the power must be engrafted on an estate in the thing.” 211 Perhaps sensing his reader’s deepening puzzlement, he further explained that “a power to A. to sell for his own benefit, would be a power coupled with an interest; but a power to A. to sell for the benefit of B., would be a naked power.” 212 In the case at hand, the naked power was an agency that was given to secure a loan. 213 The plaintiff purposefully “waived taking a mortgage or bill of sale.” 214 Apparently, this would have given him a power coupled with an interest, but he wanted to avoid the necessary paperwork. 215 In spite of clear proof that the parties intended to create an irrevocable agency, 216 Justice Marshall was unforgiving: “It was the fault of the plaintiff . . . and no maxim of equity is better established than this, ‘that no man is entitled to the aid of a Court of equity, when the necessity of resorting to that court is created by his own fault.’” 217

206. Id. at 679 (emphasis added).
207. Interview with Maggie Megaw, supra note 16.
208. See id.
210. Id. at 204.
211. Id.
212. Id. at 205 (emphasis added).
213. Id. at 177.
214. Id. at 190.
215. Id. at 176.
216. Id. at 185 (“the power was unquestionably intended by the parties to be irrevocable for ever, and to transfer an interest in the thing itself . . . .”) (emphasis added).
217. Id. at 190.
Where *Hunt* was criticized for its formalistic approach to contract, later decisions were more lenient. Although still bound by Justice Marshall’s ruling, courts took advantage of its unclarity. Agreements were often enforced where there was evidence of *intent* on which the agent relied, even where the agreements lacked what Justice Marshall would require as a formal power coupled with an interest. By construing the term “interest” more liberally, these courts managed to follow precedent while disregarding its rationale. Their looser interpretation of interest reflected the parties’ *intention* to create security, instead of requiring an actual security as the Chief Justice had done. Differing interpretations of the phrase “power coupled with an interest” were “to be expected, inasmuch as the variable in the formula, the word ‘interest,’ has no precise meaning.”

### III. My Name is Trinity: The Hotel Industry’s Terrible Three

In the 1990s, after centuries of confusion, a trio of decisions shed much-needed light on this elusive interest with which a power must be coupled in order for an agency to be irrevocable. These decisions forced change on an unsuspecting hotel industry. Hotel owners

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219. Yale Note, supra note 203, at 115 (citing, e.g., Walker v. Brown, 165 U.S. 654 (1897)).

220. Id. at 111.

221. Harvard Note, supra note 218, at 253 (“where the agent has entered into an obligation in reliance on his agency”).

222. Id. at 254–55 & nn.11–13 (“legal lien was enough to constitute an interest”) (citing Knapp v. Alvord, 1843 WL 4801 (N.Y. Ch. Apr. 4, 1843); (“power to collect rents, given as security for money advances is ‘coupled with an interest’”) (citing Stevens v. Sessa, 64 N.Y.S. 28 (App. Div. 1900)); (“power to pay out money to be received by the agent in [sic] behalf of the principal is ‘coupled with an interest,’ if in reliance on the power the agent has entered contractual obligations as to the money with the principal’s consent.”) (citing Mulloney v. Black, 138 N.E. 584 (Mass. 1923)).

223. Compare Lane Mortg. Co. v. Crenshaw, 269 P. 672, 679 (Cal. 1928) (“[A] power is said to be coupled with an interest when the power forms part of a contract, and is a security for money or for the performance of any act which is deemed valuable...”), with Hunt v. Rousmanier’s Adm’rs, 21 U.S. 174, 180 (1823) (“There is an essential difference between a contract to perform a particular thing, and the actual performance of that thing.”).

224. See *Hunt*, 21 U.S. at 176, 185, 190.

225. Yale Note, supra note 203, at 111.


were permitted to revoke their agreements with companies that held long-term contracts to manage their hotels.229 The management companies were agents to the hotel owners, and the parties had contractually agreed that the agency would be irrevocable.230 The managers were in for a rude surprise when they discovered that they did not possess a power coupled with an interest to effect their intentions.231 Sam and his friends in independent film would do well to learn from their mistakes.

A. The Mercenary:232 Ballad of the Hotel Manager

Like the foreign sales agent,233 the role of the hotel management company has evolved over time.234 Hotel chains were once “largely owned by insurance companies, pension funds and other institutional investors, and were disallowed by their industries’ regulators to participate in the risk of operating hotels.”235 As a result, the owners leased the hotels to management companies that assumed both the risk and the reward, and paid the owners a percentage of the bottom line.236 This arrangement resembled the distributor relationship in independent film, with the management company in the role of the distributor, and the hotel owner cast as filmmaker.237
Eventually, in an attempt to capture more profit, the hotel owners chose to assume the risk of operating the hotels themselves. Under this new arrangement, the owner bore both risk and reward, and compensated the manager with a percentage of the proceeds. The hotel manager was thus recast in the role of the sales agent in independent film. Like Sam and other foreign sales agents, the manager was “able to operate for this percentage of revenues without bearing the risk of loss.”

This shared ability of hotel managers and sales agents to operate without bearing loss was ripe for conflicts of interest. Once absolved of responsibility, “management companies would want to manage as many properties as possible, spreading the name and reputation of their company as widely as possible, without regard for the bottom line profitability of the hotel owners.” The managers under this model received a share of the profits, so reduced profits would have affected their take. Yet the managers appeared content to make up in volume what they lost on the profitability for each individual hotel. Although multiple representation, such as that undertaken by the hotel managers, is not proscribed by agency law unless the principals’ interests are adverse to each other, focusing on one principal to the detriment of another often does create an adverse interest. Similar conflict accusations are routinely levied against all manner of agents in the entertainment industry, including the foreign sales agent in independent film.

