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ARTICLES

NOTES

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Statement of Purpose

Consistent with its unique development, The New York University Journal of Intellectual Property & Entertainment Law (JIPEL) is a nonpartisan periodical specializing in the analysis of timely and cutting-edge topics in the world of intellectual property and entertainment law. As NYU's first online-only journal, JIPEL also provides an opportunity for discourse through comments from all of its readers. There are no subscriptions, or subscription fees; in keeping with the open-access and free discourse goals of the students responsible for JIPEL's existence, the content is available for free to anyone interested in intellectual property and entertainment law.

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VOL. 9 BOARD OF EDITORS – ACADEMIC YEAR 2019-2020

PREFACE

Our Fall 2019 issue, Volume 9, Issue 1, includes an exciting and rich collection of works that spans an unusually broad, yet timely and relevant, variety of topics in the areas of IP and entertainment law and policy.

First, Professors Landry and Baker expertly explore the history of name, image, and likeness (NIL) rights for student-athletes within the NCAA, advocating a novel framework solution that would revolutionize student-athlete rights to use their own NILs. In their work, Professors Landry and Baker offer a blueprint for the NCAA as it works to develop rules and regulations pertaining to student-athlete use of their NILs. This work is remarkably timely, given the NCAA's recent announcement to develop rules to permit student-athletes to benefit from the use of their NILs.

Next, Professors Adornato and Horsfall examine the use of trade secret laws on the part of employers to assert ownership of employees' social media accounts within the journalism industry. They deftly argue that this constitutes an improper application of the trade secret laws. Instead, they encourage the development of a novel policy that would provide employers and employees with guidelines addressing employees' use of social media in their professional lives as journalists.

Moving from the worlds of NIL rights and trade secrecy, Professor Guerra-Pujol skillfully investigates the world of literary fan art, reframing related copyright disputes within the Coasean context of law and economics. To illustrate his argument, Professor Guerra-Pujol uses Ernest Hemingway's *The Old Man and the Sea* and the extensive collection of fan art inspired by the original novella.

Next, Dr. Yang Li's Note discusses the "Patent Dance," a procedural requirement in which drug companies engage prior to the production of a generic version of a branded pharmaceutical product. In her work, Dr. Li carefully analyzes implications of appellate and Supreme Court decisions that have, in effect, rendered this requirement optional. Dr. Li explores the policy and procedural implications of these decisions, including effects on litigation gamesmanship, litigation incentives, and requirements for pleading standards.

Finally, Kyung Taeck Minn's forward-looking Note delves into the high-tech world of self-governing Decentralized Autonomous Organizations (DAOs), smart contracts, and blockchain. In his work, Minn contends that self-governed resolution of governance problems within these organizations is unrealistic, and he proposes an elegant solution to the challenges presented by self-governance of these organizations.

I am excited to announce a new initiative that will begin with Volume 9, Issue 2. In an effort to embrace more fully our online-only format, we will begin publishing articles online as soon as they are finalized by our editorial board instead of waiting for all articles in an issue to be finalized before publishing any of them. All submissions will still be considered part of an issue that will be assembled once all articles are published. As an IP and entertainment law journal, we regularly publish on the most cutting-edge topics where legal issues are often driven by rapid technological developments. This initiative will result in a shorter turnaround between accepting a manuscript for publication and when it is published. Our board looks forward to this change, and we hope that our authors and readers do as well.

I hope that you enjoy this issue, and on behalf of the 2019-2020 *JIPEL* editorial board, thank you for reading.

Sincerely,

Nicholas G. Vincent, Ph.D.
Editor-in-Chief
NYU Journal of Intellectual Property & Entertainment Law

NEW YORK UNIVERSITY

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CHANGE OR BE CHANGED: A PROPOSAL FOR THE NCAA TO COMBAT CORRUPTION AND UNFAIRNESS BY PROACTIVELY REFORMING ITS REGULATION OF ATHLETE PUBLICITY RIGHTS

JAMES LANDRY* AND THOMAS A. BAKER III, PH.D.**

This Article addresses the black market for college athlete services that results from the NCAA's restrictions on athlete compensation based on the purported need to preserve amateurism. Specifically, this Article focuses on the NCAA's name, image, and likeness (NIL) restrictions that prevent college athletes from making use of their own reputations for commercial purpose. The Article examines the relevant litigation on the subject of athlete publicity rights and amateurism and concludes that the NCAA's NIL restrictions serve no legitimate purpose. The NCAA is in the process of changing its NIL rules to afford athletes more freedom to benefit from the commercial use of their NILs. The specific rules that formulate the NCAA's new policy have not yet been revealed and probably have not yet been developed. Proposed within this Article is a modest suggestion that the NCAA address the

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** Dr. Baker is an associate professor of sport law at the University of Georgia and is also the editor of the *Journal of Legal Aspects of Sport*. Dr. Baker's work has been cited by courts, and one of his studies was admitted into evidence in *Alston v. NCAA* (consolidated into *Grant-in Aid*). In addition to his academic work, Dr. Baker is also a contributor to *Forbes* on topics related to sports law. He earned his Ph.D. from the University of Florida and his J.D. from Loyola University New Orleans School of Law. He would like to acknowledge and afford appreciation for the work of Professor Gabe Feldman at Tulane University for his contributions to the subject of NCAA athlete publicity rights.

recent scandals involving corruption of its amateur model for intercollegiate athletics by removing its restrictions on athlete NIL use. The proposal in this Article includes specific suggestions for how the NCAA should lift the restrictions. Our proposal is also a response to recent litigation and proposed legislation on the subject of amateurism and college athlete NIL restrictions. The NCAA is in a precarious position in that its NIL restrictions are now exposed and vulnerable to antitrust challenge. We suggest for the NCAA to break trend and take a proactive approach to addressing corruption and unfairness by adopting our proposal for materially changing the way it regulates athlete NIL use.

INTRODUCTION

In the opening minutes of a college basketball game against archrival North Carolina, Zion Williamson from Duke University, the future number one pick in the 2019 National Basketball Association (NBA) draft,[1] sprained his right knee after his shoe "broke."[2] Fortunately, the shoe's failure only resulted in a knee sprain rather than a career-threatening injury.[3] Williamson wore Nikes because Duke has a multimillion-dollar deal with the shoe manufacturer that requires the school's college athletes to wear Nike apparel during competitions.[4] Williamson earns nothing from his school's arrangement with Nike because the National Collegiate Athletic Association (NCAA) prohibits college athletes like Williamson from profiting from the commercial use of their names, images, and likenesses (NILs).[5] The NCAA's NIL restrictions are part of its amateurism model for intercollegiate athletics—a model that purports to protect college athletes from commercial exploitation.[6]

Instead of protecting its athletes, the NCAA's NIL restrictions actually facilitate exploitation by preventing college athletes from receiving their fair share from the multi-billion dollar industry of intercollegiate athletics.[7] The NCAA is even

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[1] Jim Eichenhofer, *2019 NBA Draft Profile: Zion Williamson*, NBA.COM (June 3, 2019), https://www.nba.com/pelicans/2019-nba-draft-profile-zion-williamson (Zion has been the unchallenged first overall pick for a lengthy period of time).

[2] Mark Tracy & Kevin Draper, *A Star's Shoe Breaks, Putting College Basketball Under a Microscope*, N.Y. TIMES (Feb. 21, 2019), https://www.nytimes.com/2019/02/21/sports/zion-nike-shoe-ncaa.html (Former President Barak Obama was in attendance at the game and tweeted, "His shoe broke" after witnessing the product failure and resulting injury.).

[3] Ryan McGee, *Duke Loses Zion Williamson to Mild Knee Sprain When Shoe Blows Out*, ESPN.COM (Feb. 21, 2019), http://www.espn.com/mens-college-basketball/story/id/26042130/duke-loses-zion-williamson-mild-knee-sprain-shoe-blows-out.

[4] Luke Decock, *If the Shoe Splits, Repair It: Nike Execs Fly for Impromptu Talks at Duke*, NEWS & OBSERVER (Feb. 21, 2019), https://www.newsobserver.com/sports/spt-columns-blogs/luke-decock/article226605384.html (noting that Nike and Duke have had this arrangement for twenty-seven years).

[5] *See* Tracy & Draper, *supra* note 2. For more on the unfairness of the NCAA's amateurism rules, see Taylor Branch, *The Shame of College Sports*, ATLANTIC (Oct. 2011), http://www.workplacebullying.org/multi/pdf/branch.pdf; Kurt Helin, *Zion Williamson signs shoe deal with Nike's Jordan Brand*, NBCSPORTS (July 23, 2019), https://nba.nbcsports.com/2019/07/23/zion-williamson-signs-shoe-deal-with-nikes-jordan-brand (Upon being drafted, Williamson went on to sign a reported seven-year, $75 million deal with Nike's Jordan brand, the second largest shoe deal ever for a rookie NBA player).

[6] *See generally* Branch, *supra* note 5.

[7] Thomas Baker, *Arike Ogunbowale's 'Dancing With the Stars' Should Set The Stage For NCAA Rule Changes*, FORBES (Apr. 30, 2018),

in on the exploitation with its $8 billion media deal with CBS and Turner Broadcasting for media rights to the Division I Men's Basketball Tournament.[8] The "gross commercialization" of intercollegiate sports has substantially intensified the demand for schools to recruit the best talent to their respective campuses.[9] The NCAA's amateurism model, however, manipulates the market for college athlete services by capping the amounts that college athletes can receive to an amount that is supposed to reflect the cost it takes to attend their universities.[10] As a result, a black market for athlete services developed in which NCAA member institutions and their business partners seduce college athletes to their schools with payments and other benefits that are exchanged in violation of NCAA rules.[11]

To address the black market for college athlete services the Department of Justice (DOJ) launched an investigation into the corruption in college basketball that led to the arrest of ten individuals on claims of fraud and corruption.[12] The list of those arrested included the names of four basketball coaches at Division I NCAA programs and a senior executive at Adidas.[13] In commenting on the results of the investigation, acting U.S. Attorney Joon H. Kim stated, "[t]he picture of college basketball painted by the charges is not a pretty one—coaches at some of the nation's top programs taking cash bribes, managers and advisors circling blue-chip prospects like coyotes, and employees of a global sportswear company funneling cash to families of high school recruits."[14]

In response to the DOJ's investigation, the NCAA created the Commission on College Basketball (hereinafter referred to as the "Commission") to investigate fraud in college basketball and deliver a report with recommendations for what the NCAA

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https://www.forbes.com/sites/thomasbaker/2018/04/30/ogunbowales-dancing-with-stars-should-set-the-stage-for-ncaa-rule-changes/.

[8] *Id.*

[9] Thomas A. Baker III & Natasha T. Brison, *From* Board of Regents *to* O'Bannon*: How Antitrust and Media Rights Have Influenced College Football*, 26 MARQ. SPORTS L. REV. 331, 345 (2016).

[10] *Id.*

[11] Thomas Baker, *Why the Latest NCAA Lawsuit Is Unlikely to Change Its Amateurism Rules—But Should*, FORBES (Sept. 11, 2018), https://www.forbes.com/sites/thomasbaker/2018/09/11/the-economics-of-amateurism-breaking-down-the-latest-lawsuit-against-the-ncaa/.

[12] U.S. Dep't of Justice, U.S. Attorney Announced the Arrest of 10 Individuals, Including Four Division I Coaches, For College Basketball Fraud and Corruption Schemes, (Sept. 26, 2017), https://www.justice.gov/usao-sdny/pr/us-attorney-announces-arrest-10-individuals-including-four-division-i-coaches-college.

[13] *Id.*

[14] *Id.*

should do to address corruption.[15] Former United States Secretary of State Dr. Condoleezza Rice led the Commission, and in her remarks on its recommendations, she noted her personal hope that student-athletes would be permitted "more room" by the NCAA to use their NILs.[16] Dr. Rice's hope echoes sentiments and suggestions asserted by Professor Gabe Feldman in the White Paper he proposed to the Knight Commission on Intercollegiate Athletics.[17]

Professor Feldman presented his proposal to the Knight Commission in 2016, and in it, he suggested for the NCAA to permit student-athletes to use their NILs for "non-game related" commercial activities.[18] Professor Feldman suggested relaxing NIL rules as a means to relieve some of the perceived "exploitative, unethical, unfair, inequitable, and unnecessary" rules that have invited criticism and litigation directed at the NCAA from student-athletes and those who defend their rights.[19] Two years after the release of the White Paper, the NCAA did something unexpected by relaxing its NIL restrictions to permit a waiver so that Notre Dame women's basketball player Arike Ogunbowale could participate on the popular reality show "Dancing With The Stars" (DWTS).[20] The Ogunbowale waiver provision was so unprecedented that it seemingly signaled a possible willingness from the NCAA to either grant more waivers or possibly even change its NIL policy to reflect what Professor Feldman first proposed in his groundbreaking White Paper.[21] Some

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[15] NCAA, COMMISSION ON COLLEGE BASKETBALL CHARTER, http://www.ncaa.org/governance/commission-college-basketball-charter (last visited Dec. 19, 2019).

[16] Condoleezza Rice, *Independent Commission on College Basketball Presents Formal Recommendations* (Apr. 25, 2018), http://www.ncaa.org/sites/default/files/2018CCBRemarksFinal_webv2.pdf. *See also* RECOMMENDATIONS TO NCAA BOARD OF GOVERNORS, DIVISION I BOARD OF DIRECTORS AND NCAA PRESIDENT EMMERT, COMMISSION ON COLLEGE BASKETBALL (Apr. 2018), http://www.ncaa.org/sites/default/files/2018CCBReportFinal_web_20180501.pdf.

[17] GABE FELDMAN, WHITE PAPER: THE NCAA AND "NON-GAME RELATED" STUDENT-ATHLETE NAME, IMAGE AND LIKENESS RESTRICTIONS, PREPARED FOR THE KNIGHT COMMISSION ON INTERCOLLEGIATE ATHLETICS (May 2016).

[18] *Id.*

[19] *Id.*

[20] Jacob Bogage, *Arike Ogunbowale on 'Dancing with the Stars' Forces NCAA into Tricky Two-Step*, WASH. POST (Apr. 19, 2018), https://www.washingtonpost.com/news/early-lead/wp/2018/04/19/arike-ogunbowale-on-dancing-with-the-stars-forces-ncaa-into-tricky-two-step/?utm_term=.16980e4f320a.

[21] *See* Baker, *supra* note 7; *see also* Bogage, *supra* note 20; Nick Martin, *Arike Ogunbowale's Appearance on Dancing With The Stars Will Be A "Personal Growth Experience" To Fit Dumb NCAA Rules*, DEADSPIN (Apr. 19, 2018), https://deadspin.com/arike-ogunbowales-appearance-on-dancing-with-the-stars-1825389789.

pundits have asserted that Professor Feldman's proposal, if adopted, could serve as a less restrictive alternative that would allow reviewing courts to preserve the "revered tradition of amateurism" while also reducing its anti-competitive effect.[22]

Unfortunately, the NCAA has not been proactive in expanding athlete rights within its regulation of intercollegiate athletics.[23] As a result, external pressures in the form of litigation and legislation have forced the NCAA to adjust its policies.[24] This pressure is evident by the recent unanimous passing of the California Fair Pay to Play Act, a law that makes it illegal for a university to revoke an athletic scholarship or eligibility for benefiting from one's NIL.[25] And California is not alone because similar legislation has been proposed in states that include Washington,[26] South Carolina,[27] and New York.[28] Legislation is also pending in Congress[29] that, if passed, would affect the NCAA's regulation of college athlete NILs. In response to these legislative acts, the NCAA has since announced that it will develop a new NIL

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[22] *See* Baker, *supra* note 7; Mark Tracy, *NCAA Panel Proposes Reforms Including End To 'One and Done,' in Wake of Federal Corruption Charges*, N.Y. TIMES (Apr. 25, 2018); *see also* Bogage, *supra* note 20; Martin, *supra* note 21. *See generally* Marc Edelman, *9 Reasons to Allow College Athletes to License Their Names, Images and Likenesses*, FORBES (May 11, 2018), https://www.forbes.com/sites/marcedelman/2018/05/11/9-reasons-to-allow-college-athletes-to-license-their-names-images-and-likenesses/.

[23] *See generally* Dennis Dodd, *NCAA makes interesting decision to address moving target of name, image and likeness*, CBS SPORTS (May 14, 2019), https://www.cbssports.com/college-football/news/ncaa-makes-interesting-decision-to-address-moving-target-of-name-image-and-likeness.

[24] Thomas Baker, *5 Issues To Keep An Eye On With The NCAA's New NIL Policy*, FORBES (Nov. 1, 2019), https://www.forbes.com/sites/thomasbaker/2019/11/01/examining-the-ncaas-evolving-nil-policy-keep-an-eye-on-the-following-issues/#5340ab2a7591.

[25] The Fair Pay to Play Act would make it illegal for colleges and universities in California to take away an athlete's scholarship or eligibility as a punishment for that athlete profiting from his or her name, image or likeness. The new law will go into effect in January 2023. *See* Dan Murphy, *California bill to pay NCAA athletes takes another step*, ESPN.COM (Sept. 9, 2019), http://www.espn.com/espnw/sports/article/27582269/calif-bill-pay-ncaa-athletes-takes-another-step.

[26] *See* H.B. 1084, 66th Legis. (Wash. 2019), http://lawfilesext.leg.wa.gov/biennium/2019-20/Pdf/Bills/House%20Bills/1084.pdf.

[27] Jenna West, *South Carolina Lawmakers to File Proposal Similar to California's Fair Pay to Play Act*, SPORTS ILLUSTRATED (Sept. 13, 2019), https://www.si.com/college-football/2019/09/13/south-carolina-proposal-pay-college-athletes-fair-pay-play-act.

[28] S.B. 206, Cal. Legis. (Ca. 2019), https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200SB206. (coauthored by California Senators Nancy Skinner and Steven Bradford).

[29] Student-Athlete Equity Act, H.R. 1804, 116th Cong. § 1 (2019), https://www.scribd.com/document/401306067/Mark-Walker-bill.

policy.[30] This may seem like a big win for college athletes, but the shape of that policy will not be known until the new NIL rules are released in 2021.[31] In its announcement, however, the NCAA stated that its new policy will comply with its model for amateur athletics.[32]

In addition to the NIL legislation at the state and federal levels, the NCAA's amateurism rules were found to violate antitrust law in two recent federal district court decisions.[33] While the NCAA may desire to develop NIL rules that perpetuate the current model, the NCAA must instead accept that the deference once afforded to its amateurism model by legislators, courts, and the general public has eroded. Yet, the NCAA still stands behind its amateurism rules, and until the NCAA's new NIL policy is released in advance of its 2021 implementation, we have no way of knowing just how much freedom college athletes will be afforded by the NCAA for the commercial use of their own identities.

This article serves the important purpose of examining the extent of NCAA's NIL restrictions, legal challenges to those restrictions, as well as proposals for changing them ahead of 2021. The results of our examination led us to conclude that the window for compromise has passed, and the only way to confront corruption in college sports is to remove the NCAA's restrictions on athlete compensation that prevent them from profiting off of the commercial use of their NILs. We found that modest changes to the NCAA's amateurism model that relax current standards for NIL use will benefit only a limited number of college athletes and will not remove corruption from the billion-dollar industry of intercollegiate sports. Furthermore, we advise against a case-by-case use of waivers to allow for more NIL use like Ogunbowale's because it is untenable to consistently enforce a policy that permits *some* "non-game related" commercial use by athletes of their own NILs. Our investigation led us to conclude that expanded use by the NCAA of NIL waivers would result in arbitrary and confusing standards that generate, rather than correct, unfairness.

Part I of this article examines the corruption in college athletics and recent investigation, as well as the NCAA's response. Part II briefly reviews the history of

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[30] *Board of Governors starts process to enhance name, image and likeness opportunities*, NCAA (Oct. 29, 2019), http://www.ncaa.org/about/resources/media-center/news/board-governors-starts-process-enhance-name-image-and-likeness-opportunities.

[31] *Id*.

[32] *Id*.

[33] *See* O'Bannon v. Nat'l Collegiate Athletic Ass'n, 802 F.3d 1049 (9th Cir. 2015); *In re* Nat'l Collegiate Athletic Ass'n Athletic Grant-In-Aid Cap Antitrust Litig., No. 14-md-02541 CW (N.D. Cal. 2019) [*Grant-In-Aid*].

the legal challenges against the NCAA. Part III reviews the publicity rights of college athletes. Part IV assesses current proposals to alter the NCAA rules. Part V discusses the current proposal limitations, including college athlete "star power" and NCAA oversight ability. Part VI calls for meaningful change to the NCAA rules and proposes to remove the NIL restrictions completely. Part VII concludes by emphasizing the benefits of allowing college athletes a free market to be compensated for their NIL.

I
CORRUPTION IN COLLEGE ATHLETICS

Ironically, the NCAA was first formed to combat perceived corruption in college football that cost the lives of athletes by making football more dangerous than necessary.[34] In an attempt to capitalize[35] off of consumer interest in college football, many of the first universities to field squads skirted what few rules existed by hiring "ringers" to pretend to be students and play on teams alongside legitimate students.[36] The ringers were recruited to campus through offers of food, trips, and money.[37] The ringers were far more physical than their fellow (student) competitors, and the inclusion of these professional players made college football dangerous to the point that then President Theodore Roosevelt threatened the schools to either address the situation or expect government intervention.[38] In response to the

[34] ANDREW S. ZIMBALIST, UNPAID PROFESSIONALS: COMMERCIALISM AND CONFLICT IN BIG-TIME COLLEGE SPORTS: WITH A NEW POSTSCRIPT BY THE AUTHOR 8 (2001).

[35] Marc Edelman, *The Future of Amateurism after Antitrust Scrutiny: Why a Win for the Plaintiffs in the NCAA Student-Athlete Name & Likeness Licensing Litigation Will Not Lead to the Demise of College Sports*, 92 OR. L. REV. 1019, 1023 (2014); *see also* ZIMBALIST, *supra* note 36, at 7 ("[I]n the 1880s Yale had a slush fund of $100,000 to aid football.").

[36] JOSEPH CROWLEY, THE NCAA'S FIRST CENTURY: IN THE ARENA 4 (2006) ("In 1894, Indiana believed Purdue to be recruiting the Hoosiers' football captain from the year before and to have made a financial offer to enhance its chances of success. Indiana tried to retain the player, but he ended up at Michigan. In 1893, according to coach Stagg, the Wolverines had seven football players who were not enrolled in classes. This use of ringers . . . was duplicated in most colleges at that or earlier periods.").

[37] ZIMBALIST, *supra* note 34, at 8 ("Yale lured tackle James Hogan by offering him free meals and tuition, a suite in Vanderbilt Hall, a trip to Cuba, a monopoly on the sale of game scorecards, and a job as a cigarette agent for the American Tobacco Company.").

[38] Edelman, *supra* note 37, at 1025.

President's mandate, the organization that would grow into what we now recognize as the NCAA was formed.[39]

Initially, the NCAA was created as an attempt to bring public respectability and safety to the industry of college athletics.[40] One of the NCAA's earliest initiatives for making college sports safer and more respectable involved the implementation of the requirements that athletes must be enrolled as students and may not receive any form of compensation from the school.[41] With this move, the NCAA defined its products as "amateur" and for those who participate "in competitive physical sports only for the pleasure, and the physical, mental, moral, and social benefits directly derived therefrom."[42] The creation of the NCAA, however, legitimized college football for consumers around the country, which resulted in commercialization of the game by schools that built large stadia on their campuses to attract more fans and their money.[43] Schools needed to keep those new stadia filled with consumers and to do this some ignored the NCAA's amateurism rules and paid the best students to play for their teams.[44] In its nascence, the NCAA lacked the punitive power to enforce its amateurism rules against cheating institutions.[45] In 1929, the Carnegie Commission created a report on the landscape of college athletics and determined that three-quarters of the 112 universities studied

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[39] *Id.* ("From these meetings came the charter of the National Collegiate Athletic Association as a trade association designed to devise formal game rules, promote safety, and give college athletics some degree of public respectability.").

[40] O'Bannon v. Nat'l Collegiate Athletic Ass'n, 802 F.3d 1049, 1054 (9th Cir. 2015) ("President C.A. Richmond of Union College commented in 1921 that the competition among colleges to acquire the best players had come to resemble the contest in dreadnoughts that had led to World War I, and the NCAA sought to curb this problem by restricting eligibility for college sports to athletes who received no compensation whatsoever.") (footnotes omitted).

[41] *Id.*

[42] Daniel E. Lazaroff, *The NCAA in Its Second Century: Defender of Amateurism or Antitrust Recidivist?*, 86 OR. L. REV. 329, 333 (2007) (quoting ALLEN L. SACK & ELLEN J. STAUROWSKY, COLLEGE ATHLETES FOR HIRE 33-34 (1998) (quoting Nat'l Collegiate Athletic Ass'n, Proceedings of the Eleventh Annual Convention 118 (1916)) (In 1922, the NCAA redefined the amateur athlete as "one who engages in sport solely for the physical, mental, or social benefits he derives therefrom, and to whom the sport is *nothing more than an avocation*.").

[43] ZIMBALIST, *supra* note 34, at 8.

[44] Lazaroff, *supra* note 42, at 332.

[45] *See* ZIMBALIST, *supra* note 34, at 8-9.

were in violation of the NCAA rules.[46] The Carnegie Commission determined that "the heart of the problem facing college sports was commercialization."[47]

The commercialization of college football intensified despite the fact that the U.S. was going through its Great Depression, and some athletes were well compensated for playing college football.[48] In response to what it identified as "corruption," the NCAA adopted the "Sanity Code," which provided the NCAA with the authority to sanction schools or terminate membership based on rule violations.[49] The Sanity Code also restricted financial aid to athletes by requiring them to go through "normal channels" that non-athletes were compelled to follow.[50] These new rules led to other problems in the NCAA, when five University of Kentucky basketball players were convicted of point fixing.[51] Judge Streit, who presided over the point fixing case, wrote in his opinion that the University of Kentucky athletics program was "the acme of commercialism and overemphasis, [including] undeniable evidence of covert subsidization of players, ruthless exploitation of athletes, cribbing on examinations, illegal recruiting, a reckless disregard for players' physical welfare, matriculation of unqualified students, demoralization [corruption] of the athletes by the coaches, the alumni, and the townspeople."[52]

Unable to rid corruption from college sports, the NCAA's Sanity Code did not last two years,[53] before being replaced with a new amateurism model for college athletics that permitted schools to provide scholarships in exchange for athletic participation.[54] The modern era of college athletics brought with it new technological

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[46] *Id.*

[47] *Id.* (explaining that commercialization consisted of "an interlocking network that included expanded press coverage, public interest, alumni involvement and recruiting abuses." This was such a deep-rooted problem, that two years later a survey by the *New York Times* reveled that no college had altered its code of conduct to adhere to the NCAA rules.).

[48] *See id.* at 9 (noting that the University of Oklahoma had a payroll of nearly $200,000 (equivalent of $2,581,000 in 2019 based on inflation)).

[49] *See* Lazaroff, *supra* note 42, at 332-33.

[50] *Id.* at 333.

[51] ZIMBALIST, *supra* note 34, at 8. This was during their two championship runs between 1948-1950.

[52] *Id.* at 10 (quoting Murray Sperber, *Onward to Victory*, 340 (1998)).

[53] Lazaroff, *supra* note 42, at 333.

[54] *Id.* at 333-34 ("During the 1950s, the NCAA developed new regulations governing financial aid to athletes, and economic support could now be given without regard to financial need or 'remarkable academic ability.' In essence, financial inducements could be used to entice gifted athletes to participate in sports and the original amateur ideal had been replaced with a significantly different model. Notwithstanding this liberalization of the criteria for financial aid to athletes,

advancements like radio and television, and the NCAA capitalized by leveraging the sale of media rights to its products.[55] Initially, however, not all member institutions were in favor of increased commercialization, and the NCAA addressed concerns by imposing limits on the number of televised broadcasts for college football and the number of times that schools could appear on national television.[56] In 1984, the limits on broadcasts were removed by the Supreme Court's decision in *NCAA v. Board of Regents of the University of Oklahoma* (*Board of Regents*).[57] During the three decades following the Court's decision in *Board of Regents*, the industry of big-time intercollegiate sports ballooned into a billion-dollar business.[58]

The tremendous commercialization of intercollegiate sports coupled with caps on athlete compensation resulted in the inflation of an "arms race" in which schools invested substantially in facilities and on coaching salaries as means for attracting the best talent.[59] NCAA amateurism rules prohibit schools from spending more on a student athlete than what it costs to attend a university, so the schools had to spend on something else in order to attract the students away from rival institutions.[60] When

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schools began a 'spending spree' to buy winning teams. Despite 'ever more detailed regulations,' and increased enforcement efforts by the NCAA, schools throughout the nation 'devised new ways to pay their athletes on the side.' The increased commercialization of intercollegiate sports and the opportunity to reap vast amounts of revenue from successful football and basketball programs created significant incentives for schools to do whatever they could to maximize athletic success. The NCAA, with a revised enforcement mechanism and rules addressing student-athlete eligibility, 'capping' financial inducements, limiting transfers, and penalizing 'under-the-table payments,' created the foundation for 'today's corporate college sport.'").

[55] *See* Edelman, *supra* note 35, at 1030 (noting that the first major media deal was valued at $1 million).

[56] Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of Univ. of Okla., 468 U.S. 85, 90 (1984)

[57] *See id*. at 120.

[58] *See* Edelman, *supra* note 35, at 1030.

[59] Baker & Brison, *supra* note 9. For an example, in 2017, Clemson University opened the doors to a $55 million football-only facility that was designed for recruiting purposes and includes an indoor slide, bowling alleys, and even a miniature golf course. Clemson has won two out of the last three College Football Playoff championships, including the 2019 championship. *See* Cork Gaines, *Clemson's $55 Million Football Complex Shows How Swanky College Football Facilities Have Become For The Top Programs*, BUS. INSIDER (Jan. 8, 2019), https://www.businessinsider.com/photos-clemsons-football-facility-2017-10; for information on the escalation of coaching salaries (e.g., football coaching salaries), see generally Richard Johnson, *A History of Skyrocketing College Football Salaries From Walter Camp to Nick Saban*, SBNATION (Oct. 4, 2018), https://www.sbnation.com/college-football/2018/6/4/17390394/college-football-coach-salaries-history-highest.

[60] Prior to 2015, athletes were limited to grant-in-aid, an amount set to cover the basic components of educational expenses (e.g., tuition, fees, books, and room and board).

all other forms of spending failed in this regard, coaches and others who were involved with and facilitated the programs were left with only one other recruiting lure—pay students under the table in violation of NCAA rules.[61]

The black market for college athlete services is, perhaps, best evidenced by recent investigations surrounding men's basketball programs at major NCAA institutions. For example, the 2013 national championship won by the University of Louisville's men's basketball team has been sullied by reports that escorts were hired by coaches to seduce recruits to campus from 2010-2014.[62] In 2010, the University of North Carolina ("UNC") was also subject to an investigation surrounding their use of fake classes—for 18 years—to ensure that college athletes would remain eligible to participate in their sports.[63] During this span of time, UNC won three college basketball national championships.[64] Most recently, the NCAA handed down sanctions against the University of Missouri ("Mizzou") and their athletic program, because they allegedly employed a tutor to complete the majority of work for several of their athletes.[65] This finding followed a 2016 investigation that also found several impermissible benefits provided to Mizzou basketball players.[66]

The corruption problem in college basketball reached a tipping point in 2017 when the Federal Bureau of Investigation ("FBI") announced arrests of individuals for allegedly making payments to high-school basketball recruits.[67] Some of those arrested were college coaches, but representatives from Adidas were also arrested for participating in student payment so that athletes would select schools with

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[61] *See* Ricky O'Donnell, *Brian Bowen's FBI Scandal Shows the Many Ways a College Basketball Recruit Can Get Paid*, SBNATION (Oct. 5, 2018), https://www.sbnation.com/college-basketball/2018/10/5/17941060/brian-bowen-fbi-scandal-offers-creighton-texas-arizona-louisville-nike-adidas.

[62] Associated Press, *NCAA Takes Away a Louisville Title Over Stripper Parties*, N.Y. POST (Feb. 20, 2018), https://nypost.com/2018/02/20/ncaa-takes-away-a-louisville-title-over-stripper-parties.

[63] Sara Ganim & Devon Sayers, *UNC Athletics Report Finds 18 Years of Academic Fraud to Keep Athletes Playing*, CNN (Oct. 23, 2014), https://www.cnn.com/2014/10/22/us/unc-report-academic-fraud/index.html.

[64] *NCAA Basketball Tournament History*, ESPN.COM, http://www.espn.com/mens-college-basketball/tournament/history/_/team1/7739 (last visited Mar. 4, 2019).

[65] *See* Alex Kirshner, *12 Things to Know About the 29-Page NCAA Report That Led to Mizzou's Bowl Ban*, SBNATION (Feb. 1, 2019), https://www.sbnation.com/college-football/2019/2/1/18206252/missouri-ncaa-sanctions-bowl-ban.

[66] *Id.*

[67] *See* Harry Lyles Jr., *The FBI's Investigation of College Basketball Corruption, Explained*, SBNATION (Sept. 27, 2017), https://www.sbnation.com/college-basketball/2017/9/27/16366056/college-basketball-scandal-corruption-fbi.

licensing arrangements with Adidas.[68] Product brands like Adidas, Nike, and Under Armour have all contracted with NCAA member institutions to outfit athletes and coaches with gear.[69] The product brands pay the schools and the coaches per these arrangements,[70] but the athletes are not permitted to profit off of the deals due to the NCAA's amateurism rules.[71] Allegedly, Adidas representatives participated in illicit payments to sway recruits to "Adidas schools" as a means for building relationships with college players that could result in licensing deals with those same players when they turned professional.[72]

As the FBI's investigation unfolded, it became apparent that the underlying issues were not limited to Adidas-related schools.[73] The FBI was involved in phone calls and meetings where money was swapped between parties and intended for the parents of recruits.[74] The phone calls often mentioned the bidding war that was proceeding between rival companies for certain high-profile recruits and even mentioned parents of recruits wanting to be paid.[75] Christian Dawkins, a former

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[68] *See* United States v. Gatto, 295 F. Supp. 3d 336 (S.D.N.Y. 2018).

[69] *See* Daniel Kleinman, *The Most Valuable College Apparel Deals 2018*, FORBES (Sept. 11, 2018), https://www.forbes.com/sites/danielkleinman/2018/09/11/the-most-valuable-college-apparel-deals-2018/#2116e6db4be9.

[70] *See* Matthew Kish, *How Nike Funnels Money to College Football Coaches*, BIZ JOURNALS (Sept. 3, 2013), https://www.bizjournals.com/portland/blog/threads_and_laces/2013/09/how-nike-funnels-money-football-coaches.html.

[71] *See* NAT'L COLLEGIATE ATHLETIC ASS'N, 2018-19 NCAA DIVISION I MANUAL 4, §2.9 (2018), https://www.ncaapublications.com/p-4547-2018-2019-ncaa-division-i-manual-august-version-available-august-2018.aspx ("Student-athletes shall be amateurs in an intercollegiate sport, and their participation should be motivated primarily by education and by the physical, mental and social benefits to be derived. Student participation in intercollegiate athletics is an avocation, and student-athletes should be protected from exploitation by professional and commercial enterprises.").

[72] *Gatto*, 295 F. Supp. 3d at 340.

[73] *See* Matt Norlander, *How Maryland, Under Armour Were Roped into FBI Investigation of Kansas Recruit*, CBS SPORTS (Apr. 11, 2018), https://www.cbssports.com/college-basketball/news/how-maryland-under-armour-were-roped-into-fbi-investigation-of-kansas-recruit/.

[74] *See* Will Hobson, *How College Hoops Corruption Became a Federal Investigation, and Why It Might Get Bigger*, WASH. POST (Sept. 27, 2017), https://www.washingtonpost.com/sports/colleges/how-college-hoops-corruption-became-a-federal-investigation-and-why-it-might-get-bigger/2017/09/27/dfdfa6e0-a3d6-11e7-ade1-76d061d56efa_story.html?utm_term=.0744ccbcd765.

[75] *See id.*

athlete agent who was indicted by the FBI for his role in the scheme,[76] was recorded on one call as saying "[y]ou can make millions off of one kid."[77] With so much to be made from potential licensing deals, payments to students were often in the six-figure range and came with the promise that the high school recruit would attend a certain university to play their college basketball career.[78] In describing the FBI's findings, acting Manhattan U.S. Attorney Joon H. Kim said,

> The picture of college basketball painted by the charges is not a pretty one—coaches at some of the nation's top programs taking cash bribes, managers and advisors circling blue-chip prospects like coyotes, and employees of a global sportswear company funneling cash to families of high school recruits. For the ten charged men, the madness of college basketball went well beyond the Big Dance in March. Month after month, the defendants allegedly exploited the hoop dreams of student-athletes around the country, treating them as little more than opportunities to enrich themselves through bribery and fraud schemes. The defendants' alleged criminal conduct not only sullied the spirit of amateur athletics, but showed contempt for the thousands of players and coaches who follow the rules, and play the game the right way.[79]

During the trial, however, it became clear that the corruption and exploitation extended beyond Adidas and its licensing partner institutions to include coaches and Amateur Athletic Union (AAU) teams and high schools.[80] For example, Brian Bowen Sr., the father of a recruit, testified that an AAU coach paid him for his son, Brian Bowen Jr., to play for the high school team.[81] The trial ended with a guilty verdict on all counts being handed down for all three defendants. Afterward, United

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[76] *Three Men Convicted in Hoops Corruption Scandal*, REUTERS (Oct. 24, 2018), https://www.reuters.com/article/us-basketball-ncaa-verdicts/three-men-convicted-in-hoops-corruption-scandal-idUSKCN1MZ0AM.