In the 1990s, hotel “owners and lenders repeatedly and successfully enforced their rights under agency law to be protected against [such] conflicts of interest.” Sales agents do not foresee a comparable

238. Hale, supra note 234, at 583–84.
239. Id. at 584.
240. Id.; see also supra Part I.B.
241. Hale, supra note 234, at 584.
242. Id.; see also McDaniel, supra note 228, at 415.
243. See Hale, supra note 234, at 584.
245. Id.
247. Interview with Steve Monas, supra note 3.
248. See McDaniel, supra note 228, at 21 & n.7 (citing Gov’t Guarantee Fund of Fin. v. Hyatt Corp., 95 F.3d 291 (3d Cir. 1996)) (“The court held that non-disturbance was not enforceable against a principle [sic], but suggested that failure by the principle [sic] to perform the covenant by terminating without cause might be relevant to dam-
stampede to revoke sales agency agreements in the film industry.\textsuperscript{249} These agents posit that when a film is selling, the principal is happy, and when sales are lacking, the agent is happy to cut it loose.\textsuperscript{250} While that is the ideal scenario, there are many reasons filmmakers may wish to revoke their sales agency agreements, including conflicts of interest.\textsuperscript{251} The producer may also believe that another agent may better represent her film, or may want to enter into deals directly. Lack of sales is not the only motivator—a film’s success may also drive a producer to attempt a better deal.\textsuperscript{252} For example, initial theatrical performance of the film \textit{Platoon}\textsuperscript{253} led its producers to terminate its home video deal with Vestron Video in favor of HBO.\textsuperscript{254} Vestron successfully sued, but by then the damage had been done—the video had already been out for several years.\textsuperscript{255} As is often the case with litigation, even when you win, you lose.

\textbf{B. Four of the Apocalypse:}\textsuperscript{256} Lessons From Fallen Agents

The legal implications from the hotel industry apply to all industries in which there are agency relationships.\textsuperscript{257} Although the practical ramifications for the film industry remain untested, the same is true about much of what appears in entertainment contracts.\textsuperscript{258} Yet these untested

\begin{footnotesize}
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\item \textsuperscript{249} Telephone Interview with Alison Cohen, supra note 36; accord Telephone Interview with Michael Meyer supra note 140; Telephone Interview with Mark Damon, supra note 74.
\item \textsuperscript{250} Telephone Interview with Alison Cohen, supra note 36; accord Telephone Interview with Michael Meyer supra note 140; Telephone Interview with Mark Damon, supra note 74.
\item \textsuperscript{251} See supra (discussion about conflicts of interest).
\item \textsuperscript{252} See Vestron, Inc. v. Home Box Office Inc., 839 F.2d 1380, 1381 (9th Cir. 1988) (describing the producer’s termination of a home video distribution deal for the films \textit{Platoon} (Orion Pictures 1986) and \textit{Hoosiers} (Orion Pictures 1986), after initial theatrical success).
\item \textsuperscript{253} \textit{Platoon} (Orion Pictures 1986).
\item \textsuperscript{254} See \textit{Vestron}, 839 F.2d at 1381.
\item \textsuperscript{255} \textit{Id.}; accord Interview with Steve Monas, supra note 3. Monas was Vice President of Business Affairs with Vestron Pictures during the suit. \textit{Id}.
\item \textsuperscript{256} \textit{Four of the Apocalypse} (Anchor Bay Entertainment 1975).
\item \textsuperscript{257} The hotel cases are founded on basic agency principles and do not rely on any factual premises unique to the hotel industry. See Woolley v. Embassy Suites, Inc., 278 Cal. Rptr. 719 (1991); Pac. Landmark Hotel, Ltd. v. Marriott Hotels, Inc., 23 Cal. Rptr. 2d 555 (1993); Gov’t Guarantee Fund of Fin. v. Hyatt Corp., 95 F.3d 291 (3d Cir. 1996). Another example of a revocable agency agreement is the revocable proxy in Delaware corporations law. See, e.g., Rivka Weil, \textit{Declassifying the Classified}, 31 Del. J. Corp. L. 891 (2006); Haft v. Haft, 671 A.2d 413, 413 (Del. Ch. 1995).
\item \textsuperscript{258} The ubiquitous waiver of droit morale (moral rights) is one example. See Moore, supra note 4, at 109. Although the artist’s moral rights cannot be waived in
\end{itemize}
\end{footnotesize}
provisions are generally included because it is the transactional attorney’s job to protect against risks, both known and merely contemplated. Whether their preparations will ultimately shield their clients from future attack may only be answered in hindsight. In the meantime, attorneys with foresight look to case law in analogous industries. Savvy sales agents and their attorneys can learn from their comrades in the hotel industry in the specific ways that follow and possibly arm themselves against revocation, if they so desire.

1. ACE HIGH: AGENCY TRUMPS CONTRACT

In the context of independent film, a distributor is a grantee of one or more exclusive rights, and such grants are subject to both copyright and contract law. When the two authorities are in conflict, copyright law governs, so long as the issue involves a matter to be determined under the Copyright Act. Where rights are not granted, the relationship is an agency and governed by agency law and contract. The hotel management cases resolved the issue—who wins in the conflict between agency and contractual authority regarding revocability of agency contracts—in favor of agency. This is because California statute codified the common law rule first articulated by Chief Justice Marshall in 1823, that on its face limits or modifies the contract law in this manner. "The principal’s power of revocation is absolute and applies even if doing so is a violation of the contract or the agency is characterized as 'irrevocable.'"

"It is a cardinal principle of agency law that a principal who employs an agent always retains the power to revoke the agency." The underlying rationale is that agency is founded on the mutual as-

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259. ACE HIGH (Paramount Pictures 1968).
260. See supra Part I.C.
261. Effects Assocs., Inc. v. Cohen, 908 F.2d 555, 559 (9th Cir. 1990).
262. Scholastic Entm’t Inc. v. Fox Entm’t Grp., Inc., 336 F.3d 982, 985–86 (9th Cir. 2003).
263. See supra Part I.C.
266. Hunt v. Rousmanier’s Adm’rs, 21 U.S. 174 (1823).
267. See, e.g., Woolley, 278 Cal. Rptr. at 724–25.
268. Id. at 725 (citing RESTATEMENT (SECOND) OF AGENCY, § 118, cmt. b. at 300; WARREN A. SEAVERY, HANDBOOK OF THE LAW OF AGENCY § 46, at 87 (West 1964)).
269. Woolley; 278 Cal. Rptr. at 724 (emphasis added).
sent of both parties, and if one party no longer wishes to be represented by the other, then that assent is destroyed. Contracts are also driven by mutual assent, at least at formation. But because of the intimate nature of an agency, with its heightened duties, “it should always be within the power of the principal to manage his own business[,] and that includes the power of the principal to re-assume the control over his own business which he has but delegated to his agent.” Therefore, the power of assent in agency, which includes the power to revoke assent, is stronger than the power of assent in contract to limit the parties’ ability to revoke agency.