[77] Hobson, *supra* note 74.

[78] *See id.*

[79] U.S. Dep't of Justice, *supra* note 12.

[80] *See* Kyle Boone, *Jay Williams Admitted His Former Sports Agency Paid Kevin Love's AAU Coach $250K*, CBS SPORTS (Sept. 28, 2017), https://www.cbssports.com/college-basketball/news/jay-williams-admitted-his-former-sports-agency-paid-kevin-loves-aau-coach-250k/ (last visited Feb. 11, 2019).

[81] Tim Whelan Jr., *Brian Bowen Sr. Testifies that Then-La Lumiere Coach Paid to Lure Son to School*, USA TODAY HIGH SCH. SPORTS (Oct. 7, 2018), https://usatodayhss.com/2018/brian-bowen-sr-testifies-that-then-la-lumiere-coach-paid-to-lure-son-to-school. Brian Bowen Sr. also confirmed that multiple college basketball programs made financial offers for Bowen Jr. to play for them. *Id.*

States Attorney Robert S. Khuzami released a statement: "Today's convictions expose an underground culture of illicit payments, deception and corruption in the world of college basketball. . . .These defendants now stand convicted of not simply flouting the rules but breaking the law for their own personal gain."[82]

In response to the DOJ's investigation, the NCAA formed the Commission on College Basketball (hereinafter referred to as the "Commission") to independently assess the current landscape of collegiate athletics—specifically basketball.[83] Beyond addressing the deep-seated corruption and exploitation that has been present in college basketball for years, the Commission, led by Former United States Secretary of State Dr. Condoleezza Rice, was tasked with evaluating the relationship between the NCAA national offices, member institutions, student-athletes, and coaches with outside entities as well as the NCAA's relationship with the NBA.[84]

Following its investigation, the Commission issued a report to NCAA President Mark Emmert stating that, "[t]he levels of corruption and deception are now at a point that they threaten the very survival of the college game as we know it."[85] In addition to issues they were tasked with evaluating, the Commission brought to attention the legal challenges the NCAA was in the midst of facing regarding the use of college athlete NILs.[86] They felt that the NCAA's amateurism rules should be cleared up or removed completely due to their confusing nature.[87] However, the existence of pending cases that challenged the legality of the NCAA's amateurism led the Commission to caution against drastic change to the amateurism rules and the suggestion for the NCAA to focus on other ways for addressing the charges of "player exploitation."[88]

In her own report, Dr. Rice, provided the following personal statement: "[I]t is hard for the public, and frankly for me, to understand what can be allowed within the college model—for the life of me I don't understand the difference between Olympic payments and participation in Dancing with the Stars—and what can't be

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[82] *Adidas Executive And Two Others Convicted Of Defrauding Adidas-Sponsored Universities In Connection With Athletic Scholarships*, U.S. DEP'T OF JUSTICE (Oct. 24, 2018), https://www.justice.gov/usao-sdny/pr/adidas-executive-and-two-others-convicted-defrauding-adidas-sponsored-universities.

[83] *See* RECOMMENDATIONS TO NCAA BOARD OF GOVERNORS, *supra* note 16, at 1.

[84] *Commission on College Basketball Charter*, *supra* note 15.

[85] RECOMMENDATIONS TO NCAA BOARD OF GOVERNORS, *supra* note 16, at 1.

[86] *Id.* at 8.

[87] *Id.*

[88] *Id.*

allowed without opening the door to professionalizing college basketball."[89] Dr. Rice's comments evidence the complicated state of intercollegiate athletics for sports that have been commercialized to the point of corruption.[90] It is important to also note that her comments were made in response to the DOJ's investigation of the corruption in college basketball that consisted of little more than conduct that violated NCAA policies.[91] In essence, the DOJ weaponized the FBI to enforce the NCAA's amateurism rules—the very same rules that have and continued to be challenged based on antitrust law.[92]

II
AMATEURISM AND THE LAW

The NCAA is battle-tested when it comes to defending its amateurism rules in litigation. For the most part, the Sherman Antitrust Act[93] has provided the foothold for plaintiffs challenging the NCAA's amateurism restrictions on the basis that they impose unreasonable restraints on trade.[94] Yet it wasn't until the 1980s that an antitrust attack on the NCAA's version of amateurism reached the appellate level.[95] Until then, district courts rejected plaintiff claims on the basis that the NCAA's version of amateur athletics did not involve interstate commerce, meaning that any and all NCAA's rules were found to fall outside of the Sherman Act's reach.[96] First,

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[89] *Id.* at 5.

[90] *See, e.g.*, Marc Edelman, C*orruption Will Continue in NCAA College Basketball Until Schools Can Openly Pay Their Players*, FORBES (Sept. 27, 2017), https://www.forbes.com/sites/marcedelman/2017/09/27/corruption-will-continue-in-ncaa-college-basketball.

[91] Ori Oren, *How the NCAA Has Created Criminality*, COLUM. BUS. L. REV. ONLINE (Aug. 13, 2019), https://journals.library.columbia.edu/index.php/CBLR/announcement/view/146.

[92] *Id.*

[93] Sherman Act, 15 U.S.C. §§ 1-7 (2006).

[94] Marc Edelman, *How Antitrust Law Could Reform College Football: Section 1 of the Sherman Act and the Hope for Tangible Change*, 68 RUTGERS U. L. REV. 809, 819 (2016).

[95] Bd. of Regents of Univ. of Okla. v. Nat. Collegiate Athletic Ass'n, 707 F.2d 1147 (10th Cir. 1983), *aff'd*, 468 U.S. 85, (1984).

[96] *See* College Athletic Placement Serv., Inc. v. Nat'l Collegiate Athletic Ass'n, 506 F.2d 1050 (3d Cir. 1974); *see also* Jones v. Nat'l Collegiate Athletic Ass'n, 392 F. Supp. 295 (1975) (concerning a Northeastern college hockey player who was declared ineligible for violating the NCAA Principle of Amateurism, a rule that one is no longer an amateur if they have been paid to play the sport they desire to participate in at the collegiate level. Jones sought to prevent the NCAA from declaring him ineligible and from enforcing punishment on Northeastern if they were to allow him to play by alleging the rules were arbitrarily applied to his case. Ultimately, the court sided with the NCAA and found Jones did not have a substantial likelihood of success under the Sherman Act since NCAA rules were designed to protect amateurism, not to form a monopoly.); NAT'L

Section A is going to look at how the NCAA's treatment under antitrust changed dramatically with the Court's decision in *Board of Regents*. Then, Section B will go over each of the plaintiffs' claims in *O'Bannon*, the first case to overcome the procompetitive presumption of validity that the NCAA had been afforded in courts. Next, Section C will review *In re National Collegiate Athletic Association Athletic Grant-in-Aid Cap Antitrust Litigation*, the most recent successful antitrust challenge against the NCAA. Finally, Section D narrows in on how these cases demonstrate that amateurism is not the primary driver of consumer interest in college athletics and why a change in approach is needed.

A. *NCAA v. Board of Regents*

The plaintiffs in *Board of Regents*, the Universities of Oklahoma and Georgia, brought the case on behalf of the members of the College Football Alliance, based on their desire to lift limits on college football broadcasts that were imposed by the NCAA.[97] The plaintiffs alleged that the NCAA's broadcast restrictions were anticompetitive and therefore violated the Sherman Antitrust Act.[98] Ultimately, the Court agreed with the plaintiffs and found that the NCAA's restrictions operated as an illegal restraint on trade within the live television broadcast market for college football.[99] The Court's decision was the first to recognize that the NCAA engaged in commercial activity and was also the first to subject any NCAA regulations to antitrust scrutiny.[100]

Justice John Paul Stevens wrote for the majority in *Board of Regents*, and in the opinion he recognized that horizontal price fixing and output limitations like those created in the NCAA's television plan are "ordinarily condemned" under

COLLEGIATE ATHLETIC ASS'N, 2018-19 NCAA DIVISION I MANUAL 4, § 2.9 (2018), https://www.ncaapublications.com/p-4547-2018-2019-ncaa-division-i-manual-august-version-available-august-2018.aspx.

[97] *See* Bd. of Regents of Univ. of Okla. v. Nat. Collegiate Athletic Ass'n, 707 F.2d 1147 (10th Cir. 1983), *aff'd*, 468 U.S. 85 (1984).

[98] Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of Univ. of Okla., 468 U.S. 85, 94 (1984) ("[The current plan] limits the total amount of televised intercollegiate football games and the number of games that any one college may televise, and no member of the NCAA is permitted to make any sale of television rights except in accordance with the plan.").

[99] *Id.* at 96-99 (finding that competition in the relevant market, which it defined as "live college football television," had been restrained in three ways: (1) the NCAA fixed the price for particular telecasts; (2) its exclusive network contracts were tantamount to a group boycott of all other potential broadcasters and its threat of sanctions against its members constituted a threatened boycott of potential competitors; and (3) its plan placed an artificial limit on the production of televised college football").

[100] *Id.*

antitrust law as "illegal *per se*."[101] Yet, Justice Stevens likened the NCAA markets to that of a professional sports league (i.e., a joint venture) and in doing so he noted that league-wide rules require some horizontal restraints to the create the product.[102] To better elaborate his argument, Justice Stevens provided examples of the "myriad of rules" that defined the competition marketed by the NCAA.[103] First up, Justice Stevens pointed to the constitutive rules for play (e.g., size of the field, number of players on a team).[104] Next, Justice Stevens identified the NCAA's particular brand of football as having an academic tradition that differentiated it from professional sports.[105] He found that the academic tradition consisted of rules needed to preserve the "character and quality" of the NCAA's products.[106] For Justice Stevens, the "academic tradition" consisted of rules that students attend class and that they "not be paid."[107]

On that point, Justice Stevens, in dictum, used the NCAA's amateurism rules as an analogy for the type of horizontal activity that *can* produce a net procompetitive effect by widening consumer choice through the creation of an amateur option for football consumption.[108] Justice Stevens' dicta in *Board of Regents* included the statement that "[t]here can be no question but that [the NCAA] needs ample latitude [to regulate amateurism], or that preservation of the student-athlete in higher education adds richness and diversity to intercollegiate athletics and is entirely consistent with the goals of the Sherman Act."[109]

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[101] *Id.* at 100.
[102] *Id.* at 101-02.
[103] *Id.*
[104] *Id.* at 101.
[105] *Id.* at 101-02.
[106] *Id.* at 102.
[107] *Id.*
[108] If the NCAA were not permitted to enforce rules that regulated amateurism in college football, the member institutions would pay players and doing so would impair the consumer interest. *See, e.g., id.* at 117 ("It is reasonable to assume that most of the regulatory controls of the NCAA are justifiable means of fostering competition among amateur athletic teams and therefore procompetitive because they enhance public interest in intercollegiate athletics.").
[109] *Id.* at 120.

In the wake of *Board of Regents*, a line of cases followed that challenged the NCAA's amateurism rules in the Third,[110] Fifth,[111] Sixth,[112] and Seventh Circuits.[113] The decisions from those four circuits can be read together as crafting a procompetitive presumption (quasi-exemption) that fortifies NCAA amateurism rules from rule of reason review on the basis that they serve a procompetitive purpose in preserving the nature and character of the NCAA's intercollegiate

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[110] Smith v. Nat'l Collegiate Athletic Ass'n, 139 F.3d 180 (3d Cir. 1998). *Smith* involved a challenge to the NCAA's transfer policies rather than its amateurism rules. Specifically, the plaintiff in Smith challenged the NCAA's post-baccalaureate bylaw that prevented students with remaining eligibility from finishing out their college athletic careers at graduate institutions. This rule no longer exists, but what is important in *Smith* is that the Third Circuit extended Justice Stevens' dicta to include this bylaw even though the student selected the graduate school based on educational program opportunity. Even though the plaintiff in Smith seemingly embodied the "academic tradition" that Justice Stevens celebrated in *Board of Regents*, the Third Circuit still found that the bylaw at issue furthered the NCAA's purpose of maintaining survival of intercollegiate athletics. *Id.* at 187.

[111] McCormack v. Nat'l Collegiate Athletic Ass'n, 845 F.2d 1338 (5th Cir. 1988) (*McCormack* was the first of the federal circuit court opinions to apply Justice Stevens' dicta from *Board of Regents* in a case involving a challenge to NCAA regulation of student-athlete compensation limits). The plaintiff in *McCormack* filed an antitrust challenge to the NCAA's enforcement of its amateurism rules against Southern Methodist University after it was discovered that the school compensated football players in violation of NCAA policy. The court in *McCormack* cited to Justice Stevens' dicta in *Board of Regents* in concluding that the NCAA's eligibility rules "allowed [for college football's] survival in the face of commercializing pressures." *Id.* at 1345 (citing *Bd. of Regents* at 102).

[112] Bassett v. Nat'l Collegiate Athletic Ass'n, 528 F.3d 426 (6th Cir. 2008). In *Bassett*, a former basketball coach attacked the NCAA's enforcement of amateurism rules on the grounds that they violated antitrust law by costing him his coaching career. The majority found that enforcement of NCAA amateurism rules was "anti-commercial" and therefore outside of the Sherman Act's reach so long as the enforcement strategy was "reasonably and rationally related to the rules themselves." *Id.* at 433.

[113] Banks v. NCAA, 977 F.2d 1081 (7th Cir. 1992). In *Banks v. NCAA*, the court cited *Board of Regents* in finding that the NCAA's rules prohibiting college players from entering professional drafts and being represented by agents were necessary in order to preserve the character of the NCAA's products. Judge Flaum wrote a partial dissent in *Banks* in which he described the NCAA's version of amateurism as "chimerical." *Id.* at 1099. The Seventh Circuit also heard *Agnew v. NCAA*, in which Judge Flaum wrote for the majority in upholding a motion to dismiss the plaintiff's antitrust attack on the NCAA bylaws that limit scholarships to one year and prevent schools from offering multi-year scholarships. 683 F.3d 328 (7th Cir. 2012). The majority in Banks rejected the notion that the NCAA's regulation of college athletes was not commercial, but failed to find a relevant market asserted by the plaintiffs in their complaint. *Id.* at 343-45.

products.[114] The procompetitive presumption of validity for NCAA amateurism restrictions held firm, for the most part, until *O'Bannon v. NCAA*.[115]

B. *O'Bannon v. NCAA*

The first case to overcome the procompetitive presumption of validity that courts afforded the NCAA's regulation of amateurism was brought by Ed O'Bannon, a former All-American University of California Los Angeles collegiate basketball player.[116] O'Bannon filed his action on behalf of a class of current and former student-athletes and against the NCAA and Collegiate Licensing Company (CLC) after he recognized the unauthorized use of his depiction in the Electronic Arts (EA) video game March Madness.[117] O'Bannon alleged that the NCAA rules governing amateurism were an illegal restraint of trade under Section 1 of the Sherman Act, 15 U.S.C. § 1, as they prevented student-athletes from being compensated for use of their NIL in the video games produced by EA and television broadcasts.[118]

At the district court level, Judge Claudia Ann Wilken rejected the idea that *Board of Regents* insulated the NCAA's rules from the rule of reason and found that the NCAA's regulation of student-athlete NILs violated antitrust by restricting athlete compensation more than what was needed to preserve consumer interest in amateurism.[119] Actually, Judge Wilken was skeptical of the degree of interest in amateurism that the NCAA assigned to its consumers.[120] Although skeptical,[121] Judge Wilken accepted the preservation of amateurism as one of two procompetitive

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[114] Baker & Brison, *supra* note 9, at 349 ("[T]he Ninth Circuit singled out *Agnew* as the only one from the three that came "close to agreeing with the NCAA's interpretation of *Board of Regents*.") (quoting *O'Bannon*, 802 F.3d at 1064).

[115] O'Bannon v. Nat'l Collegiate Athletic Ass'n, 802 F.3d 1049, 1055 (9th Cir. 2015).

[116] *Id.*

[117] O'Bannon v. Nat'l Collegiate Athletic Ass'n, 7 F. Supp. 3d 955 (N.D. Cal. 2014), *aff'd in part, vacated in part*, 802 F.3d 1049 (9th Cir. 2015).

[118] Around this same time, *Keller* had been filed, and during pretrial, the courts consolidated the cases. Plaintiffs moved for class certification, and after it was granted, plaintiffs voluntarily dismissed their claims—settling with EA and CLC. *O'Bannon* and *Keller* were then deconsolidated. As mentioned before, *Keller* proceeded and was successful with the right of publicity claims. Now, we are looking at *O'Bannon* regarding the Sherman Act claims. *See O'Bannon*, 802 F.3d at 1055.

[119] *Id.* at 1056 ("After a fourteen-day bench trial, the district court entered judgment for the plaintiffs, concluding that the NCAA's rules prohibiting student-athletes from receiving compensation for their NILs violate Section 1 of the Sherman Act.").

[120] *See O'Bannon*, 7 F. Supp. 3d at 1000.

[121] *Id*.

justifications.[122] Further, Judge Wilken accepted two less restrictive alternatives in: (1) allowing student-athletes to receive stipends equal to the full cost of attendance, and (2) allowing schools to hold a portion of their NIL licensing revenue, $5,000 per student-athlete, in trust, to be distributed after graduation.[123] On appeal to the Ninth Circuit, the NCAA alleged plaintiffs' Sherman Act claim failed on the merits, but also argued that (1) *NCAA v. Board of Regents* amateurism rules are "valid as a matter of law," (2) the compensation rules at issue are not governed by the Sherman Act because they do not regulate commercial activity, and (3) the plaintiffs did not have standing under the Sherman Act.[124]

1. The Ninth Circuit Rejects the Presumption of Validity

The NCAA argued that Justice Stevens' dicta in *Board of Regents* built around its amateurism rules a procompetitive presumption of validity that effectively rendered them as quasi-exempt under antitrust law, but the Ninth Circuit disagreed.[125] The Ninth Circuit correctly interpreted Justice Stevens' dicta as explaining why the NCAA rules should be analyzed under the rule of reason scrutiny.[126]

In reaching this conclusion, the Ninth Circuit diverged from the way its sister circuits interpreted *Board of Regents*.[127] The court in *O'Bannon* specifically took

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[122] The integration of athletes into their academic environments was the second procompetitive justification accepted. *See O'Bannon*, 802 F.3d at 1058.

[123] *O'Bannon*, 802 F.3d at 1061 ("The court also held that it would be permissible for the NCAA to prohibit schools from funding these stipends or trusts with anything other than revenue derived from the use of players' NILs.").

[124] *Id.*

[125] *Id.* at 1063-64. ("The Court's opinion supports the proposition that the preservation of amateurism is a legitimate procompetitive purpose for the NCAA to pursue, but the NCAA is not asking us to find merely that its amateurism rules are procompetitive; rather, it asks us to hold that those rules are essentially exempt from antitrust scrutiny. Nothing in *Board of Regents* supports such an exemption. To say that the NCAA's amateurism rules are procompetitive, as *Board of Regents* did, is not to say that they are automatically lawful.").

[126] *Id.* at 1063. ("The *Board of Regents* Court certainly discussed the NCAA's amateurism rules at great length, but it did not do so in order to pass upon the rules' merits, given that they were not before the Court. Rather, the Court discussed the amateurism rules for a different and particular purpose: to explain why NCAA rules should be analyzed under the Rule of Reason, rather than held to be illegal per se.").

[127] *Id.* at 1064 ("Only one—the Seventh Circuit's decision in *Agnew v. NCAA*, 683 F.3d 328 (7th Cir. 2012)—comes close to agreeing with the NCAA's interpretation of *Board of Regents*, and we find it unpersuasive."); *see* Agnew v. Nat'l Collegiate Athletic Ass'n, 683 F.3d 328 (7th Cir. 2012); Banks v. NCAA, 977 F.2d 1081 (7th Cir. 1992).

time to distinguish its approach from the Seventh Circuit's in *Agnew v. NCAA*.[128] The Ninth Circuit found that the Seventh Circuit in *Agnew* read *Board of Regents* too broadly by determining that when an NCAA rule is clearly designed to protect amateurism it should be "presumed procompetitive."[129] The Ninth Circuit stated that it was a "dubious" proposition to interpret *Board of Regents* as a decision that "blessed" NCAA rules by removing them from antitrust scrutiny.[130] The Ninth Circuit paid deferential respect to Justice Stevens' dicta in *Board of Regents*, but held that the NCAA amateurism rule's validity must be proven, not presumed.[131] In making that ruling, the Ninth Circuit became the first to subject the NCAA's regulation of amateurism to rule of reason review.[132]

Beyond asserting the procompetitive presumption of validity based on *Board of Regents*, the NCAA had two other rationalizations as to why the rules restricting NIL compensation should be validated by the court without resort to rule of reason review. First, the NCAA claimed that the compensation rules did not regulate commercial activity, treating them as "eligibility rules."[133] In addressing this defense, the Ninth Circuit referenced *Agnew* for correctly finding that it is undeniable that college programs expect an economic gain by recruiting high school athletes and thus these rules "clearly regulate the terms of commercial transactions between athletic recruits and their chosen schools."[134] Important in this analysis is the fact that the Ninth Circuit rejected the use of a creative wordplay ("eligibility rules") to circumvent antitrust law.[135]

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[128]*Agnew* examined the loss of scholarships for two injured college football players. *Agnew*, 683 F.3d at 332. They alleged that the NCAA bylaw restricting members from providing scholarships for more than one year was an illegal horizontal trade agreement to restrict prices in the market, and therefore should be illegal under the Sherman Act. *Id.* However, the plaintiffs failed to support their argument that a market existed in their complaint. *Id.* The court said that it was important to protect amateurism and to extend the reach of bylaws as far as they protect the NCAA's "revered tradition of amateurism." *Id.* at 342.

[129] *O'Bannon*, 802 F.3d at 1064.

[130] *Id.*

[131] *Id.*

[132] *See* Baker & Brison, *supra* note 9, at 352.

[133] *O'Bannon*, 802 F.3d at 1064-65.

[134] *Id.* ("[A] school may not give a recruit compensation beyond a grant-in-aid, and the recruit may not accept compensation beyond that limit, lest the recruit be disqualified and the transaction vitiated." *Id. See also Agnew*, 683 F.3d at 340 ("No knowledgeable observer could earnestly assert that big-time college football programs competing for highly sought-after high school football players do not anticipate economic gain from a successful recruiting program.")).

[135]*Agnew*, 683 F.3d at 343-44; *see also* Simpson v. Union Oil Co. of Cal., 377 U.S. 13, 21-22 (1964) ("[A]ntitrust laws prevent calling the 'consignment' an agency, for then the end result . . .

Second, the NCAA asserted that the plaintiffs lacked standing because they failed to show an "antitrust" injury—an injury that antitrust laws were designed to prevent from occurring.[136] Agreeing with the district court, the Ninth Circuit confirmed that the plaintiffs incurred injury by not being able to negotiate their compensation in a free market for their services.[137] The court in *O'Bannon* rightly recognized that, if it were not for the restrictions, the schools and their business partners (e.g., EA) would negotiate directly with the student-athletes for use of their NILs.[138]

2. The Market for College Athletes

In *O'Bannon*, the Ninth Circuit acknowledged that the NCAA's amateurism rules fixed the price for athlete services within a relevant college education market.[139] At the district court level, Judge Wilken found an additional market for student-athlete NILs, but the Ninth Circuit ignored that market and instead focused all of its analysis on the education market.[140] In regards to that market, the Ninth Circuit looked to the evidence in the record regarding the competition for student services.[141] The Ninth Circuit, however, did not view the schools as buyers, but instead treated them as sellers of educational services in the marketplace for potential college athletes.[142] While the Ninth Circuit warrants accolades for being the first to find a relevant market for college athletes, it also deserves demerits for pushing past Judge Wilken's recognition of a relevant market for athlete NILs.[143] However, the court in this case was charged with conducting an examination of the NCAA's compensation

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would be avoided merely by clever manipulation of words, not by differences in substance." (internal citation omitted)).

[136] *O'Bannon*, 802 F.3d at 1066-67 (quoting Glen Holly Entm't, Inc. v. Tektronix Inc., 343 F.3d 1000, 1007-08 (9th Cir. 2003) (quoting Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977))).

[137] *Id.* at 1067.

[138] *Id.* at 1067-68.

[139] *Id.* at 1070.

[140] *Id.*

[141] *Id.* at 1071-72.

[142] Although the Ninth Circuit's analysis of the market is belied by the reality that the schools providing the most prestigious academic opportunities rarely field the best intercollegiate sports teams. *Id.* at 1057-58 ("The rules prohibiting compensation for the use of student-athletes' NILs are thus a price-fixing agreement: recruits pay for the bundles of services provided by colleges with their labor and their NILs, but the 'sellers' of these bundles—the colleges—collectively 'agree to value [NILs] at zero.' Under this theory, colleges and universities behave as a cartel—a group of sellers who have colluded to fix the price of their product." (alternation in original) (internal citation omitted)).

[143] *Id.*

limits and did not need to address the legality of the NCAA's rules that restrict the use of athlete NILs.

3. The Procompetitive Presumption

The Ninth Circuit rejected a reading of *Board of Regents* that provided the NCAA with a quasi-exemption in the way of a procompetitive presumption of validity for its amateurism rules.[144] However, the court in *O'Bannon* had no problem citing to Justice Stevens' dicta in *Board of Regents* in finding a procompetitive justification in the preservation of amateurism.[145] The Ninth Circuit had no market-based evidence in the record to support its finding that consumer interest in intercollegiate athletics demanded the existence of rules that prohibit college athletes from being adequately compensated for their efforts.[146] Nevertheless, the Ninth Circuit found a "concrete procompetitive effect" in preserving the NCAA's version of amateurism based on the concept's appeal to consumers.[147] That effect provided the Ninth Circuit with a basis for agreeing with the district court's decision that preservation of amateurism and the integration of athletics and academics justified some restraints imposed by the NCAA's amateurism model.[148]

There are two critical points worth noting in the Ninth Circuit's reasoning that preserving amateurism and athlete integration produce net procompetitive effects when balanced against the economic harms resulting from the NCAA's amateurism restraints.[149] The first involves the fact that in reaching this conclusion the Ninth Circuit dismissed Judge Wilken's skepticism regarding the degree of interest consumers place on the role of amateurism in making the NCAA's products.[150] In her opinion, Judge Wilken questioned whether amateurism acted as a primary driver of consumer interest and instead found that what attracts consumers to college sports were aspects unrelated to amateurism, "such as loyalty to their alma mater or affinity for the school in their region of the country."[151] Yet, the only mention from the majority of Judge Wilken's skepticism came in the comment that she "probably underestimated the NCAA's commitment to amateurism."[152] There is no questioning

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[144] *Id.* at 1072-73.
[145] *Id.* at 1073.
[146] *Id.*
[147] *Id*. at 1073.
[148] *Id*.
[149] *Id.*
[150] *Id*.
[151] *Id.* at 1059 (citing O'Bannon v. Nat'l Collegiate Athletic Ass'n, 7 F. Supp. 3d 955, 977-78 (N.D. Cal. 2014), *aff'd in part, vacated in part,* 802 F.3d 1049 (9th Cir. 2015)).
[152] *Id.* at 1073.

that the NCAA is committed to preserving an appearance of amateurism in its products, but the frequency of rule violations and scandals involving breaches of the amateurism model by member institutions, their business partners, and the athletes unquestionably undermines the value of amateurism in intercollegiate athletics.

The other point worth noting involves the notion that the nature of intercollegiate athletics is preserved by NCAA rules that restrict athlete compensation and the use of their NILs as means for facilitating athlete integration into their academic communities.[153] As with the mission of preserving amateurism, there is also no market-based evidence for the notion that integrating athletes into classrooms serves as a core component of the NCAA's products and is justified by compensation limits and NIL restrictions.[154] In actuality, the athlete integration justification defies common sense and contradicts the Ninth Circuit's own reasoning in *O'Bannon*.[155]

In regards to the conflict with common sense, the Ninth Circuit ignored examples involving former college athletes like Johnny Manziel who had to stop attending live classes because of his celebrity, which was built as a college athlete.[156] The NCAA permits college athlete NIL use in commercial broadcasts that are viewed by millions of people around the world.[157] Further, the NCAA allows member institutions to market college athletes for prestigious awards like the Heisman Trophy.[158] If athlete integration were a sincere and paramount concern for the NCAA, it would not participate in or tolerate the business of promoting and profiting off of the use of college athletes' NILs in the media. Turning back to the example of Johnny Manziel, the NCAA's only concern regarding their "integration"

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[153] *Id.* at 1072.

[154] *Id.* at 1075.

[155] *See id.* at 1079.

[156] *See* Michael Middlehurst-Schwartz, *Johnny Manziel Taking Only Online Classes at Texas A&M*, USA TODAY (Feb. 18, 2013), https://www.usatoday.com/story/gameon/2013/02/18/johnny-manziel-texas-am-online-classes/1929057/.

[157] *See* Alex Kirshner, *Don't Miss the Point About NCAA Tournament Money*, SBNATION (Mar. 7, 2018), https://www.sbnation.com/college-basketball/2018/3/7/17093112/ncaa-tournament-revenue-tv-athletes-2018.

[158] *See* Alex Kirshner, *The Best and Weirdest School Heisman Trophy Campaigns*, SBNATION (Aug. 15, 2018), https://www.sbnation.com/college-football/2018/8/3/17625796/heisman-trophy-campaigns-best.

resulted not from his removal from classroom settings, but from Manziel's alleged involvement in the selling of his autographs.[159]

The Ninth Circuit was also inconsistent in its justification of athlete integration in *O'Bannon*.[160] The NCAA argued that any relaxing of its amateurism rules would deprive college athletes of choice by removing an amateur and educational option for their athletic pursuits.[161] The majority in *O'Bannon* rejected the NCAA's reasoning and instead found that abandonment or loosening of NCAA compensation limits might actually enhance academic opportunities for college athletes by affording them the resources to stay in school longer.[162]

The court's recognition on that point is important because the reasoning should extend to include the reality that not all students come from the same economic settings. Some students come from wealth and privilege while others grew up in depressed economic conditions.[163] This reality exists even when there are no athletes in the classroom. Restricting financial resources for college athletes does not make them like everybody else; it actually makes them very different from other students who are permitted to use any celebrity built into their reputations to their advantage.[164] Similarly, the schools and the NCAA already make commercial use of

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[159] *See* Peter Berkes, *Johnny Manziel Briefly Suspended, Ending NCAA Autographs Investigation*, SBNATION (Aug. 28, 2013), https://www.sbnation.com/college-football/2013/8/28/4668634/johnny-manziel-suspended-texas-a-m.

[160] *O'Bannon*, 802 F.3d at 1075.

[161] *Id.*

[162] *Id.* at 1073 ("Indeed, if anything, loosening or abandoning the compensation rules might be the best way to 'widen' recruits' range of choices; athletes might well be more likely to attend college, and stay there longer, if they knew that they were earning some amount of NIL income while they were in school.").

[163] See Landon T. Huffman & Coyte G. Cooper, *I'm Taking my Talents to . . . An Examination of Hometown Socio-Economic Status on the College-Choice Factors of Football Student-Athletes at a Southeastern University*, 5 J. ISSUES IN INTERCOLLEGIATE ATHLETICS 226 (2012).

[164] *See* Njororai Wycliffe & W. Simiyu, *Individual and Institutional Challenges Facing Student Athletes on U.S. College Campuses,* 1 J. PHYSICAL EDUC. & SPORTS MGMT. 16, 16-24 (2010) ("Student athletes face challenges of individual nature including their personal involvement in academic oriented activities, time constraints, class attendance, personal goal setting and career choices, physical and emotional fatigue, transition to college environment and academic grades, as well as external ones such as coach demands, institutional policies, discrimination; marginalization from college mainstream activities; college mission and learning environment, and eligibility demands from National Collegiate Athletic Association and National Association of Intercollegiate Athletics."). *See generally For Student-Athletes' Mental Health: A More Educated Approach,* NCAA, http://www.ncaa.org/about/student-athletes-mental-health-more-educated-approach (last visited Feb. 20, 2019).

athlete NILs, so how could additional use by the athletes impair their integration? If anything, a relaxed NIL regime that permits college athletes to profit from their identities may afford athletes the opportunity to extend their college education. Unfortunately, the Ninth Circuit's inconsistencies on the integration justification were overshadowed by the flaws in the court's findings following its application of the less restrictive alternative test.

4. The Ninth Circuit's Less Restrictive Alternative

The Ninth Circuit confirmed that the district court did not err in allowing grants-in-aid up to the full cost of attendance, as it would be substantially less restrictive.[165] Quoting from Mark Emmert, President of the NCAA, these payments would be allowed without violating NCAA amateurism principles because they would cover "legitimate costs" to attend school.[166] Further, none of the evidence on the record showed that this higher payment would alter consumer interest in the NCAA product, or impede the integration of student-athletes into their academic communities.[167] However, the Ninth Circuit felt the district court erred when it relied on the opinion of NCAA's witness, a former television executive, Neal Pilson.[168] The NCAA proffered up Pilson as an expert on consumer interest in college athletics and his "expertise" led him to suggest that consumers would not be bothered if student-athletes were compensated $5,000 a year.[169] The court disagreed with that testimony and considered it to be nothing more than an "offhand comment."[170] Instead, the Ninth Circuit viewed any payment not tethered to educational expenses as a "quantum leap."[171]

The finding that cost-of-attendance stipends are a less restrictive means based on their purported tether to education is in error. The majority in *O'Bannon* warned that paying athletes "any" amount of money that is not tethered to educational expenses would impair consumer interest in the NCAA's products.[172] Yet, the cost-of-attendance payments are not connected to the educational expenses

[165] *See* O'Bannon v. Nat'l Collegiate Athletic Ass'n, 802 F.3d 1049, 1073 (9th Cir. 2015).
[166] *Id.* at 1075.
[167] *Id.* at 1064
[168] *Id.* at 1078.
[169] *Id.*
[170] *Id.*
[171] *Id.*
[172] *Id.* at 1078-79.

required by the school.[173] Instead, they are estimates by each institution that include various expenses one may incur while attending a university.[174] The member institutions do not control the use of cost-of-attendance stipends by athletes, who can spend the money as they see fit.[175] Since 2015, college athletes have been paid cost-of-attendance stipends that make them nothing more than "poorly-paid professionals."[176] The fact that the word "attendance" is used by the matrix for estimating the amount schools provide does not transform the compensation into an education-related expense.[177] In this regard, the use of terminology to tether the payments to education is no different from the NCAA's classification of its regulations as "eligibility rules."[178] Accordingly, if the Ninth Circuit's reasoning on consumer interest in *O'Bannon* held true, consumers would have lost interest in the NCAA's products, but that has not happened.[179] Instead, another set of antitrust actions resulted from *O'Bannon* in *Alston v. NCAA* and *Jenkins v. NCAA*, which were consolidated into *In re National Collegiate Athletic Association Athletic Grant-In-Aid Cap Antitrust Litigation* (*Grant-in-Aid*).[180] On March 8, 2019, on the brink of "March Madness," Judge Wilken delivered her decision in *Grant-in-Aid*, which was her second ruling against the NCAA's amateurism rules.[181]

C. In re National Collegiate Athletic Association Athletic Grant-In-Aid Cap Antitrust Litigation (Grant-in-Aid)

Grant-in-Aid involved an antitrust action brought by and on behalf of current and former student-athletes who played Division I football, as well as men's and women's college basketball, against the NCAA and eleven of their conferences.[182] The claims in *Grant-in-Aid* alleged that the defendants violated the Sherman Act

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[173] *See* Thomas A. Baker, Marc Edelman & Nicholas M. Watanabe, *Debunking the NCAA's Myth That Amateurism Conforms with Antitrust Law: A Legal and Statistical Analysis*, 85 TENN. L. REV. 661, 683 (2018).

[174] *Id.*

[175] *Id.*

[176] *Id.* at 679, 699.

[177] *Id.* at 683.

[178] O'Bannon v. Nat'l Collegiate Athletic Ass'n, 802 F.3d 1049, 1065 (9th Cir. 2015).

[179] *See* Baker *supra* note 173, at 697.

[180] *In re* Nat'l Collegiate Athletic Ass'n Athletic Grant-In-Aid Cap Antitrust Litig., 375 F. Supp. 3d 1058, 1065 n. 5 (N.D. Cal. 2019).

[181] *See O'Bannon*, 802 F.3d at 1051, 1054-55.

[182] The conferences include: American Athletic Conference, Atlantic Coast Conference, Big 12, Big Ten, Conference USA, FBS Independents, Mid-American, Mountain West, Pac-12, Southeastern Conference, and Sun Belt. *See College Football Conferences*, ESPN.COM, http://www.espn.com/college-football/conferences (last visited Mar 15, 2019).

through the imposition of a cap on athlete compensation.[183] In their complaint, the plaintiffs alleged that the cap on their compensation was set well below what they would otherwise receive in exchange for their athletic participation from an unrestrained market.[184] Their claims built on Judge Wilken's and the Ninth Circuit's rulings in *O'Bannon*.