While contractual recitations are not determinative of the type of relationship at issue, they may factor as evidence. In one hotel management agreement, the use of the term “Agent” undermined the management company’s protestations that it could not be an agent to the hotel owner because its relationship with the owner “defied simple principal-agent classification.” However, the contract also expressly denounced any “partnership or joint venture.” The court held that these terms were not “mere labels,” but evidence of an agency created for the benefit of the principal. While not dispositive, the chosen terminology balanced in favor of a finding that the relationship was an agency, since not a partnership or joint venture, and therefore was revocable at will.

In the independent film business, foreign sales agents often make similar disclaimers, such as: “Nothing contained in this agree-

270. Id. at 724–25.
271. Utley v. Donaldson, 94 U.S. 29, 47 (1876) (“There can be no contract without the mutual assent of the parties.”).
272. Woolley, 278 Cal. Rptr. at 725 (emphasis added).
273. Id.
274. See, e.g., id.
275. Id. (arguing that because the hotel owner entrusted the “entire operation” of the hotel to the manager, the relationship was not an agency. “However the very nature of a managerial relation is to delegate authority from principal to agent. ‘A manager normally has the widest authority of all business agents and, unless limited by instructions, is in complete control of its operations.’” (quoting Seavey, supra note 268, § 26, at 48.)).
276. Woolley, 278 Cal. Rptr. at 725.
277. Id.
278. Id. at 726 (“The agency must be created for the benefit of the agent in order to protect some title or right in the subject of the agency or secure some performance to him.”) (emphasis in original) (citing Becket v. Welton Becket & Assocs., 114 Cal. Rptr. 531, 533 (1974)).
280. Interview with Steve Monas, supra note 3.
ment shall constitute or be construed to be . . . a partnership or joint venture . . . ,”\(^{281}\) whether or not the agreement includes the term “Agent.” While contractual recitations in the face of contradictory evidence do not suffice to prove the nature of that relationship,\(^ {282}\) the court held that “[g]iven provisions that unambiguously provided that the agreements were between principal and agent and did not create a . . . partnership or joint venture, [then] as a matter of law the agency could be terminated.”\(^ {283}\) Foreign sales agents who include such disclaiming language in an attempt to shield themselves from tort liability should be aware that this may mean risking unwaivable revocability. In summary, if the relationship is not an agency, care should be taken to call the distributorship, partnership, joint venture, or other entity by its proper legal term. Conversely, even if the term “Agent” is not used, if there is found to be an agency relationship, the agreement may be revoked, unless it includes a power coupled with an interest.\(^ {284}\)

2. A FISTFUL OF DOLLARS:\(^ {285}\) COMPENSATION IS NOT THE REQUISITE INTEREST

An agent who wishes to establish an irrevocable agency agreement must first establish a “power coupled with an interest.”\(^ {286}\) That is, the power to act as an agent must be coupled with an interest in the agency. Chief Justice Marshall defined “the interest which can protect a power”\(^ {287}\) as “an interest in the thing itself . . . the power must be engraven on an estate in the thing.”\(^ {288}\) However, the precise meaning

\(^{281}.\) Woolley, 278 Cal. Rptr. at 725.
\(^{282}.\) Id.; see also E1 Films Can. Inc. v. Syndicate Films Int’l, No. B236146, 2013 WL 153347, at *5 (Cal. Ct. App. Jan. 15, 2013) (holding that the language of the contract that the appellant entered into “in its capacity as sales agent for the licensor of a Picture” was not sufficient in the face of contradictory evidence that it acted on its own behalf).


\(^{284}.\) Woolley, 278 Cal. Rptr. 724–25.

\(^{285}.\) A Fistful of Dollars (United Artists 1964). Sergio Leone originally asked Mark Damon to play a villain in the film, but his agent made him pass. See Cowboy, supra note 67, at 361–62. Damon did contribute to A Fistful of Dollars by reaching out to his friend Clint Eastwood, then starring in the television series Rawhide (1966), and asking him to meet with Sergio Leone. Id. at 362 (“And to this day . . . whenever I see Clint he says, ‘Mark it’s all your fault.’”).


\(^{287}.\) See Hunt, 21 U.S. at 204.

\(^{288}.\) Id.
of the term “interest” was under continual revision in the courts until the hotel cases provided some clarity for California agents.

Now, one thing is clear: “Monetary compensation, in whatever form it may take, does not create a power coupled with an interest so as to make the agency irrevocable.” For example, because a hotel “‘management fee’ of five percent of the gross revenue” is compensation, a court declared that it could not be interest. An agreement that a hotel owner would share in profit participation with the hotel manager above and beyond the management fee similarly failed, because the manager did not also participate in the losses, as required of a partner, or non-agent. In the language of entertainment contracts, “profit participation” is also known as “contingent compensation.” Sam should therefore take heed that whether performing for a flat fee, a percentage of revenues, profit participation or other compensation model, compensation is not an interest that will keep his agency from being revoked.

3. A BULLET FOR THE GENERAL: INTELLECTUAL PROPERTY DOES NOT SAVE THE DAY

The agent’s contribution of its own intellectual property is likewise not an interest. Hotel managers and foreign sales agents both create materials to market and build the principal’s brand. However, the courts consider these contributions to be within the scope of the agency, as they are made for the benefit of the principal, in order to sell the product. One hotel manager argued that it had made a capital investment to the hotel of its intellectual property, including trademarks, logos, marketing materials and proprietary information. According to the manager, the intellectual property was “to be used in

289. Yale Note, supra note 203, at 111 (“the word ‘interest,’ has no precise meaning”).
291. Woolley, 278 Cal. Rptr. at 726 (citing 2 BERNAARD WITKIN, SUMMARY OF CAL. LAW (10TH), § 209, at 207; O’Connell v. Super. Ct. of S.F., 41 P.2d 334, 336 (Cal. 1935)).
292. Woolley, 278 Cal. Rptr. at 726.
293. Id.
294. Gov’t Guarantee Fund, 95 F.3d at 303.
295. See MOORE, supra note 4, at 149.
297. See Gov’t Guarantee Fund, 95 F.3d at 305.
298. Id.; see also Telephone Interview with Robbie Little, supra note 36.
299. See Gov’t Guarantee Fund, 95 F.3d at 305.
300. Id.
connection with the hotel only because it insisted upon and received agency powers to manage the resort.”

The logical conclusion, the manager argued, is that its management duty was a security for its investment of intellectual property into the hotel.

This argument failed. The court held that the manager’s contributions of intellectual property were “merely a normal incident of an agency relationship, and did not create an irrevocable agency.”