Similarly, the NCAA's defense in *Grant-in-Aid* also tracked the findings in *O'Bannon* by asserting that the caps on athlete compensation served the procompetitive purposes of preserving consumer interest in amateurism[185] and promoting athletes' integration into their educational communities.[186] In her district court decision, Judge Wilken recognized that extending compensation to cover the cost-of-attendance did not impair consumer demand for the NCAA's intercollegiate products.[187] Furthermore, she recognized that the commercial deals brokered by the NCAA since 2015 have been some of the most valuable and long-term deals ever leveraged for media rights in college sports.[188] Judge Wilken accepted the testimony of plaintiffs' expert Dr. Daniel Rascher that the NCAA's compensation rules did not serve the purpose of preserving amateurism.[189] He cited to his own studies for the position that consumer demand in college sports is not influenced by caps on athlete compensation.[190] Judge Wilken also determined that the NCAA failed to proffer credible evidence for the position that the caps were needed to maintain consumer interest in its products.[191] Additionally, Judge Wilken found that the caps did not integrate student-athletes into their educational communities.[192]

The court in *Grant-in-Aid* did recognize the role of amateurism in protecting the distinction between college and professional athletics.[193] Yet, the court did not

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[183] *Grant-in-Aid*, 375 F. Supp. 3d at 1058.
[184] *Id.* at 1062.
[185] *Id.*
[186] *Id.*
[187] *Id.* at 1099-1100.
[188] *Id.* at 1077; *see, e.g.*, Rodger Sherman, *The NCAA's New March Madness TV Deal Will Make Them A Billion Dollars A Year,* SBNATION (Apr. 12, 2016), https://www.sbnation.com/college-basketball/2016/4/12/11415764/ncaa-tournament-tv-broadcast-rights-money-payout-cbs-turner ("The NCAA Tournament will be broadcast on CBS/Turner through 2032. The companies signed an eight-year, $8.8 billion extension with the NCAA for the broadcast rights to March Madness, putting the tournament's yearly TV value at over a billion dollars for the first time.").
[189] *Grant-in-Aid*, 375 F. Supp. 3d at 1076-77.
[190] *Id.*
[191] *Id.* at 1080.
[192] *Id.* at 1102.
[193] *Id.* at 1089.

accept that caps imposed by the NCAA were necessary.[194] Instead, Judge Wilken held that the goals of protecting amateurism and academic integration could be done through less restrictive means.[195] Siding with the plaintiffs' proposal, the court found that limits could be imposed on non-educational expenses, but not educational-related expenses that were paid out by the schools.[196] Accordingly, the court removed the NCAA's ability to limit athlete compensation and left to the athletic conferences the responsibility to set their own limits, so long as those limits were not created in collaboration with other conferences.[197]

Judge Wilken's decision effectively stripped the NCAA of its power to limit athlete compensation for costs tethered to athlete education.[198] In making this determination, Judge Wilken borrowed the "tether" terminology used by the Ninth Circuit in *O'Bannon*, but this time the term worked against the NCAA's interests in maintaining control over athlete compensation.[199] While there was nothing in the *Grant-in-Aid* decision that directly speaks to the NCAA's ability to restrict athlete NIL use, the decision serves as another in a series of serious paper cuts that have hurt the NCAA's ability to restrict athlete compensation. Since the NCAA can no longer cap athlete compensation from its members, how can it restrict athlete compensation from those willing to sponsor athletes for the use of their NILs?

D. Amateurism Is Not the Primary Driver of College Athletics Consumer Success

In *O'Bannon*, the Ninth Circuit deviated from the district court when it ruled that the NCAA's amateurism rules serve the procompetitive purpose of preserving the popularity of collegiate athletics.[200] In making this ruling, the Ninth Circuit circles back to *Board of Regents* and Justice Stevens' statement that amateurism is required for collegiate athletics to be successful.[201] However, in *O'Bannon* the Ninth Circuit viewed amateurism as a procompetitive purpose in their analysis, instead of

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[194] *Id.* at 1083 (limiting the unlimited payments that are found in professional sports is procompetitive compared to no restriction at all).
[195] *Id.* at 1062.
[196] *Id.* at 1087 ("It would be less restrictive than the current compensation rules, allowing for additional compensation and benefits related to education. It would therefore be less harmful to competition in the relevant market, but would not provide a vehicle for unlimited cash payments, unrelated to education.").
[197] *Id.* at 1109.
[198] *Id.*
[199] *Id.* at 1105.
[200] O'Bannon v. Nat'l Collegiate Athletic Ass'n, 802 F.3d 1049, 1073 (9th Cir. 2015).
[201] *Id.* at 1074.

being valid as a rule of law.[202] In making their opinion, the district court did not believe that amateurism was the primary driver for collegiate athletics success; instead they theorized that other factors such as "loyalty to their alma mater or affinity for the school in their region of the country" were more indicative of success.[203]

Since *O'Bannon* allowed for stipends unrelated to educational expenses to be paid to student-athletes, experts have been able to study whether a relationship between payments to student-athletes and college athletics popularity exists.[204] By evaluating live game attendance and television attendance before and after stipend payments in the amount of cost of attendance began, researchers determined there was no relationship between stipend payments to student-athletes and the popularity of the institutions.[205] Instead, the data pointed to team performance as the main driver of popularity in game attendance.[206] This study demonstrates that the Ninth Circuit in *O'Bannon* was incorrect, and payments to the student-athletes for their NILs would not irreparably harm the NCAA.[207]

While the Ninth Circuit said payments unrelated to education would ignore what makes the NCAA what it is today—amateurs participating in a sport while earning an education—they did not evaluate which payments would comprise the cost of attendance.[208] Schools are able to use the cost of attendance payments as a recruiting tool, raising them as needed.[209] Without oversight of the composition of the cost-of-attendance payments, the NCAA allows for payments to be made to players for their on-field performance.[210] This creates a further imbalance between the member institutions, since universities with higher revenues are able to offer greater cost-of-attendance payments.[211] The knowledge of how the cost of

[202] *Id.* at 1064.
[203] *Id.* at 1059
[204] *See* Baker, *supra* note 173, at 688.
[205] *Id.* at 694.
[206] *Id.* at 696.
[207] *Id.* at 700.
[208] *O'Bannon*, 802 F.3d at 1076-77.
[209] *See* Baker, *supra* note 173, at 683-84.
[210] *See id.* at 678.
[211] For example, Texas A&M paid out $6,294 per student in 2018, or a total of $1.6 million between all students—they had a highest total revenue in college of $148 million. While Texas Tech, who ranked 25th in total revenue at $60 million, offered each of their student-athletes a stipend of $4,820, for a total of $899,224. *See* Carter Karels, *Three Years in Cost of Attendance Stipends Paying Off*, SAN ANTONIO EXPRESS NEWS (Aug. 4, 2018), https://www.expressnews.com/sports/article/Three-years-in-cost-of-attendance-stipends-paying-

attendance payments are being exploited by member institutions, and the proof that they have not decreased collegiate athletics popularity, show that the *O'Bannon* court was incorrect in saying that allowing payments to college athletes would be a "quantum leap" in removing amateurism from the NCAA.[212]

Compensating college athletes for their NILs would be within the current scope of how amateurism is currently defined since the payments would not come from the member institutions. Given this fact, alteration or removal of the NIL restrictions seems like the logical solution to remove the current recruiting black market.

III
COLLEGE ATHLETE PUBLICITY RIGHTS

Ed O'Bannon wasn't the only former college athlete to challenge the legal use of athlete NILs in EA's NCAA-based sport video games. Two former NCAA quarterbacks, Sam Keller and Ryan Hart, both filed actions around the same time as O'Bannon, except that they based their claims on the right of publicity.[213] Keller filed his action in a Ninth Circuit jurisdiction, and his case was eventually consolidated with O'Bannon's, creating *In re NCAA Student-Athlete Name & Likeness Licensing Litigation* (*Name & Likeness*).[214] Hart's case was filed in a Third Circuit jurisdiction.[215] The *Name & Likeness* and *Hart* cases were nearly identical in both the claims that were made and in the way the courts resolved them.

In both *Name & Likeness* and *Hart*, former student-athletes asserted their right to manage their celebrity and control the commercial use of their identities through legal actions, claiming they owned a right of publicity.[216] Derived from the right of

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13132632.php; Chris Smith, *College Football's Most Valuable Teams: Texas A&M Jumps To No. 1*, FORBES (Sept. 11, 2018), https://www.forbes.com/sites/chrissmith/2018/09/11/college-footballs-most-valuable-teams/#c93317d6c647.

212 *O'Bannon*, 802 at 1078.

213 *See* Complaint at 17, Keller v. Elec. Arts, Inc., No. 09-1967 (N.D. Cal. 2009). *See generally* Hart v. Elec. Arts, Inc., 717 F.3d 141 (3d Cir. 2013).

214 *See In re* Nat'l Collegiate Athletic Ass'n Student-Athlete Name & Likeness Licensing Litig., 724 F.3d 1268 (9th Cir. 2013).

215 *Hart*, 717 F.3d at 141.

216 *See Student-Athlete Names & Likeness Litig.*, 724 F.3d at 1273 ("EA did not contest before the district court and does not contest here that Keller has stated a right-of-publicity claim under California common and statutory law. Instead, EA raises four affirmative defenses derived from the First Amendment.") (internal citations omitted); *see also Hart*, 717 F.3d at 153 n.14. The court acknowledged that the right of publicity is a right for athletes and rejected the notion that athletes are already compensated for their image.

privacy,[217] the right of publicity recognizes and protects an individual's economic interest in their NIL.[218] Grounded in state common law doctrine and reinforced by legislation in twenty-two states,[219] the right of publicity is now recognized as an independent right.[220] The right of publicity was first conceptualized as an independent right in *Haelan Laboratories, Inc. v. Topps Chewing Gum, Inc.*,[221] a

[217] Beth A. Cianfrone & Thomas A. Baker III, *The Use of Student-Athlete Likenesses in Sport Video Games: An Application of the Right of Publicity*, 20 J. LEGAL ASPECTS SPORT 35, 38 (2010) ("The doctrine is closely associated with the right to privacy because it extends the privacy right that people have in protecting their identity and controlling its use in a commercial setting.").

[218] Thomas A. Baker III, et al., Simplifying the Transformative Use Doctrine: Analyzing Transformative Expression in EA's NCAA Football Sport Video Games, 7 ELON L. REV. 467, 490 (2015) (quoting Brian D. Wassom, Uncertainty Squared: The Right of Publicity and Social Media, SYRACUSE L. REV. 227, 231 (2013)) ("While there is no uniform source of legal authority on the right of publicity, section 46 of the Restatement (Third) of Unfair Competition provides the 'best summary' for how the right is generally understood to work. Section 46 states that 'one who appropriates the commercial value of a person's identity by using it without consent the person's name, likeness, or other indicia of identity for the purposes of trade is subject to liability.'" (footnote omitted)). See also Thomas Glenn Martin, Jr., Comment, Rebirth and Rejuvenation in a Digital Hollywood: The Challenge Computer-Simulated Celebrities Present for California's Antiquated Right of Publicity 4 UCLA ENT. L. REV. 99, 110 (1996) ("Courts seem to agree that the right of publicity is the right of an individual, especially a public figure or celebrity, to control the commercial use of his or her name or likeness."). The Ninth Circuit Court of Appeals, interpreting California law, has expanded the scope of the right of publicity from an individual's specific attributes, such as name, likeness, voice, signature or photograph, to embrace an individual's identity or persona, thereby employing an "identifiability" test to prove infringement of an individual's right of publicity. See, e.g., White v. Samsung Elec. Am., Inc., 989 F.2d 1512 (9th Cir. 1993), cert. denied, 113 S. Ct. 2443 (1993); Waits v. Frito-Lay, Inc., 978 F.2d 1093 (9th Cir. 1992), cert. denied, 113 S. Ct. 1047 (1993); Midler v. Young & Rubicam, Inc., 944 F.2d 909 (9th Cir. 1991) (unpublished opinion), cert. denied, 503 U.S. 951 (1992); Midler v. Ford Motor Co., 849 F.2d 460 (9th Cir. 1988).

[219] Matthew G. Matzkin, *Gettin' Played: How the Video Game Industry Violates College Athletes' Rights of Publicity by Not Paying for Their Likenesses*, 21 LOY. L.A. ENT. L. REV. 227, 229 (2001).

[220] *See Statutes & Interactive Map*, RIGHT OF PUBLICITY, http://rightofpublicity.com/statutes (last visited Mar. 17, 2019).

[221] *See* Haelan Labs., Inc. v. Topps Chewing Gum, Inc., 202 F.2d 866, 867 (2d Cir. 1953). The plaintiff entered into a contract with a professional baseball player for the exclusive right to use their image on baseball cards that were included in packs of plaintiff's chewing gum. Defendant induced the professional baseball player to allow use of player's image on/ within their packs of chewing gum, during the plaintiff's contract with player. Defendant argues that plaintiff's contract with player was no more than a release of their right of privacy, which without the plaintiff would have incurred liability for use of image. Furthermore, defendant states that the right of privacy is personal and not assignable. Therefore, player did not transfer any "property" right to the plaintiff. The majority of the court rejected defendant's contention. They acknowledged that one has value

case in which two chewing gum manufacturers fought over the use of a professional baseball player's likeness. The court in *Haelan* constructed the right of publicity on its finding that celebrities should have the right to control the commercial use of their identities.[222] This independent right of publicity was confirmed in the Supreme Court's decision in *Zacchini v. Scripps-Howard Broadcasting,*[223] which was also the first case to test this new right against the First Amendment.[224] The court in *Zacchini* acknowledged an inherent tension between the First Amendment and the right of publicity, given that the latter often infringes upon expressions covered by the former.[225] The *Zacchini* court held that the state's right for celebrities to protect the use of their identities must be balanced against the First Amendment; however, the court left open the means for balancing these competing interests.[226]

Following *Zacchini*,[227] several balancing tests were developed, but the test that has since gained the most influence and traction in terms of use is the "transformative" test, which was borrowed from intellectual property law.[228] The

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in their photograph and without a right of publicity over their image they are deprived of that value. Therefore, player should be granted the "right of publicity" over their image, and thus have the exclusive right to determine the use of their picture.

[222] *See id.* at 868.

[223] Zacchini v. Scripps-Howard Broadcasting Co., 433 U.S. 562 (1977) (Plaintiff sought compensation for the television network's appropriation of his entire human-cannonball performance. The court recognized that Plaintiff had a "proprietary" interest in controlling commercialization of his act, as it is how he made his livelihood. The defense argued that, as a television station company, they have the privilege to report matters of public interest, as granted by the First and Fourteenth Amendments in the United States Constitution. The majority of the *Zacchini* court rejected the defense that plaintiff's performance was of public interest, which would have afforded defendant use. Instead, the court made clear that there is a commercial value to the plaintiff's right of publicity regarding the performance, thus it deserves protection.).

[224] *See id.*

[225] *Id.* at 576.

[226] *Id*. at 577-79.

[227] Baker *et al.*, *supra* note 218, at 473 ("In *Zacchini*, the Court cautioned against the chilling of free expression by requiring courts to balance the public's interest in the challenged expression against the individual's right to prevent unjust enrichment.").

[228] Comedy III Prods., Inc. v. Gary Saderup, Inc., 21 P.3d 797, 808 (Cal. 2001) (quoting Campbell v. Acuff-Rose Music, Inc. 510 U.S. 569, 579 (1994)) ("As the Supreme Court has stated, the central purpose of the inquiry into this fair use factor 'is to see, in Justice Story's words, whether the new work merely 'supersede[s] the objects' of the original creation, or instead adds something new, with a further purpose or different character, altering the first with new expression, meaning, or message; it asks, in other words, whether and to what extent the new work is 'transformative.' Although such transformative use is not absolutely necessary for a finding of fair use, the goal of copyright, to promote science and the arts, is generally furthered by the creation of transformative works.' This inquiry into whether a work is 'transformative' appears to us to be

California Supreme Court in *Comedy III Productions, Inc. v. Gary Saderup, Inc.*[229] (*Comedy III*) was the first to use the transformative test to balance the right of publicity against the First Amendment.[230] An expression is transformative when "the work in question adds significant creative elements so as to be transformed into something more than a mere celebrity likeness or imitation."[231] In answering this question, the reviewing court must discern whether the celebrity's NILs were used as raw materials in the creation of a new and expressive creation.[232]

The transformative test evaluates the value associated with a good and the source from which it is derived.[233] A perfect example of value derivation analysis can be found in *No Doubt v. Activision Publishing, Inc.*, a case involving the unauthorized use of NILs belonging to a rock band (No Doubt) and its members.[234] Initially, the band agreed to the use of their NILs in the game, but later retracted that authorization when they learned that their avatars were playing songs by other artists.[235] The game producer defendant argued that the use of No Doubt within the video game was transformative, and protectable under the First Amendment as an artistic work, because those who played the game could alter the avatars and manipulate the music they played.[236] The Court determined that since No Doubt was a band that sang and played instruments, the avatars in the video game were exactly replicating No Doubt's real life activities.[237] Thus, the defendants featured the band

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necessarily at the heart of any judicial attempt to square the right of publicity with the First Amendment. As the above quotation suggests, both the First Amendment and copyright law have a common goal of encouragement of free expression and creativity, the former by protecting such expression from government interference, the latter by protecting the creative fruits of intellectual and artistic labor.") (internal citations omitted).

[229] *See generally id.* at 800-01(plaintiff alleging a misappropriation of deceased celebrity likeness by defendant on lithographs and t-shirts in violation of their right of publicity).

[230] *Id.* at 808 ("[W]hen a work contains significant transformative elements, it is not only especially worthy of First Amendment protection, but it is also less likely to interfere with the economic interest protected by the right of publicity. As has been observed, works of parody or other distortions of the celebrity figure are not, from the celebrity fan's viewpoint, good substitutes for conventional depictions of the celebrity and therefore do not generally threaten markets for celebrity memorabilia that the right of publicity is designed to protect.").

[231] *Id.* at 799.

[232] Cianfrone & Baker, *supra* note 217, at 53 (quoting *Comedy III Prods.,* 21 P.3d at 809 (Cal. 2001)).

[233] *Comedy III Productions*, 21 P.3d at 810.

[234] *See* No Doubt v. Activision Pub'g, Inc., 192 Cal. App. 4th 1018 (2011).

[235] *Id.* at 1024.

[236] *Id.* at 1034.