Like hotel managers, foreign sales agents make significant investments to their projects, creating marketing campaigns, treatments, synopses, and other materials for each film. As the hotel holdings make clear, these contributions, without more, do not comprise the interest necessary for an irrevocable agency.

What that extra element might be is unclear. If the intellectual property contributions rise to the level of joint authorship, the foreign sales agent may have an argument that it is a co-owner or tenant in common in the relevant copyrights; but then the foreign sales agent may also cease to be an “actual agent,” with its protection from contractual and tort liability.

The court hints that the result in the hotel case might have been different if there had been “a separate clause linking the franchise agreement to the agency relationship . . . to protect the agency’s interest.”

Accordingly, if Sam or another sales agent were to take this court’s suggestion, he might draft a license agreement or clause that separately grants to the filmmaker the use of his intellectual property (copyrights, trademarks, etc.) toward the marketing of the film, and specify that it secures his performance as a sales agent. The issue of materials created by the sales agent is explicitly covered in many existing sales agency forms, but the court seems to suggest contractual language that clearly links the branding agreement to the agency relationship, and states that the use of the materials is intended to secure the agency’s interest.

301. Id. (emphasis in the original).
302. Id.
303. Id. (emphasis added).
304. Telephone Interview with Robbie Little, supra note 36.
305. See Gov’t Guarantee Fund, 95 F.3d at 305.
307. Id. at *5 (holding the appellant/agent liable on the contract that it claimed to have entered into on behalf of a disclosed principal, because it was deemed to not be an “actual agent.”).
308. See Gov’t Guarantee Fund, 95 F.3d at 306.
309. Interview with Steve Krone, supra note 5.
However, this suggestion may not be as applicable to the foreign sales agent. Even with a separate clause granting the filmmaker the use of the agent’s intellectual property, with that grant made to secure the agent’s interest, the intellectual property may still be deemed to be an ordinary incident of the agency relationship. Here, the worlds of hotel manager and foreign sales agent diverge. The hotel manager’s intellectual property usually consists of its trademarks and other materials already in existence, which it contributes to an empty building in order to create a hotel brand. The sales agent, on the other hand, creates branding specifically for the film. These differences cast doubt on the applicability of the court’s suggestion to the sales agent, because even with a separate clause granting the filmmaker the use of the agent’s intellectual property, that intellectual property was still created in the context of an agency relationship, for the benefit of the filmmaker.

4. GOD FORGIVES, I DON’T: INTEREST MUST BE COUPLED IN THE SAME ENTITY

A loan may be a type of interest in a power coupled with an interest, but only if that interest is properly coupled with the agency. One hotel manager almost succeeded in creating this coupling; however, it failed to observe formalities. The management company made a series of loans to the hotel owner, which would have created an interest that the power of its agency would be deemed to secure. However, the loans were made by a subsidiary of the management company, not the hotel manager itself. The trial court initially held that the interest was the same for the manager as for its subsidiary, thus “disregarding the separate corporate entities involved.” However, the appellate court held that the entities should not be conflated, because “the law permits the incorporation of businesses for the very purpose of isolating liabilities among separate entities.”

310. Gov’t Guarantee Fund, 95 F.3d at 305.
311. Telephone Interview with Robbie Little, supra note 36.
314. Id.
315. Id. at 561–63.
316. Id. at 562.
317. Id. at 563.
318. Id. (citing Cascade Energy & Metals Corp. v. Banks, 896 F.2d 1557, 1576 (10th Cir. 1990)).
This holding has special relevance to the film industry, where custom and practice is often a tangle of entities and assignments. Advances for festivals, materials, or recoupable minimum guarantees (“MGs”) may provide the requisite interest, at least until the interest is recovered. However, the shell game that many sales agents play, of obtaining pictures under one entity then entering into an agency relationship with another, related, entity to shield itself from liability may backfire. The cautionary tale told by *Pacific Landmark Hotel v. Marriott*, warns against attempting to shield from liabilities to the extent that one is also shielded from the attendant protection. Meanwhile, in the film business, New Line lost its superior security interest claim for the motion picture *The Grass Harp* after New Line entities New Line Productions and New Line Cinema unsuccessfully “refer[red] to ‘New Line’ in a collective sense perhaps to derive benefit by blurring the entities together[.]” The lesson is this: In the foreign sales agent’s changing landscape of mergers, subsidiaries, affiliates and partnerships, names matter, and formalities must be observed.


320. See infra Part V.B.

321. E1 Films Can. Inc. v. Syndicate Films Int’l, No. B236146, 2013 WL 153347, at *6 (Cal. Ct. App. Jan. 15, 2013) (“the evidence showed that appellant, BYP, the Yari Film Group and the four film licensors were essentially interchangeable, sharing common ownership, business and e-mail addresses, employees and corporate titles. For example, Glasser simultaneously served as appellant’s president, the Yari Film Group’s chief creative officer and the executive producer of the four films. Rapkowski testified that the reason he demanded payment from BYP rather than appellant was that E1 ‘considered all of these companies to be one and the same, controlled by the same controlling minds. E-mails were coming with e-mail signatures from all of these interchangeably, the principals of these companies were all working for all of them interchangeably, and in my mind this was all one company.’ Accordingly, substantial evidence supported the trial court’s determination that ‘there was no legal ‘principal’ or ‘agent.’ It would be contrary to the evidence and manifestly unjust to conclude that SFI was only an ‘agent,’ and thus immune from liability, in the face of the corporate fictions erected by these various Yari Film Group entities.’”).

322. 23 Cal. Rptr. 2d at 556–57, 561–63.


324. LeFlore, 67 Cal. Rptr. 2d at 345.

325. See Dawtrey, supra note 52.

326. It is clear that this was not a case of mistaken formalities, but Marriott’s purposeful attempt to shield itself from liability while gaining the benefit of its subsidiary’s deal. See *Pac. Landmark Hotel*, 23 Cal. Rptr. 2d at 562–63 (“For business reasons, Marriott chose to have the Management Agreements drafted only between [Marriott] and Owners. [Marriott] was not given any interest in the Hotel via any other document evidencing loans to or investments in Owners. . . . We assume one of the purposes of these separate corporate identities was to insulate Marriott from liability.”) (emphasis added).
IV. The Ugly Ones: Inadequate Remedies

There is a significant reduction in the nature of available remedies caused by the revocability doctrine. Because the sales agency agreement is a personal services contract, specific performance is not available. Monetary damages are hard to prove when they are predicated on estimates for future sales that are speculative by nature. It is possible that if a sales agency is revoked and the film sold elsewhere, a court may calculate the damages by the replacement sales. But the services provided by foreign sales agents are unique and based on personal variables such as the reputation and network of each agent, so even subsequent sales are not guaranteed to be recoverable.

Other than expenses, legal damages for a revoked agency agreement are difficult to ascertain with certainty. Therefore, a liquidated damages clause may protect agents who enter into “irrevocable” sales agency agreements from the revocability doctrine. As always when creating a liquidated damages provision, care must be taken to ensure that “the amount set in the agreement [is] a reasonable forecast of just compensation” and not a penalty. Otherwise, although Sam will likely recover his expenses and/or any liquidated damages, to force Sam into legal action with such limited remedies may be to “deprive him of the benefit of his bargain.” However, with a power coupled with an interest, Sam would be in a stronger position, as he would then have an equitable interest to protect.

A. Adiós Gringo: No Specific Performance of Personal Services Contracts

“It has long been a principle of equity that a contract to perform personal services cannot be specifically enforced.” This is because specific performance would “run contrary to the Thirteenth Amendment’s prohibition against involuntary servitude.” Moreover, specific per-

327. THE UGLY ONES (United Artists 1967).
328. See infra Part IV.A.
329. See infra Part IV.B.
330. See infra Part IV.B.
331. See Dawtrey supra note 52.
333. See Yale Note supra note 203, at 113.
334. See Roth v. Moeller, 197 P. 62, 63 (Cal. 1921).
335. ADIOS GRINGO (Trans Lux 1965).
formance “would impose upon the court the prodigious if not impos-
sible task of passing judgment on the quality of the performance . . . of
a contract which calls for special knowledge, skill or ability.” 338 Fi-
nally, “[c]ourts wish to avoid the friction and social costs which result
when the parties are reunited in a relationship that has already failed,
especially where the services involve mutual confidence and the exer-
cise of discretionary authority.” 339 Many sales agents, when discuss-
ing the theoretical threat of revocation, agree that “we don’t want to
do business with anyone who doesn’t want to do business with us.” 340

Considering that there is not much that Sam can legally do to stop
his principal from revoking, this is not a bad attitude to adopt. “An in-
junction cannot be granted to prevent the breach of a contract which
cannot be specifically enforced. And it is a fundamental rule that spe-
cific performance cannot be decreed to enforce a contract for personal
services, regardless of which party seeks enforcement.” 341 Sales
agency agreements, like hotel management contracts, qualify as per-
sonal services, because they “call for the rendition of services which
require the exercise of special skill and judgment.” 342 Personal ser-
vices have “a distinctly personal and non-delegable character,” 343 and
comprise a category that includes “actors and artists, managers, sales
agents, school-teachers, mechanics, cooks, and contracts for the furnis-
ing of personal care and support.” 344

The hotel cases held that even large management corporations qual-
ify as providing personal services to hotel owners. 345 Accordingly,

338. Woolley, 278 Cal. Rptr. at 727 (citations omitted).
339. Id. (citing Poultry Producers, 208 P. at 97–98).
340. Interview with Steve Monas, supra note 3; accord Telephone Interview with
Alison Cohen, supra note 36; Telephone Interview with Michael Meyer, supra note
140; Telephone Interview with Roman Kopelevich, supra note 87; Telephone Inter-
view with Robbie Little, supra note 36; Telephone Interview with Mark Damon,
supra note 74.
341. Woolley, 278 Cal. Rptr. at 726–27 (internal citations omitted).
342. Id. at 727. In California, personal services contracts cannot be enforced
against the agent for more than seven years. See Foxx v. Williams, 52 Cal. Rptr.
896, 906 (1966). This challenges the validity of most foreign sales agency agreements,
where terms are generally for upwards of ten years. Interview with Steve Monas,
supra note 3. However, the agent is not usually the party attempting to terminate
the agreement. Id.
343. Woolley, 278 Cal. Rptr. at 727.
344. Id. (emphasis added) (citation omitted). In California, “[t]he rule is statu-
tory . . . and California cases applying it to a variety of comparable fact situations are
numerous . . . [including] exclusive sales agency.” Id. (citing CAL. CIV. CODE § 3390
(West 1985 & Supp. 2013); Long Beach Drug Co. v. United Drug Co., 88 P. 2d 698,
699 (Cal. 1939)) (other citations omitted).
345. See, e.g., Woolley, 278 Cal. Rptr. at 727.
sales agents that are also larger entities, not just lone operators like Sam, would likewise be deemed to provide personal services to their principals. Moreover, many sales agency agreements include a “key man” clause, wherein the principal designates only the named individual as her agent.346 The key man clause specifies that if the named individual ever leaves the entity with which the principal contracted, the principal will not be bound by the agency entity absent that “key” individual.347 Therefore, the services provided by a foreign sales agency, whether by an entity or by the “key man,” are personal to the filmmaker/principal, and cannot be specifically performed as a remedy in contract.

B. Death Does Not Count the Dollars:348 No Speculative Damages

Thus deprived of specific performance on the revoked contract, foreign sales agents may recover only monetary damages.349 But where “the contract did not vest in the agents a power coupled with an interest,” the principal retains the power350 “to revoke the agency at any time.”351 Therefore, “after revocation plaintiffs had no remedy other than an action for damages suffered by them prior to the time of the revocation.”352 Sam and his colleagues match a product with a buyer, not unlike a real estate broker,353 or a broker of potatoes.354 For the foreign sales agent selling films, like the potato broker, “the right to a commission depend[s] on their sale of the potatoes.”355 Neither agent should be allowed to speculate on how many potatoes he would have sold if given the chance.356