[237] *Id.*

in its game in the same setting from which the band derived its fame.[238] The court added that the alterations that game players could make to the avatars did not add enough transformative expression to qualify for First Amendment protection.[239] Both the Ninth Circuit in *Name & Likeness* and the Third Circuit in *Hart* relied heavily on the facts and reasoning in *No Doubt* in resolving their respective cases.[240]

The controversy at the center of both *Name & Likeness* and *Hart* involved a franchise of video games (*NCAA Football* and *NCAA Basketball*) that began in 1998 and continued until the conclusion of the two cases.[241] The sport video games (SVGs) were produced to replicate the sports of men's basketball and football in a video game. Within the games were replications of stadia, mascots, and fight songs from real NCAA sports teams.[242] The problem with the SVGs was that in EA's attempt to make sure that the games replicated real-life NCAA games, EA also incorporated the identities of active NCAA players.[243] These identities were reflected in the jersey numbers, skill sets, and just about all noticeable physical characteristics.[244] Players could even activate a feature hidden within the game by uploading player rosters.[245] Real rosters could be found in a file-sharing forum and once uploaded, the game announcers would say the names of specific players.[246] In its initial answer, EA asserted an affirmative defense to Keller's complaint with the assertion that the NCAA had granted EA the licensed right to use athlete NILs in the games.[247] Keller's complaint was amended to answer EA's affirmative defense that

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[238] *Id.*

[239] The court disagreed with the defenses because No Doubt was being used to play songs and sing, just as they do in real life. Being allowed to change the main character's voice to sing as a male was not transformative enough. *See id.* ("That the avatars can be manipulated to perform at fanciful venues including outer space or to sing songs the real band would object to singing, or that the avatars appear in the context of a video game that contains many other creative elements, does not transform the avatars into anything other than exact depictions of No Doubt's members doing exactly what they do as celebrities.").

[240] *In re* NCAA Student-Athlete Name & Likeness Litig., 724 F.3d 1268, 1279 (9th Cir. 2013) ("Like the majority in *Hart*, we rely substantially on *No Doubt*, and believe we are correct to do so."); *see also* Hart v. Elec. Arts, Inc., 717 F.3d 141 (3d Cir. 2013).

[241] Chris Smith, *NCAA Football Video Game Is Worth Over $75,000 Per Year For Top Teams*, FORBES (Aug. 22, 2013), https://www.forbes.com/sites/chrissmith/2013/08/22/ncaa-football-video-game-is-worth-over-75000-per-year-for-top-teams/#300c49bb26d4.

[242] Complaint at 3, Keller v. Elec. Arts, Inc., No. 09-1967 (N.D. Cal. 2009).

[243] *Id.*

[244] *Id.* at 4.

[245] *Id.* at 9.

[246] *Id.*

[247] *See* Electronic Arts Inc.'s Answer to Antitrust Allegations in Second Consolidated Amended Class Action Complaint at 63, *In re* Student-Athlete Name & Likeness Litig., No. C 09-

it did not really use player NILs.[248] Meanwhile, the NCAA managed to get itself dismissed from the *Name & Likeness* case, leaving its business partners EA and CLC left to defend the obvious use of player NILs in their games.[249] In fact, the district court in *Name & Likeness* rejected EA's claim that it did not use player NILs when it dismissed EA's motion for judgment on the pleadings.[250]

Both the *Name & Likeness* and *Hart* cases reached their respective Circuits on appeals that focused on whether the incorporation of college athlete NILs into EA's NCAA SVGs was transformative enough for First Amendment protection.[251] The Ninth Circuit in *Name & Likeness* and the Third Circuit in *Hart* both found that EA intended to mimic student-athletes' appearances within the video game so that they could be identified.[252] Following the reasoning in *No Doubt*, both Circuit Courts found that college athlete NILs were replicated in the SVGs in the exact sports settings for which athletes were known.[253] Both Circuit Courts determined that the ability to transform an avatar that is purposely created to display a player's likeness is insufficient to be considered transformative.[254] Addressing the transformative nature of game altering features, the Third Circuit in *Hart* found that where "unaltered likeness is central to the core of the game experience, we are disinclined to credit users' ability to alter the digital avatars in our application of the transformative use test to this case."[255]

The *Name & Likeness* and *Hart* decisions serve as important warnings for those who partner with the NCAA in commercial use of college athlete NILs. The NCAA was well aware that its business partner, EA, made use of college athlete

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01967 CW, 2011 WL 3565064 (N.D. Cal. Aug. 11, 2011) (noting as Electronic Arts' fourteenth affirmative defense that "[p]laintiffs' claims are barred, in whole or in part, by the doctrine of license, because some Antitrust Plaintiffs and putative class members have licensed the right to use their Names, Images, and/or Likenesses").

[248] Complaint at 4, *Keller*, No. 09-1967.

[249] Order on Defendants' Motion to Dismiss at 1, Keller v. Elec. Arts, Inc., No. C 09-1967 CW, 2010 WL 530108 (N.D. Cal. Feb. 8, 2010), *aff'd sub nom*. *In re* NCAA Student-Athlete Name & Likeness Licensing Litig., 724 F.3d 1268 (9th Cir. 2013).

[250] *Id.* at 10.

[251] *See* Hart v. Elec. Arts, Inc., 717 F.3d 141, 165 (3d Cir. 2013); *Name & Likeness*, 724 F.3d at 1272-73.

[252] *See Hart*, 717 F.3d at 166; *Name & Likeness*, 724 F.3d at 1276.

[253] *See Hart*, 717 F.3d at 166; *Name & Likeness*, 724 F.3d at 1276.

[254] *Hart*, 717 F.3d at 167 ("If the mere presence of the feature were enough, video game companies could commit the most blatant acts of misappropriation only to absolve themselves by including a feature that allows users to modify the digital likenesses."); *Name & Likeness*, 724 F.3d at 1276.

[255] *Hart*, 717 F.3d at 168.

likeness in its products.[256] In fact, NCAA member institutions provided EA with athlete biographical information and images for incorporation into the games.[257] If not for *Name & Likeness* and *Hart*, the NCAA likely would have continued its relationship with EA, and SVGs production would be ongoing today.[258] Still, the plaintiffs in *Name & Likeness* and *Hart* should not be credited with killing the highly-successful NCAA Basketball and Football SVGs. That dishonor belongs to the NCAA, its members, and their conferences, because EA expressed its desire to continue production and compensate the college athletes for the use of their NILs.[259] Instead, the game fell victim to NCAA bylaw section 12.4.1.1, which prohibits athletes from receiving compensation for third parties' use of their likeness in commercial products.[260] The sincerity of that bylaw and its function are undermined, however, by the recognition that commercial broadcasts of NCAA-sponsored events are, in fact, products that make use of college athlete NILs.[261] Once that fact is acknowledged, we are left with the realization that the NCAA's NIL restrictions seemingly exist only to prevent college athletes from profiting off of the use of their NILs.

The hypocrisy and unfairness produced of the NCAA's NIL restrictions is not lost on some influential lawmakers, who have proposed federal and state legislation

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[256] Jon Solomon, *NCAA Knew EA Sports Video Games Used Real Players, E-Mails From Ed O'Bannon Lawsuit Show*, AL.COM (Nov. 13, 2012), https://www.al.com/sports/2012/11/ncaa_knew_ea_sports_video_game.html.

[257] Complaint at 8, Keller v. Elec. Arts, Inc., No. C 09-1967 CW, 2010 WL 530108 (N.D. Cal. Feb. 8, 2010), *aff'd sub nom*. *In re* NCAA Student-Athlete Name & Likeness Licensing Litig., 724 F.3d 1268 (9th Cir. 2013).

[258] *See generally id.*

[259] Jon Solomon, *Ed O'Bannon Lawyers: EA Will Testify it Wanted to Pay Players*, CBS SPORTS (June 4, 2014), https://www.cbssports.com/college-football/news/ed-obannon-lawyers-ea-will-testify-it-wanted-to-pay-players/ (discussing how plaintiffs in the *O'Bannon v. National Collegiate Athletic Ass'n* trial planned to show documentary evidence from an EA executive describing how EA "wanted to obtain the rights for more precise likenesses and the names of every college athlete on each roster, for which EA was willing to pay more to the NCAA and the college athletes themselves").

[260] Nat'l Collegiate Athletic Ass'n, *supra* note 71, at 72, §12.4.1.1 ("Such compensation may not include any remuneration for value or utility that the student-athlete may have for the employer because of the publicity, reputation, fame or personal following that he or she has obtained because of athletics ability.").

[261] This free advertising allows for the multibillion-dollar industry to continue to prosper while the student-athletes receive nothing. Furthermore, the universities force the student-athletes with any knowledge of someone using their NIL to stop them or risk losing their eligibility.

that aims to protect college athletes' publicity rights.[262] Most recently, California state lawmakers unanimously passed the Fair Pay to Play Act,[263] which will come into effect on January 1, 2023.[264] The Fair Pay to Play Act makes it illegal for a college or university[265] to remove an athlete's scholarship—or declare them ineligible—if they make any money off of their NIL.[266] Further, U.S. Rep. Mark Walker of North Carolina introduced a bill in the House of Representatives on March 14, 2019 that, if passed, would modify the definition of Qualified Amateur Sports Organizations within the Internal Revenue Code as a means for pressuring the NCAA to lift its restrictions on college athlete NILs.[267] In defense of his bill, Rep. Walker stated that "[s]igning on with a university, if you're a student-athlete, should not be [a] moratorium on your rights as an individual. This is the time and the moment to be able to push back and defend the rights of these young adults."[268] Walker, who was a college athlete and is now vice chair of the Republican House conference,[269] added that his bill would not force the NCAA or its members to compensate college athletes for their NIL use, but instead seeks to lift restrictions on college athlete use of their own NILs.[270] Bills proffered in South Carolina and New

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[262] *See, e.g.*, Brian Murphy, *NCAA Must Allow Players to Profit from Name and Image, NC Republican's New Bill Says*, NEWS & OBSERVER (Mar. 7, 2019), https://www.newsobserver.com/sports/article227181209.html; *see also* Jenna West, *South Carolina Lawmakers to File Proposal Similar to California's Fair Pay to Play Act*, SPORTS ILLUSTRATED (Sept. 13, 2019), https://www.si.com/college-football/2019/09/13/south-carolina-proposal-pay-college-athletes-fair-pay-play-act; Charlotte Carroll, *N.Y. State Senator Proposes Bill to Pay College Athletes Directly*, SPORTS ILLUSTRATED (Sept. 18, 2019), https://www.si.com/college-football/2019/09/18/ny-senator-kevin-parker-proposes-bill-pay-college-athletes.

[263] S.B. 206, 2019 Leg., Reg. Sess. (CA 2019), https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200SB206 (enacted) (coauthored by State Sen. Nancy Skinner and Steven Bradford and approved by the California Governor on Sept. 30, 2019, to take effect on Jan. 1, 2023.)

[264] *Id.*

[265] *Id.* (This law will apply to all intercollegiate athletic programs in California that make an average of $10,000,000 or more in media rights.).

[266] After the unanimous passing of the Fair Pay to Play Act in California, South Carolina lawmakers signaled their intent to introduce a similar bill in January 2020, and New York lawmakers have announced their plan to propose a similar bill as well. *See* West, *supra* note 262; Carroll, *supra* note 262; *see also* Steve Berkowitz (@ByBerkowitz), TWITTER (Sept. 4, 2019) https://twitter.com/ByBerkowitz/status/1169275190842449921 (The bill has a clause that prohibits athletes to have sponsorship deals that conflict with school sponsorship deals.)

[267] Murphy, *supra* note 262.

[268] *Id.*

[269] *Id.*

[270] *Id.*

York follow the reasoning found in Rep. Walker's bill by making it illegal under state law for schools to revoke scholarships of college athletes who collect income from their NILs.[271] In Washington state, another bill is pending that would allow student-athletes to earn compensation for their NILs and permit them to retain the services of sports agents.[272] The Washington bill would add a new section to chapter 19.86 Revised Code of Washington ("RCW")—Unfair Business Practices.[273] The existence of these legislative acts demonstrates the vulnerability of the NCAA's NIL restrictions and reflect the reality that the NCAA should change its rules or risk legal intervention. The next section addresses proposals for change that the NCAA should strongly consider before it is legislatively forced to change.

IV
PROPOSALS FOR CHANGING NCAA NIL RULES

This section addresses a previous proposal that the NCAA might refer to when creating its new NIL policy through the process of rule creation. While there is no way of knowing exactly what the NCAA will roll out when it unveils the new and improved approach to regulating college athlete NILs, the policies covered in this section represent realistic options that the NCAA may adopt, either in whole or in part.

In 2016, Professor Gabe Feldman proffered his White Paper, a seminal and (at the time) pioneering proposal for changing the NCAA's NIL rules, to the Knight Commission of Athletics.[274] Professor Feldman's thoughtful proposal sought to balance college athlete interest in controlling the use of their NILs with the NCAA's interest in preserving its amateurism model for intercollegiate athletics.[275]

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[271] *See generally id.*

[272] H.B. 1084, 66th Leg., Reg. Sess. (WA 2019), http://lawfilesext.leg.wa.gov/biennium/2019-20/Pdf/Bills/House%20Bills/1084.pdf.

[273] *Id.*

[274] *About The Knight Commission*, KNIGHT COMMISSION ON INTERCOLLEGIATE ATHLETICS, https://www.knightcommission.org/about-knight-commission/ (last visited Feb. 20, 2019) ("The Knight Commission on Intercollegiate Athletics is an independent group with a legacy of promoting reforms that support and strengthen the educational mission of college sports…The Knight Commission was formed by the John S. and James L. Knight Foundation in October 1989 to recommend a reform agenda in response to highly visible athletics scandals and low graduation rates for college football and men's basketball players that threatened the integrity of higher education.").

[275] *See generally id.*

A. Preserving Amateurism

While acknowledging the NCAA's interest in maintaining the (illusory) line between professional and amateur athletics and the argument that paying athletes would alter the nature of the NCAA's products,[276] Professor Feldman distinguished game-related NIL use from college-athlete use of their NILs.[277] Professor Feldman suggested lifting NIL restrictions for non-game related activities as a means for preserving the purported line of demarcation between amateur and professional sports within the NCAA.[278] Professor Feldman believed that an approach that relaxed NCAA NIL rules so that college athletes had the freedom to commodify and market their reputations would not offend the revered tradition of amateurism so long as the athletes are not paid directly by the schools for their athletic performance and remain enrolled as students in pursuit of a "legitimate college education."[279]

B. The NCAA's Educational Mission

Regarding the NCAA's claims that its NIL restrictions further its educational mission,[280] Professor Feldman asserted that education would not be compromised by his proposal. Instead, college athletes should be permitted to benefit from participating in the same commercial markets to which all other students have access.[281] Professor Feldman was right in his observation that there is no real nexus between NIL restrictions and college athlete education. Otherwise, why wouldn't similar restrictions exist for all students attending NCAA institutions? The NCAA's claim that its rules prevent the creation of a social wedge between athletes and other students is not supported by relevant literature or by common sense.[282] If anything,

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[276] O'Bannon v. Nat'l Collegiate Athletic Ass'n, 802 F.3d 1049, 1076 (9th Cir. 2015).

[277] Feldman, *supra* note 17, at 4; *see also O'Bannon*, 802 F.3d at 1077.

[278] Feldman, *supra* note 17, at 4.

[279] Audrey C. Sheetz, *Student-Athletes vs. NCAA: Preserving Amateurism in College Sports Amidst the Fight for Player Compensation*, 81 BROOK. L. REV. 865, 870-71 (2016).

[280] *See, e.g.*, Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of Univ. of Okla., 468 U.S. 85, 120 (1984); *O'Bannon*, 802 F.3d at 1075.

[281] Feldman, *supra* note 17, at 5-6.

[282] *See generally* Simiyu, *supra* note 164, at 16-24 ("Student athletes face challenges of individual nature including their personal involvement in academic oriented activities, time constraints, class attendance, personal goal setting and career choices, physical and emotional fatigue, transition to college environment and academic grades, as well as external ones such as coach demands, institutional policies, discrimination; marginalization from college mainstream activities; college mission and learning environment, and eligibility demands from National Collegiate Athletic Association and National Association of Intercollegiate Athletics.").

a wedge exists as a result of the disparate treatment of college athletes that results from NCAA rules that distinguish athletes from other members of the student body.

C. Over-Commercialization

Commercial exploitation of college athletes is a purported concern of the NCAA. However, the sincerity of that concern is belied by the NCAA's own profiteering from the commercial use of college athlete NILs in building the billion-dollar industry of intercollegiate athletics.[283] As Professor Feldman wrote:

> The NCAA has long conceded that commercialization and amateurism can co-exist, just not with respect to student-athletes. The perceived—and actual—unfairness in this arrangement grows with each new television deal, coaching contract, and facility renovation, while the selective and blanket restrictions on student-athletes are maintained.[284]

This imbalance is intensified by the fact that most college athletes do not go onto lucrative careers in professional sports, and this limits their ability to profit off of their NILs once they are no longer competing on their collegiate teams.[285] Professor Feldman recognized the urgency for college athletes to capitalize on their opportunities as college athletes and suggested that relaxing NIL rules might reduce some of the demand that results in the black market for college athlete services.[286] He added that with less need to monitor for NIL infractions, the NCAA and its members could focus more on working with college athletes in their efforts to grow their personal brands in a way that assists them when their college careers come to a close.[287]

D. Fearmongering

Defenders of the NCAA's NIL limits often defend them on the basis that relaxing the rules would open the door to a flood of attacks on amateurism principles.[288] However, Professor Feldman believes this is an ill-advised argument,

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[283] Lindsay J. Rosenthal, *From Regulating Organization to Multi-Billion Dollar Business: The NCAA Is Commercializing the Amateur Competition It Has Taken Almost a Century to Create*, 13 SETON HALL J. SPORT L. 321, 336 (2003) ("[T]he NCAA has strict guidelines regulating the exploitation by commercial entities of its member's student-athletes.").

[284] Feldman, *supra* note 17, at 6.

[285] *Id.*

[286] *Id.*

[287] *Id.* at 7.