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346. Interview with Steve Monas, supra note 3.
347. Id. Of course, even without the “key man” clause, the principal retains the power to revoke or terminate at will, for any or no reason, as discussed, supra. However, with a “key man” clause, the principal will also have a contractual right to terminate, upon the departure of the individual. As discussed infra, even when a contractual right is breached, damages for that breach are likely inadequate. Therefore, the contractual right of the principal to terminate may not add much value in practice.
348. DEATH DOES NOT COUNT THE DOLLARS (a.k.a. DEATH AT OWELL ROCK and NO KILLING WITHOUT DOLLARS) (Koch Media 1967).
349. At least, that is what befell their hotel manager counterparts. See Woolley, 278 Cal. Rptr. at 728.
350. The decision uses the word “right,” where it is clear that it means “power.” See Campodonico v. Marchesotti, 134 P.2d 856, 857 (Cal. 1943) (“[T]he contract did not vest in the agents a power coupled with an interest, so that defendant had the right to revoke the agency at any time . . . .”) (emphasis added).
351. Id.
352. Id. (emphasis added).
353. See Ravid, supra note 124.
354. See Campodonico, 134 P.2d at 856.
355. Id. at 857.
356. Id.
There are several grounds for damages on breaches of contract. The first is actual damages, the amount of money that the injured party “has already expended towards performance.” Sam, like many sales agents, expends large amounts of money on marketing the films that he represents—even, at times, developing them. The Supreme Court held that when the performance of the contract requires such an outlay of expenditures, “the claimant ought at least to be made whole” with regard to what money he has already spent. However, Sam may not be made whole for the time he has spent on the project, although a reasonable portion of the salary that Sam has paid towards staff and himself may be recoverable upon proper proof. But because most sales agents are paid by how many licenses they secure and not by how much time they spend securing them, Sam may not be able to calculate those damages with sufficient certainty to recover them.

Lost profits, the second basis for recovery, are also not viable when the profits are based on commissions for future sales, uncertain to occur. Damages for unsold potatoes or unlicensed films are “too remote and speculative in their character, and therefore incapable of that clear and direct proof which the law requires.” Even with a proven track record and mathematical statistics that demonstrate a steady demand for products much less ethereal than motion pictures, courts are asked, “what amount could plaintiff, with his long experience and wide acquaintance in the trade, have sold?” and “are constrained to answer that [they] do not know.” If the markets for such stable commodities as potatoes and canned goods are deemed too unpredictable to recover, then motion picture audiences are downright mercurial.

358. Telephone Interview with Roman Kopelevich, supra note 87; Telephone Interview with Robbie Little, supra note 36.
359. Behan, 110 U.S. at 344.
361. See, e.g., Interview with Steve Monas, supra note 3.
362. See, e.g., Stephany, 217 P. at 798.
363. Behan, 110 U.S. at 344.
364. Spitzer v. Pathe Exchange, 23 P.2d 308, 311 (Cal. 1933) (holding that “there was no evidence of profits” where a foreign sales agent breached the contract with its producer, because the value of the picture remained untested in that, or any market.).
366. Spitzer, 23 P.2d at 308–09.
368. See Stephany, 217 P. at 799 (canned goods).
369. Id.
370. Id.
371. See Campodonico v. Marchesotti, 134 P.2d 856, 857 (Cal. 1943) (potatoes); Stephany, 217 P. at 797–98 (canned goods).
372. See Levinson supra note 116, at 187 (“There can be no assurance of the economic success of any motion picture since the revenues derived from the
And motion pictures are not entirely like potatoes—they are creative works, that are “difficult to quantify, and public tastes are difficult to anticipate.” 373 Because of this added unpredictability, many different types of entertainment contracts fail to prove, and therefore recover, damages. 374 Not to mention that with Hollywood accounting, most movies claim a net loss! 375 Courts sympathetic to this difficulty may take into account “whether or not the entertainer or entertainment project... has developed a track record of success demonstrating public acceptance, thereby supporting the ‘reasonable’ assumption that such success—and damages calculated thereon—will continue.” 376

For plaintiffs able to clearly demonstrate their track record as specifically applied to the breached contract, “[t]he fact that the amount of damage may not be susceptible of exact proof or may be uncertain, contingent, or difficult of ascertainment does not bar the recovery.” 377

But the line between damages too speculative to recover and those sufficiently proven by a track record is very fine and fact specific. 378 For this reason, Sam’s ten-year success in the film business is not enough to ensure that he will be able to recover prospective profits on his revoked films. To procure damages on an agreement for a specific film that has been revoked, Sam must also show proof of that film’s track record, and its applicability to this market. 379 Sam can do this by pro-

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374. Id. at 1, 12.
376. Simensky, supra note 373, at 15.
378. See Sw. Fin. Corp. v. Kelly, 233 Cal. Rptr. 639, 642 (1987) (holding that damages were not speculative because of the distributor’s ten years of experience, known actors in starring roles, and a completed sale to a network); Contemporary Mission, Inc. v. Famous Music Corp., 557 F.2d 918, 927 (2d Cir. 1977) (holding that damages were not speculative because “[t]his is not a case in which the plaintiff sought to prove hypothetical profits from the sale of a hypothetical record at a hypothetical price in a hypothetical market. At the time of the sale... the record was real, the price was fixed, the market was buying and the record’s success, while modest, was increasing.”) (emphasis added); Lexington Prods. Ltd. v. B.D. Commc’ns, 677 F.2d 251, 253–54 (2d Cir. 1982) (holding that the mathematical correlation between past advertising and products previously sold provided sufficient proof of reasonably certain damages).
379. See, e.g., Cohn v. Rosenfeld, 733 F.2d 625, 627, 631 (9th Cir. 1984); accord Yaguda v. Motion Picture Publ’ns, Inc., 35 P.2d 162, 164 (Cal. 1934) (showing a product’s track record through contracts already negotiated for that product); see
viding evidence that he had concluded or had deals pending on this film before his agreement to sell it was revoked.\textsuperscript{380} Also, if after revoking the agreement, a producer sold the film herself to one of Sam’s territories, that purchase price may similarly provide sufficient certainty for Sam to recover in damages.\textsuperscript{381}

These examples of certain, calculable damages are not specific to the entertainment industry and its emerging track record exception. Even potato brokers who have lined up “purchasers ready and willing to buy said potatoes,”\textsuperscript{382} may recover damages from their lost sales.\textsuperscript{383} Because the amount of these damages \textit{can} be calculated with sufficient certainty, contracts that are pending or already entered into are \textit{not} speculative damages.\textsuperscript{384} Likewise, when the principal revokes a sales agency agreement and then enters into her own agreements in the same territory,\textsuperscript{385} while there is no proof that the original sales agent could have made the same sales as the principal,\textsuperscript{386}

[T]he breach of an exclusive sales agency contract through the invasion of the territory of the agent will entitle the latter to the profits he would have made upon sales in the amount of those made by his principal in the invaded territory. The fact that the goods were sold by defendants furnished sufficient proof that they \textit{could} have been sold by plaintiff.\textsuperscript{387}

Under these limited circumstances, foreign sales agents may find relief when and if their agency agreements are revoked. However, these are but exceptions to the rule that prospective damages are too speculative to recover.\textsuperscript{388} Sales agents without a power coupled with an interest in their agreements constantly roll the dice, between “the possibility of an enormously profitable venture and the risk of colossal failure.”\textsuperscript{389}

\textit{also} Zinn v. Ex-Cell-O-Corp., 306 P.2d 1017, 1029 (Cal. 1957) (showing that the product’s track record is applicable in that market through the principal’s direct sales of that product in that territory).
\textsuperscript{380} See Cohn, 733 F.2d at 627, 631.
\textsuperscript{381} See Zinn, 306 P.2d at 1029.
\textsuperscript{382} Campodonico v. Marchesotti, 134 P.2d 856, 857 (Cal. 1943).
\textsuperscript{383} See \textit{id.}, finding, however, that it was unnecessary to entertain this argument, since there was no evidence to support the claim.
\textsuperscript{384} See Cohn, 733 F.2d at 627, 631 (awarding damages to a licensor after it had resold the package of films to a network before its license for several of the films was revoked).
\textsuperscript{385} See Zinn, 306 P.2d at 1029.
\textsuperscript{386} \textit{Id.} (“Ex-Cell-O argues that the amount of revenue earned by it does not establish that Scaled-Pure could have accomplished the same amount of business.”).
\textsuperscript{387} \textit{Id.} (emphasis added) (citation omitted).
\textsuperscript{388} United States v. Behan, 110 U.S. 338, 344 (1884).
\textsuperscript{389} Simensky, \textit{supra} note 373, at 2 & n.6 (quoting Hayes, \textit{Hollywood's Hidden Millions}, N.Y. TIMES, Jan. 20, 1982, at D1, D4).
V. Shoot the Living and Pray for the Dead: Business Solutions

The following business advice is based on the previous legal discussion. Which, if any of the suggestions Sam takes, is dependent on his particular needs and leverage in any given deal.

A. This Man Can’t Die: Be a Distributor, Not an Agent

The first solution is for Sam to avoid agency altogether, and be a distributor to the films he represents, sub-distributing to territories. Most filmmakers will require payment before granting rights, but that is a matter for negotiation. Sam need only draft his agreements to include a transfer of copyright ownership. Because of the prevailing confusion in the industry, and the proliferation of imprecise agreements that mention both agency and distribution rights in the same document, it is likely that a number of filmmakers have already unwittingly given away their rights. To be clear to his clients, Sam should omit the term “agent” from his contracts.

Because film distributors assume the risk of failure, they reap the majority of the reward upon the project’s success. Sam’s marketing genius and international contacts will therefore yield him more of the profit. Aside from Sam’s ability to control the film’s profits, the biggest advantage to this model is that the filmmaker would not have the power to revoke or terminate Sam’s rights for any reason not expressly agreed to in the contract. Further, the duty Sam owes the filmmaker is a contractual duty, not the higher duty of a fiduciary. Finally, and perhaps of most importance to Sam, Sam’s banker would have given him a credit line for the value of his library, if he had owned the copyrights to secure against his loan.

The disadvantage to being a distributor is that Sam, per the DMCA, must assume payments on residuals for any of his films subject to collective bargaining agreements. In practice, most distributors assign the responsibility of payments back to the filmmaker, so this is not necessarily a hindrance; however, it can become one if the filmmaker is insolvent, a likelihood in independent film. Second, Sam may not have the resources to pay the “MGs” (minimum guarantees) that are customarily made to filmmakers in exchange for distribution rights. Even if he does have the money, Sam may not wish to undertake the risk of the film’s success or failure in the marketplace. Finally,
as a distributor, Sam may become liable in legal actions that arise in connection with the film.

Traditional sales agents like Sam, although not risking as much in capital as distributors, nonetheless take a chance on the films that they represent, risking time and money, reputation and commissions. If Sam obtains a grant of rights for his endeavors on behalf of his films, at least he will be protected in his representation of them.

B. For a Few Dollars More: \(^{392}\) Provide an Advance

Sales agents who do not take rights can still protect themselves by paying the filmmaker an MG. These payments are also known as “advances” because they are typically recoupable against the film’s sales.\(^ {393}\) The MG, or advance, is therefore a loan that is repaid when the film is sold. An agent’s loan to his principal qualifies as an interest, and to be coupled with the power, the agent must ensure that the loan is made by the same legal entity as the agency.\(^ {394}\) This loan, now a power coupled with an interest, creates an agency that is irrevocable, at least until the advance is recouped.\(^ {395}\)

However, once the advance is recouped, Sam would cease to have an interest, and his agency would again be revocable. Although not all films are profitable, an MG is a sales agent’s vote of confidence in that film, and recoupment is confirmation that at least that minimal bar of success has been met. However, because a recouped advance ceases to be a power coupled with an interest, Sam’s protection in his agency for that film ends just as his investment is paying off. And arguably, the most painful revocations will be instances where the film is ultra-successful and the advance is already recouped. This is far from ideal, but limited protection is better than no protection, which is where Sam currently stands.

C. Fort Yuma Gold: \(^{396}\) Perfect a Security Interest

Whether Sam decides to take rights as a distributor, provide an advance, do both, or neither for the films that he represents—he has a third choice. Sam can perfect a security interest in his films, something that distributors, lenders, and guarantors routinely do to protect their

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\(^{392}\) For a Few Dollars More (United Artists 1965).

\(^{393}\) See Moore, supra note 4, at 4, 9.

\(^{394}\) See supra Part III.B.4.

\(^{395}\) Alderman v. Cargo Craft, Inc., 573 S.E.2d 108, 109–10 (Ga. 2002) (holding that once a loan is repaid, it ceases to be the interest necessary for an agency to be irrevocable).

\(^{396}\) Fort Yuma Gold (a.k.a. For a Few Extra Dollars) (Interpeninsular 1966).
investments. The filmmaker-distributor relationship usually involves shifting most or all of the performance risk to the distributor, while the sales agency relationship shifts little or no risk to the sales agent. Perhaps this is the reason that sales agents do not take security interests and distributors do. However, while the performance risk is not borne by the traditional sales agent, the risk of revocation is. A security interest would be a simple solution to keep both the structure of the agency with its limited liability, and the security of a distributor, whose agreement with the filmmaker is in theory solid and irrevocable.