[288] Sheetz, *supra* note 279, at 881.

as legal attacks on the NCAA are more likely when there are blanket restrictions.[289] The decisions in both *O'Bannon* and *Grant-in-Aid* demonstrate that courts, within the Ninth Circuit at least, are willing to subject the NCAA's regulation of college athletes to rule of reason review.[290] The existence of blanket NIL restrictions invites college athletes to challenge the reasonableness of those restrictions and the existence of less restrictive alternatives to them. To this end, Professor Feldman smartly recognized that efforts from the NCAA to assist athletes in the use of their NILs might actually prevent lawsuits rather than create more.[291] He stated that, "[u]ntil the rights of student-athletes are better protected or respected, it appears inevitable that they and others will continue to seek judicial or legislative alternatives that present a greater threat to the NCAA's amateurism foundation."[292]

E. Proposal Specifics

Professor Feldman's proposal would have allowed for college athletes to earn compensation related to use of their non-game related NILs.[293] In order for this to occur, he laid out specific measures that the NCAA should take to ensure that college athletes were acting within the NCAA's educational mission and other core goals.[294] One of the more basic components of his proposal required college athletes to seek out permission before representing the institution in any advertisements.[295] Feldman grounded this requirement in contract law and the need for a license in order to display a member institution's trademarks.[296]

Next, Professor Feldman suggested that the NCAA and its member institutions should be notified of all NIL agreements and have final approval.[297] In addition, he recommended that the NCAA should not allow the institutions to provide any assistance in finding NIL agreements for their athletes.[298] Constraining institutions from assisting with sponsorship deals seemed to be an attempt to ensure that the institutions were not compensating college athletes for their on-field

[289] Feldman, *supra* note 17, at 7.
[290] *See generally* O'Bannon v. Nat'l Collegiate Athletic Ass'n, 802 F.3d 1049, 1076 (9th Cir. 2015); *In re* Nat'l Collegiate Athletic Ass'n Athletic Grant-In-Aid Cap Antitrust Litig., 375 F. Supp. 3d 1058 (N.D. Cal. 2018).
[291] Feldman, *supra* note 17, at 8.
[292] *Id.*
[293] *Id.* at 8-9.
[294] *Id.* at 5-6.
[295] *Id.* at 9-10.
[296] *See generally id.*
[297] *Id.* at 9-12.
[298] *Id.*

production.[299] Professor Feldman also added a requirement for college athletes to be in good academic standing as a condition to permitted NIL use.[300] By adding an academic eligibility component Professor Feldman infused within his proposal a measure for motivating athlete success in the classroom.

Next, Professor Feldman addressed the oversight of the potential NIL agreements by proposing that the NCAA form a NIL committee to govern the approval process.[301] The proposed committee would be responsible for creating objective standards to evaluate the agreements. Suggested considerations for the committee included determining an appropriate level of compensation, the appropriateness of required activities under the NIL agreement, the character and integrity of third-parties who want to use college athlete NILs, demands made on athlete involvement, and any educational benefits that flow from the NIL agreement.[302] Professor Feldman also suggested that the NCAA adopt a standard NIL agreement form for college athletes and a group licensing agreement.[303] The standard NIL forms would be provided by institutions and used by college athletes to ensure that agreements adhered to the NCAA's missions and that there would be minimal interference with the student-athlete's educational pursuits.[304] The standard NIL would also include a "reverse moral clause,"[305] allowing the athlete to terminate a contract if the company were subject to an event that created a negative public perception.

Turning next to Feldman's proposal of a model group licensing agreement, he suggested that this document would need to allow for the institution to use the non-game related NILs of all college athletes in groups for commercial products like SVGs.[306] The oversight and standard form agreements would provide the NCAA control over most aspects of the group licensing agreements.[307] The NCAA would be able to limit who could sign group licensing deals and the composition of those

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[299] *Id.*
[300] *Id.*
[301] *Id.*
[302] *Id.*
[303] *Id.*
[304] *Id.*
[305] *Id.* at 11 ("will terminate the agreement based on any conduct that brings the third party into public dispute").
[306] *Id.* ("[R]evenue… will be shared between the institution and student-athletes.").
[307] *Id.*

contractual arrangements so that the organization could maintain its interest in protecting athlete education.[308]

In order to ensure that all of the above could be accomplished in accordance with the NCAA's mission, Professor Feldman suggested that the NCAA and its members set forth guidelines before NIL agreements were effectuated.[309] He found that oversight might include reasonable restrictions in the form of a "singing period" for NIL agreements and for requirements that third parties register with the NCAA prior to engaging with college athletes for the use of their NILs.[310] He also suggested the possibility of creating a trust fund for college athletes that would hold monies mined from NIL use until the athlete graduates or terminates their eligibility.[311]

Finally, Professor Feldman suggested that the NCAA should allow college athletes to hire an agent to handle the fundamentals that come along with pursuing, evaluating, and negotiating the NIL agreements.[312] Depending on how the NCAA would alter the bylaws regarding agents, this may be the only role the agent would be allowed to take on for the college athletes.[313]

Professor Feldman's proposal was made in 2016, but his suggestions seemingly fit comments made by Dr. Rice in her personal statements on the Commission's final report.[314] Dr. Rice stated that she personally believed that college athletes should be permitted more flexibility to build their brand while not losing the opportunity to play at the collegiate level.[315] Professor Feldman's proposal balanced the line of maintaining hard limits against game related compensation while also permitting athletes to benefit from the commercial value that is inherent to their identities.[316] In this regard, Dr. Rice's statements in her report echo what Professor Feldman proposed in his White Paper.[317] While the authors of this article applaud both Professor Feldman and Dr. Rice and urge the NCAA to adopt the

308 *Id.* at 5.
309 *Id.* at 10.
310 A signing period would ensure student-athletes are focused on their education during the semesters and not distracted by business opportunities. *See id.* at 11 (Professor Feldman continues to propose a weekly cap on number of hours a student-athlete can devote to their NIL contracts.).
311 *Id.* at 12.
312 *Id.*
313 *See generally id.*
314 *See generally* Rice, *supra* note 16.
315 *Id.*
316 Feldman, *supra* note 17, at 10-12.
317 *See* Rice, *supra* note 16, at 1.

suggestions made in the White Paper, we do so with a cautioned recognition that the proposal is not a cure for the NCAA's corruption problem.

V
PROPOSAL LIMITATIONS

It's probable that the White Paper represented the best possible proposal that could have been put forth by Professor Feldman under the circumstances. The proposals within the White Paper were judicious in their care for advancing college athlete rights in ways that did not threaten the NCAA's amateurism model. The Knight Commission did not embrace Professor Feldman's proposal for a legitimate reason—it did not go far enough in regards to protecting the NIL interests of *all* college athletes.[318] Before addressing that point, it is important to note that the NCAA indicated that it might be willing to relax its NIL restrictions, to some degree, with the way it handled the waiver request for Ogunbowale to appear on DWTS.[319] The NCAA's reasoning in permitting her appearance on the hit reality show reflected a possible shift in policy to afford waivers to allow college athletes to utilize their NILs in ways similar to those Professor Feldman proposed in his White Paper.[320] Professor Feldman also proposed a case-by-case approach to permitting college athletes to use their waivers and an NIL Committee for deciding cases and factors for consideration.[321] The Ogunbowale example, however, also evidences enforcement problems with a relaxation of policy that would permit waivers for NIL use on a case-by-case basis. The possibility of enforcement problems become more pronounced when the Ogunbowale example is juxtaposed with another example, that of Donald De La Haye. The University of Central Florida (UCF) enforced NCAA NIL restrictions to pressure former college athlete Donald De La Haye to either suspend a YouTube channel he created and profited from or end his involvement on the football team.[322]

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[318] *Knight Commission Calls for NCAA to Transform its Guidelines for March Madness Revenues to Better Support College Athletes and Protect Financial Integrity*, KNIGHT COMMISSION ON INTERCOLLEGIATE ATHLETICS (May 10, 2016), https://www.knightcommission.org/2016/05/knight-commission-calls-for-ncaa-to-transform-its-guidelines-for-march-madness-revenues-to-better-support-college-athletes-and-protect-financial-integrity-2/.

[319] Baker, *supra* note 7.

[320] *Id.*

[321] Feldman, *supra* note 17, at 10-11.

[322] Richard Johnson, *UCF Says its Kicker Can't Make Money Off of YouTube Videos Because . . . NCAA*, SBNATION (last updated June 16, 2017), https://www.sbnation.com/college-football/2017/6/12/15785390/ucf-kicker-youtube-donald-de-la-haye.

A. Ogunbowale and DWTS

On March 30, 2018, the University of Notre Dame trailed the favored University of Connecticut in the final seconds of overtime in their NCAA Women's Basketball Final Four game.[323] As time ran out, Arike Ogunbowale made an 18-foot step-back jumper to win the game.[324] Two days later, in the NCAA Women's Basketball Championship game, Ogunbowale repeated the feat with another heroic winning shot as time expired, this time 23-feet from the basket, in the corner.[325] Almost instantaneously, Ogunbowale rose to superstar status with opportunities to hang out with celebrity athletes like Kobe Bryant and appear as Ellen DeGeneres' guest on her talk show.[326] As part of her newfound fame, Ogunbowale received an invitation to participate on the athlete edition of DWTS.[327]

DWTS is a ballroom dancing competition involving "stars" in the form of celebrities from film, television, and music industries such as Melissa Joan Hart, Steve-O, and Master P.[328] The show has a record of casting "stars" who were/are celebrity athletes, such as former heavyweight boxing champion Evander Holyfield and Olympic gold medal winning figure skater Kristi Yamaguchi.[329] Participants are paid for appearing on DWTS on a sliding scale with everyone making (at least) $125,000 and all having the potential to earn more with weekly payments made depending how far they advance in the competition.[330]

Merely by agreeing to participate on the show, Ogunbowale should have been set to earn $125,000, and this is where the NCAA's enforcement dilemma began.[331] Without a waiver, Ogunbowale's involvement on DWTS would have violated the

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[323] Jeré Longman, *Notre Dame, a UConn Nemesis, Topples the Huskies in a Final Four Thriller*, N.Y. TIMES (Mar. 31, 2018), https://www.nytimes.com/2018/03/30/sports/uconn-notre-dame-women-final-four.html.

[324] Ben Baskin, *Inside Arike Ogunbowale's Time as an Overnight Celebrity*, SPORTS ILLUSTRATED (Nov. 1, 2018), https://www.si.com/college-basketball/2018/11/01/notre-dame-irish-women-arike-ogunbowale.

[325] *Id.*

[326] TheEllenShow, *Kobe Bryant Surprises NCAA Champ Arike Ogunbowale*, YouTube (Apr. 6, 2018) https://www.youtube.com/watch?v=SmlhE0vTRds.

[327] Baskin, *supra* note 324.

[328] *Watch Dancing with the Stars TV Show*, ABC, https://abc.go.com/shows/dancing-with-the-stars (last visited Dec. 28, 2018).

[329] *Id.*

[330] Brian Moylan, *How Much Money Will the Stars Make on* Dancing with the Stars*?*, GAWKER (Sept. 1, 2010), https://gawker.com/5627611/how-much-money-will-the-stars-make-on-dancing-with-the-stars.

[331] *Id.*

NCAA's bylaw that prohibits athletes from financially benefitting from their "publicity, reputation, fame or personal following that he or she has obtained because of athletics ability."[332] By granting Ogunbowale a waiver, the NCAA allowed her to appear on DWTS and keep what she earned because those payments resulted from her dancing abilities—not her basketball skills. In effect, the Ogunbowale waiver process played out just as Professor Feldman would have envisioned if the proposals in his White Paper had become policy within the NCAA.

The waiver by the NCAA allowed Ogunbowale to bypass bylaw 12.4.1, which states that athlete "compensation may not include any remuneration for value or utility that the student-athlete may have for the employer because of the publicity, reputation, fame or personal following that he or she has obtained because of athletics ability."[333] The NCAA permitted the waiver in this case because it determined that Ogunbowale's invitation to participate on DWTS did not result from her athletic ability.[334] That determination is undermined by Ogunbowale's profile on the DWTS website:

> Arike Ogunbowale is a junior at Notre Dame and member of the women's basketball team, who recently won the 2018 NCAA Division I Women's Basketball Tournament. She was also named the tournament's Most Valuable Player this year. During her college career, Ogunbowale has earned multiple honors, including: Naismith Trophy Top-30, NCAA Regional Most Outstanding Performer, NCAA All-Regional Team, WBCA All-Region Team, ACC All-Tournament First-Team, EspnW National Player of the Week (11/21/16), Preseason WNIT Tournament MVP and ACC Player of the Week (11/14/16). She is a five-time USA Basketball medalist with four gold and one silver. Ogunbowale graduated from Divine Savior Holy Angels High School in Milwaukee, WI, where she scored 2,240 points in her career, making her sixth on the Wisconsin all-time scoring list. She is the youngest of three children in an athletically talented family. Her older brother Dare was a running back at the University of Wisconsin, her mother Yolanda was a softball pitcher at DePaul University and her father Gregory played soccer and rugby. Her first name means "something that you see and you cherish" in her father's native Nigeria.[335]

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[332] NAT'L COLLEGIATE ATHLETIC ASS'N, *supra* note 71, at 72, §12.4.1.
[333] *Id.*
[334] Bogage, *supra* note 20.
[335] *Arike Ogunbowale | Dancing with the Stars*, ABC, https://abc.go.com/shows/dancing-with-the-stars/cast/arike-ogunbowale (last visited Jan. 3, 2019).

It's evident from Ogunbowale's profile that DWTS intended to build off of the college athlete's accomplishments as a basketball player at Notre Dame. If Ogunbowale had not sunk those game-winning baskets in the Tournament, she likely would not have been involved in that season of DWTS. And it is in this recognition that a serious enforcement problem is revealed with any waiver process that decides athlete NIL use on a case-by-case basis and requires that the use not be linked to athletic success. Such an approach will result in arbitrary and capricious enforcement decisions similar to UCF's with Donald De La Haye's request to continue production of a YouTube channel that he started before he ever set foot on a collegiate field.[336]

B. De La Haye and YouTube

YouTube is an online platform of user-created videos that are uploaded and shared with the world.[337] The users can follow one another and the most popular users are paid based on ads, chosen by YouTube, that are displayed on or during their videos—this is also called "monetizing."[338] Under the user name Deestroying, De La Haye started a channel by uploading videos at the same time he was preparing to launch his academic and athletic career at UCF as a freshman kicker for their Division I college football team.[339] During his freshman campaign at UCF, De La Haye appeared in ten games and was used mostly for kickoffs.[340] De La Haye averaged 61.6 yards for the 33 kicks he made that season, and he also made one extra point attempt.[341] In his sophomore season, De La Haye returned to UCF and once again was used as a kickoff specialist.[342] At no point in time did De La Haye's performance as a kickoff specialist for UCF make him a local, regional, or national celebrity.

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[336] *Deestroying*, YOUTUBE, https://www.youtube.com/channel/UC4mLlRa_dezwvytudo9s1sw (last visited Dec. 20, 2018).

[337] *About YouTube*, YOUTUBE, https://www.youtube.com/yt/about/ (last visited Dec. 20, 2018).

[338] *Monetization YouTube*, YOUTUBE, https://www.youtube.com/account_monetization (last visited Dec. 20, 2018).

[339] *Donald Delahaye Bio*, UCF KNIGHTS, http://ucfknights.com/ViewArticle.dbml?ATCLID=211760364&DB_OEM_ID=34100 (last visited Dec. 18, 2018).

[340] *Donald Delahaye*, SPORTS-REFERENCE, https://www.sports-reference.com/cfb/players/donald-delahaye-1.html (last visited Dec. 18, 2018).

[341] *Id.*

[342] *Donald De La Haye Statistics*, WASH. POST, http://stats.washingtonpost.com/cfb/players.asp?id=258980&team=210 (last visited Dec. 18, 2018).

De La Haye managed to grow his YouTube channel to attract an impressive amount of subscribers (a little more than 50,000)[343] who likely followed him for reasons that had absolutely nothing to do with UCF football.[344] Yet on June 10, 2017, De La Haye surprised his subscribers with a new post to the channel titled "Quit College Sports or Quit YouTube?"[345] In the video, De La Haye announced that his channel was under investigation for potentially violating NCAA rules due to his making a modest amount of money off of the YouTube channel.[346] De La Haye stated in the video that he was scheduled to meet with UCF and the NCAA to find a way to continue to produce videos without forfeiting his NCAA eligibility.[347] About a month later, UCF submitted a request for an NIL waiver on behalf of De La Haye that sought permission for the athlete with his channel on YouTube.[348] The NCAA approved the waiver, but did so with restrictions.[349] In a video posted to his channel, De La Haye read the conditions for his waiver:

> Institution had to submit waiver on your behalf asking for release of the legislation. NCAA approved the waiver in which you can use his picture, name, and likeness to continue your self-employment business, however it is **<u>with conditions</u>**: videos cannot reference your status as a student athlete, nothing UCF related—gear, facilities, other student athlete… videos cannot depict your football or athletic skills or abilities, including anything specific to the sport of football—pass a football, kick a football, talk about quarterbacks… videos that do not satisfy these conditions will have to be removed from the monetized

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343 Johnson, *supra* note 322.

344 UCF was far from a national football powerhouse. They went 6-7 in the American Athletic Conference—which included a 51-14 point loss to Michigan. *See 2016 UCF Knights Schedule and Results*, SPORTS-REFERENCE, https://www.sports-reference.com/cfb/schools/central-florida/2016-schedule.html (last visited Dec. 18, 2018).

345 Deestroying, *Quit College Sports or Quit Youtube?*, YOUTUBE (June 10, 2017), https://www.youtube.com/watch?v=k3gdVzq3nm4.

346 *Id.*

347 *Id.*

348 Tyler Graddy, *A Timeline: UCF Kicker Donald De La Haye Declared Ineligible By Youtube Revenue Stream*, KNIGHT NEWS (Aug. 1, 2017), http://knightnews.com/2017/08/a-timeline-ucf-kicker-donald-de-la-haye-declared-ineligible-by-youtube-revenue-stream/.

349 Deestroying, *The REAL Reason I Lost My Full D1 Scholarship Because of My YouTube Channel.. (FULL STORY)*, YOUTUBE (Aug. 7, 2017), https://www.youtube.com/watch?v=-hxceaFvVog.

> account and the funds generated from these videos will have to be donated to a charity of your choice.[350]

This waiver by the NCAA granted De La Haye permission to continue to make the videos as long as he did not mention or refer to his athletic status, thereby following NCAA bylaw 12.4.1.1[351] and bylaw 12.4.4.[352] De La Haye did not initially sign the proposed waiver, but instead propositioned an amendment asking to be allowed to continue posting videos as he was, but demonetize them so that he would not generate any revenue from them.[353] Through communication with the UCF compliance office he was notified that his amendment was denied and the waiver conditions would not change.[354] In an official statement, the NCAA said, "De La Haye could continue to profit from any of his video activity as long as it was not based on his athletics reputation, prestige or ability."[355]

On July 31, 2017, UCF released a statement regarding De La Haye's eligibility.[356] UCF wrote that the waiver the NCAA approved, regarding De La Haye, allowed him to continue to "create videos that referenced his status as a student-athlete or depict his football skill or ability if they were posted to a non-monetized account."[357] However, UCF said, "De La Haye chose not to accept the conditions of the waiver and has therefore been ruled ineligible to compete in NCAA-sanctioned competition. UCF Athletics wishes him the best in his future endeavors."[358] UCF took action to suspend De La Haye prior to the NCAA, so to ensure that there would

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[350] *Id.*

[351] Inside the NCAA (@InsidetheNCAA), TWITTER (July 31, 2017, 1:40 PM), https://twitter.com/insidethencaa/status/892122868355657728?lang=en (NCAA statement regarding Donald De La Haye).