IFTA’s Model Sales Agency Agreements include a Security Agreement, for use when the sales agent is providing an advance to the filmmaker. IFTA’s Security Agreement stipulates that “[t]he Parties desire to secure the right of Secured Party [Sales Agent] to receive the payments and make the recoupments, including the Advance . . . to represent the Picture, and to exercise its rights and remedies under the Sales Agency Agreement.” The critical information in the IFTA form is the agreement that the “right” of the sales agent “to represent the Distribution Rights in the Picture throughout the Territory during the Agency Period[,]” and the “right to damages for any attempt by Producer to cancel or terminate the Sales Agency Agreement or enjoin Sales Agent’s representation of the Picture . . .” are secured by collateral. The collateral supplied by the owner includes “copyright, trademark, patent, or other intellectual property rights in the Distribution Rights in the Picture . . .” and “physical film, sound and video elements,” as well as marketing materials.

While security interests are only taken by IFTA members under the IFTA forms when the member is providing an advance, the provision of an advance or loan is not a prerequisite to taking a security interest. A different, non-IFTA model agreement for sales agents includes a
security interest clause\textsuperscript{408} that is not limited to occasions when the sales agent provides an advance or MG.\textsuperscript{409} This agreement states simply that “Owner . . . grants to Agent a security interest in all of Owner’s right, title and interest of every kind and nature, if any, in and to the Film[.]\textsuperscript{410} in order to secure the obligations and performances of the Owner under the Sales Agency Agreement.\textsuperscript{411}

Since a power coupled with an interest is a “specific, present property interest”\textsuperscript{412} in the subject of the agency, a security interest suffices as that type of interest required to render an agency irrevocable. However, an interest required to render an agency irrevocable does not suffice to create a perfected security interest.\textsuperscript{413} To perfect a security interest and reap its benefits, such as the ability to foreclose on the collateral in case of contractual default, Sam must follow specific steps.\textsuperscript{414} \textit{In re Peregrine Entertainment, Ltd.}\textsuperscript{415} clarifies that the Copyright Act preempts other state and federal law recording systems.\textsuperscript{416} Therefore, to perfect an interest in a copyright, the interest holder must record that interest with the Copyright Office.\textsuperscript{417} For all other non-copyright interests in the film, Division 9 of the California Uniform Commercial Code still governs.\textsuperscript{418}

The non-IFTA model agreements also address the issue of \textit{where} this security interest should rank in the hierarchy of other interests held in the film.\textsuperscript{419} This form agrees that the sales agent’s interest will be “subordinate to the security interests granted by Owner to the financier(s) of the Film, the completion bond company . . . and any guilds requiring security interest in and to the Film.”\textsuperscript{420} This form illustrates that such interests in the independent film business are generally taken by every other participant in the film’s financing and distribution chain. Although sales agents are not currently among

\textsuperscript{408} Id. at 575 para 17.
\textsuperscript{409} Telephone Interview with Alison Cohen, supra note 36. Although Ms. Cohen created the model sales agreement for PLI while working at FilmNation, this is not a FilmNation form. Id.
\textsuperscript{410} Cohen, supra note 407, at 575–76 para. 17(a).
\textsuperscript{411} Id.
\textsuperscript{413} See \textit{In re Peregrine Entm’t, Ltd.}, 116 B.R. 194, 198–99 (Bankr. C.D. Cal. 1990).
\textsuperscript{414} Id.
\textsuperscript{415} \textit{In re Peregrine}, 116 B.R. 194.
\textsuperscript{416} Id. at 201–02.
\textsuperscript{417} Id.
\textsuperscript{418} LeFlore v. Grass Harp Prods., Inc., 67 Cal. Rptr. 2d 340, 345 (1997).
\textsuperscript{419} Cohen, supra note 407, at 576 para. 17(a).
\textsuperscript{420} Id.
the parties perfecting a security interest as a routine matter in the films that they represent,\textsuperscript{421} perhaps they should be.\textsuperscript{422}

Because security interests in the film are not routinely granted to agents in a sales agency agreement, producers may be reluctant to grant them to agents such as Sam who request them going forward.\textsuperscript{423} In an ideal world, Sam would ask the producer if she plans to honor the contract that they have negotiated, to which she would reply, “\textit{Of course!”} Sam would then simply remind the producer that her security interest acts only to protect her intention \textit{not} to revoke the contract, and will not come into play unless she breaks her promise. However, in the film business, leverage is often more meaningful than logic. As with most changes in the entertainment industry, a party with leverage will lead the way for his “\textit{ask}” to become the new standard custom and practice. Whether Sam has that leverage or whether another sales agent must be the vanguard, a simple security interest would stabilize the sales agency agreement, and therefore, the independent film industry as a whole.

\textbf{Conclusion: The Good, the Bad and the Ugly}\textsuperscript{424}

The film business is always a gamble.\textsuperscript{425} But the inherent risk involved with whether a film finds an audience should \textit{not} be compounded by uncertainty about whether a contract may be terminated without warning. Digital distribution and alternative financing models have ushered in a new era for independent film. The foreign sales agent plays an important role in this transition. But the traditional sales agent is in constant danger of revocation. While the foreign sales agents’ forefathers may not have relied on lawyers,\textsuperscript{426} entertainment lawyers \textit{can} help Sam and his contemporaries, without killing the deal.\textsuperscript{427}

\begin{footnotesize}
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\item \textsuperscript{421} Interview with Steve Monas, \textit{supra} note 3; accord Telephone Interview with Robbie Little, \textit{supra} note 36.
\item \textsuperscript{422} Interview with Steve Monas, \textit{supra} note 3; accord Telephone Interview with Robbie Little, \textit{supra} note 36 (agreeing that a security interest is a logical way to create stable sales agency agreements, but surmising that more agents do not create them because then they would need to hire lawyers).
\item \textsuperscript{423} Telephone Interview with Alison Cohen, \textit{supra} note 36; Telephone Interview with Michael Meyer, \textit{supra} note 140; Telephone Interview with Robbie Little, \textit{supra} note 36.
\item \textsuperscript{424} \textit{THE GOOD, THE BAD AND THE UGLY} (United Artists 1966).
\item \textsuperscript{425} See Simensky, \textit{supra} note 373 at 1, 2.
\item \textsuperscript{426} Telephone Interview with Robbie Little, \textit{supra} note 36; Telephone Interview with Mark Damon, \textit{supra} note 74.
\item \textsuperscript{427} Telephone Interview with Robbie Little, \textit{supra} note 36 (“If you listen to your lawyer, you’ll never do a deal.”).
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