[352] It would be impossible to run a video account by yourself featuring yourself as the focal point and be allowed to earn money from it according to bylaw 12.4.4 which states: "A student-athlete may establish his or her own business, provided the student-athlete's name, photograph, appearance or athletics reputation are not used to promote the business." *See* NAT'L COLLEGIATE ATHLETIC ASS'N, *supra* note 71, at 73, §12.4.4.

[353] Deestroying, *supra* note 349.

[354] *Id.*

[355] Nick Martin, *UCF Kicker Ruled Ineligible After Rejecting NCAA's Demand To Stop Making Sports YouTube Videos*, DEADSPIN (July 31, 2017), https://deadspin.com/ucf-kicker-ruled-ineligible-after-rejecting-ncaas-deman-1797411213.

[356] Sam Cooper, *Opting Not to Comply with NCAA Conditions for YouTube Channel, UCF's Donald De La Haye Ruled Ineligible*, YAHOO! SPORTS (July 31, 2017), https://sports.yahoo.com/opting-not-comply-ncaa-conditions-youtube-channel-ucfs-donald-de-la-haye-ruled-ineligible-211526569.html.

[357] Graddy, *supra* note 348.

[358] *Id.*

not be repercussions against UCF for allowing a non-sanctioned player to participate.[359] The NCAA released a statement, through Twitter, the same day, that affirmed UCF's statement and added that "although Donald De La Haye has chosen not to compete any longer as a UCF student-athlete, he could have continued playing football for the university and earn money from non-athletic YouTube videos, based on a waiver the NCAA granted on July 14."[360]

Later that same day, De La Haye responded with a new video titled "I lost my full D1 scholarship because of my Youtube [sic] channel..[sic]," in which he spoke about the decision by the NCAA and mentioned how UCF and the NCAA requested for him to remove his videos and demonetize the account in order to stay eligible.[361] Since he was ruled ineligible, De La Haye lost the scholarship that covered his tuition at UCF.[362] In the description box of the video, De La Haye opened a GoFundMe account and asked for those who could to donate so that he could afford to finish his degree: "I am passionate about youtube [sic] and still will work relentlessly to get my degree but I don't have the funds necessary to do so. Please help out, even if its [sic] just $1!"[363] Shortly after the decision to rule De La Haye ineligible became public, his YouTube channel subscriber count jumped to over 89,000.[364]

The NCAA determined that De La Haye violated bylaw 12.4.4, which provides that a college athlete "may establish his or her own business, provided the student-athlete's name, photograph, appearance or athletics reputation are not used to promote the business."[365] This bylaw falls underneath the overarching rule 12.4.1.1: "compensation may not include any remuneration for value or utility that the student-athlete may have for the employer because of the publicity, reputation, fame or personal following that he or she has obtained because of athletics ability."[366]

However, it seems very improbable and illogical that De La Haye's status as a backup kicker at a struggling football program that rarely played on national television served as the driver for attracting more than 50,000 subscribers to his

[359] Iliana Limón Romero & Matt Murschel, *UCF Kicker Donald De La Haye Ruled Ineligible for Taking YouTube Revenue*, ORLANDO SENTINEL (July 31, 2017), https://www.orlandosentinel.com/sports/ucf-knights/knights-notepad/os-sp-ucf-kicker-ineligible-20170731-story.html.

[360] *Inside the NCAA*, *supra* note 351.

[361] Deestroying, *supra* note 349.

[362] *Id.*

[363] *Id.*

[364] Romero & Murschel, *supra* note 359.

[365] *See* NAT'L COLLEGIATE ATHLETIC ASS'N, *supra* note 71, at 73, § 12.4.4.

[366] *See id.* at 72, § 12.4.1.1

YouTube channel. In fact, the conclusion that De La Haye's following grew out of his NCAA athletic involvement seems as arbitrary as the conclusion reached by the NCAA in Ogunbowale's case. Recall that the NCAA determined that Ogunbowale's opportunity to appear on DWTS had nothing to do with her sinking last-second baskets to win her school a national championship on national television just a week or so before she received her invitation to join the show. The Ogunbowale and De La Haye cases demonstrate that the "based on athletics" standard for resolving NIL waivers is impossible to apply consistently and will lead to arbitrary applications. Unlike De La Haye at UCF, Ogunbowale did not have a platform for fame prior to her athletic performances at Notre Dame. Yet, she was permitted a waiver that allowed DWTS to promote the fact that she was a college basketball star whereas De La Haye couldn't even mention his status as a student at UCF. These two cases highlight the problems with discerning stardom and its source when it comes to college athletes. Underscored by the Ogunbowale example is also the reality that most college athletes are not celebrities and have little reputational value built into their NILs unless they do something extraordinary while representing their schools in a competitive play.

C. Identifying Celebrity

A "celebrity"[367] is someone who is well-known/famous within a relevant community, and their reputation provides them with the potential to serve as brand endorsers—those who leverage their NILs in the promotion and advertisement for commercial product brands.[368] Brands build off of celebrity endorsements by "cutting through the clutter" and in constructing a link between the brand and the endorser that creates a path in the minds of consumers through which positive

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[367] Jessica R. Braunstein & James J. Zhang, *Dimensions of Athletic Star Power Associated With Generation Y Sports Consumption*, 6 INT'L J. OF SPORTS MARKETING & SPONSORSHIP 242, 243 (2005) ("[A] celebrity is an individual whose name attracts one's attention and interest while having the ability to generate a profit."); *see also* Grant McCracken, *Who is the Celebrity Endorser? Cultural Foundations of the Endorsement Process*, 16 J. CONSUMER RES. 310, 315 (1989) ("Celebrities draw these powerful meanings from the roles they assume in their television, movie, military, athletic, and other careers"); DANIEL J. BOORSTIN, THE IMAGE: A GUIDE TO PSEUDO-EVENTS IN AMERICA, 57 (1961) ("The celebrity is a person who is well-known for their well-knownness. Fabricated on purpose to satisfy our exaggerated expectations of human greatness. . . . This statement not only determines the problem of finding a suitable definition of celebrity but also commissions to give thought to the meaning of "well-knownness.").

[368] McCracken, *supra* note 367, at 310 (This definition uses the term "commercial format" because it is meant to encompass all formats of endorsements, "the explicit mode ("I endorse this product"), the implicit mode ("I use this product"), the imperative mode ("You should use this product"), and the copresent mode (i.e., in which the celebrity merely appears with the product.).

meanings associated with the endorser transfer to the product brand.[369] The literature is uniform in the finding that brands can benefit from celebrity endorsements by improving their brand image in ways that positively influence consumer purchase behaviors.[370] Professional athletes are often used as endorsers because they are among the most recognizable, revered, and imitated celebrities.[371] Athletes are also viewed as highly attractive and considered as experts by consumers, which are two major factors for brands in selecting endorsers.[372]

However, landing a lucrative endorsement deal is not easy for most professional athletes because only the most influential members of society are capable of promoting a product brand based on their "source credibility."[373] Source credibility is linked to the athlete's fame and reputation.[374] Researchers have conceptualized the core component for determining whether an athlete has the source credibility needed to cut through the marketing clutter and have identified this construct as "star power."[375]

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[369] *See generally* McCracken, *supra* note 367.

[370] Thomas C. Boyd & Matthew D. Shank, *Athletes as Product Endorsers: The Effect of Gender and Product Relatedness*, 13 SPORT MARKETING Q. 82 (2004).

[371] William L. Shanklin & Alan R. Miciak, *Selecting Sports Personalities as Celebrity Endorsers*, 4 J. PROMOTION MGMT. 1 (1997).

[372] Boyd & Shank, *supra* note 370, at 91.

[373] Thilo Kunkel, Matthew Walker & Courtney M. Hodge, *The Influence of Advertising Appeals on Consumer Perceptions of Athlete Endorser Brand Image*, EUR. SPORT MGMT. Q. 1, 4 (2018) (Source credibility is "determined by four endorser characteristics: (1) expertise, (2) attractiveness, (3) trustworthiness, and (4) likeability . . . . These variables represent the combined image of the athlete, in his/her role as an endorser, and have a significant effect on brand attitudes, attitude towards the ad and purchase intentions.").

[374] *Id.*

[375] Akiko Arai, Yong Jae Ko & Stephen Ross, *Branding Athletes: Exploration and Conceptualization of Athlete Brand Image*, 17 SPORT MGMT. REV. 97-98 (2014) ("Athletes are considered not only as vehicles for advertisements or product endorsement, but also as cultural products that can be sold as 'brands.' In fact, there are numerous sport agencies currently in existence that provide a vast range of client level services. In this highly competitive industry, managing brands for athletes is becoming an essential task for agents. For example, IMG, the world's largest sport agency announced their mission statement: 'Today, we help hundreds of elite athletes, coaches, industry executives and prestigious sports organizations maximize their earnings potential and build strong personal brands…the advantage of viewing athletes as a brand…there are a growing number of distribution opportunities available, the athlete has the potential to enter into a variety of sectors and use his or her sports career as a platform for other endeavors.'" (internal citations omitted)).

D. Star Power and College Athletes

"Star power" is the ability and unique characteristics that make an individual a credible source of consumer confidence.[376] The characteristics found to influence star power include: (a) professional trustworthiness, (b) likeability in personality, (c) athletic expertise, (d) social attractiveness, and (e) style.[377] Most professional athletes do not possess enough of the attributes needed to qualify as "stars," even if they are well respected and compensated for playing their respective sports.[378] This reality is reflected in the difficulty that athletes have in securing major endorsement deals.[379] For example, the National Football League is the most popular professional sports league in the U.S., but even most of its athletes struggle in attracting major endorsement contracts.[380] Currently, there are 1,696 professional football players across the 32 active rosters in the NFL.[381] Of these players, it is estimated that (at most) three to five players per team earn six-figures from endorsement deals,[382] which means that roughly 10%, or about 160 players, are able to earn more than $100,000 off of the field.[383] Out of those 160 players, 32 are quarterbacks for their

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[376] *Id.* at 100.

[377] Braunstein & Zhang, *supra* note 367, at 244-46.

[378] *Id.* at 243.

[379] Jack Bechta, *The NFL Endorsement Market*, NAT'L FOOTBALL POST (2013), https://nationalfootballpost.com/the-nfl-endorsement-market/ (last visited Jan. 9, 2019).

[380] *Id.*

[381] Each team can have up to 53 players eligible to play in a game, plus a ten-member practice squad and players who have been designated as out for an extended time due to injury or other reasons. *See 2018-19 NFL Important Dates*, NFL FOOTBALL OPERATIONS, https://operations.nfl.com/football-ops/league-governance/2018-19-important-nfl-dates/ (last visited Feb. 12, 2019). The NCAA estimates that only 1.6% of student-athletes playing football will turn pro and play in the NFL. *See Estimated Probability of Competing in Professional Athletics*, NCAA (2018), http://www.ncaa.org/about/resources/research/estimated-probability-competing-professional-athletics [hereinafter *Estimated Probability*].

[382] Jack Bechta, Difficultly of Earning an NFL Endorsement—Interview (2019). Jack Bechta is an NFL Players Association Certified Advisor who has been representing players full-time since 1991 under the entity JB Sports, Inc. He limits his player roster to 20-25 per year intentionally so he can provide the best service to each of his clients. JB Sports is one of the most recognized and respected agencies in the world. Jack took time out of his busy schedule to speak about the difficulty NFL players have earning endorsement deals.

[383] *Id.* ("Only about 50% have earned any income from endorsements, appearances, or autograph and memorabilia signings. Of the 256 first year players drafted into the NFL out of college, it is estimated that only 50% earn any endorsement income, while only the top picks earn national level deals."); *see also* Kurt Badenhausen, *The NFL's Highest-Paid Players 2017*, FORBES (Sept. 18, 2017), https://www.forbes.com/sites/kurtbadenhausen/2017/09/18/the-nfls-highest-paid-players-2017/#5cdf1844130e, ("Most NFL players make do with less than

teams,[384] and this leaves about 128 position players, or four per team, with the capability to earn a decent amount of money from sponsorship deals.

The endorsement constraints for NFL players demonstrate how difficult it is even for professional athletes to cultivate enough "star power" to attract a major endorsement deal. The monetization of reputational value requires the work of industry professionals who specialize in placing athletes in the right marketing position.[385] Professional athletes within the NFL have access to branding experts, and even most of them are unable to land lucrative deals.[386] College athletes face even more complications in terms of cultivating the level of reputational value needed to secure a national or international endorsement deal.[387]

Whereas the NFL provided the basis for the example for how difficult it is to secure major media deals for professionals, its college counterpart (the most popular NCAA sport) will serve as the example for why it is more difficult for college athletes. Currently, there are 73,063 college football athletes governed by the NCAA.[388] The overwhelming majority lack any meaningful star power in their personal reputations.[389] For evidence on this point, Dr. Thilo Kunkel looked to social media and evaluated the number of followers for college athletes as an indicator for fame.[390] Dr. Kunkel and his research team collected and analyzed data from more than 4,000 Division I college football athletes and found that: (a) only 8.3% had more than 10,000 followers, (b) 1.9% had more than 50,000 followers, and (c) only .025% had 100,000 followers or more.[391] Based on those findings, Dr. Kunkel

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$100,000 in endorsement income, but a few top-tier NFL QBs can generate eight figures in off-field income.").

[384] Bechta, *supra* note 382.

[385] Mark Morse & Darren Glover, *Athletes Are Often Lagging Compared to Celebs in Creating a Stand-Out Brand on Social Media*, ADWEEK.COM (Feb. 5, 2019), https://www.adweek.com/brand-marketing/athletes-are-often-lagging-compared-to-celebs-in-creating-a-stand-out-brand-on-social-media/.

[386] *Id.; see also* Betcha, *supra* note 382.

[387] *Id.* ("Of the 256 first year players drafted into the NFL out of college, it is estimated that only 50% earn any endorsement income, while only the top picks earn national level deals.").

[388] *Estimated Probability*, *supra* note 381.

[389] Thilo Kunkel, College Athletes Marketability—Interview (2019) ("Social media followers is a good indication for the level of fan interest and subsequently the marketability of the athlete to sell national sponsorships.").

[390] *Id.*

[391] *Id.*

determined that less than 1.9% of college athletes currently have enough star power to earn a national endorsement deal.[392]

The NCAA was correct when it claimed in *Name & Likeness* that the majority of its athletes are not celebrities.[393] Yet, some athletes do have the potential to secure a national marketing deal, and many others could probably land a local or regional sponsorship relationship (e.g., local grocery store or car dealership). This potential is reflected in the number of local or regional endorsement deals that college coaches enjoy, even for smaller programs.[394] Any marketability, however, would more than likely be linked to the athlete's athletic accomplishments.[395] The irony inherent in the Ogunbowale/De La Haye determinations is that De La Haye was unique in that he built a following despite the fact that he wasn't a very successful and high-profile college athlete. Yet, the NCAA restricted his references to UCF in his own, personal creations while tolerating the very direct reference to Ogunbowale's athletic accomplishments by DWTS.[396]

VI
A CALL FOR MEANINGFUL CHANGE

The lack of star power in intercollegiate athletics signifies that there is minimal value in college athletes' likeness, especially on an individual level, which would effectively offset the demand to accept impermissible payment from boosters, agents, and appeal companies. Furthermore, the Ogunbowale and De La Haye examples demonstrate the administrative nightmare of distinguishing demand for athlete publicity that is not linked to NCAA competition. What the NCAA needs right now is a full overhaul of the NIL restrictions—this is the only way that they will be able to combat the illegal activity and ensure that all athletes are treated fairly and without bias when it comes to earning compensation for their NIL. The meaningful change that is required is a complete removal of restrictions on compensation surrounding the use of an athlete's NILs. Neither of those justifications or the reasoning supporting them apply to restraints that prevent college athletes from using their own NILs however they like.

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[392] This further supports the numbers provided by Jack Bechta—only the top prospects earn national level deals as a rookie. 1.9% of the 256 rookies drafted last year would provide 4.8 NFL rookie players with national level deals. *See also* Bechta, *supra* note 382.

[393] *In re* Nat'l Collegiate Athletic Ass'n Student-Athlete Name & Likeness Licensing Litig., 724 F.3d 1268, 1279 (9th Cir. 2013).

[394] Kunkel, *supra* note 389.

[395] *Id.*

[396] Baker, *supra* note 7.

A. No Reasonable Justification Exists for the NCAA's NIL Restrictions

There is no reason in law or common sense for the NCAA's NIL restrictions, which are ripe for judicial review following the decisions in both *Grant-in-Aid*[397] and *O'Bannon*.[398] Both decisions found procompetitive justifications for protecting the NCAA's amateurism model. In *Grant-in-Aid*, the NCAA's restrictions that capped compensation were found to violate antitrust law while in *O'Bannon*, the Ninth Circuit held that the NCAA's limits were necessary to preserve consumer interest in its products.[399] Both decisions also found justification for NCAA rules that facilitate athlete integration into their classroom settings.[400]

First, there can be no credible claim that the NIL restrictions are needed to preserve consumer interest in the NCAA's version of intercollegiate athletics. The NCAA has never, ever, proffered evidence that college athlete publicity impairs consumer interest in its products. Actually, the NCAA and its members already publicize college athletes and market their NILs in commercial broadcasts, advertisements, and through other types of promotions.[401] Accordingly, the NCAA and its members use college athlete NILs to attract consumers to their events. Thus, any assertion that the NCAA's NIL rules are needed to preserve consumer interest is intellectually dishonest. Second, the commercialization of college athlete NILs by the NCAA and its members also negates any argument from them that college athlete use of their own NILs will impair their academic integration. Most college athletes lack the star power needed to land major endorsements and the NCAA and its members already commercialize athlete NILs.[402] Therefore, the procompetitive justifications recognized by the courts in *Grant-in-Aid* and *O'Bannon* do not provide basis for the NCAA's NIL restrictions, and the lack of a procompetitive purpose for them make the rules ripe for rule of reason scrutiny if/when challenged.

B. The NCAA Should Adopt A Modified Version of the Proposal from Professor Feldman's White Paper

Like Professor Feldman, we propose a model that would permit college athletes to earn compensation from their use of their own NILs. The value inherent

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[397] *In re* Nat'l Collegiate Athletic Ass'n Athletic Grant-in-Aid Cap Antitrust Litig., 375 F. Supp. 3d 1058 (N.D. Cal. 2019).

[398] O'Bannon v. Nat'l Collegiate Athletic Ass'n, 802 F.3d 1049 (9th Cir. 2015).

[399] *Compare Grant-In-Aid*, 375 F. Supp. 3d 1058 *with O'Bannon*, 802 F.3d 1049.

[400] *See Grant-In-Aid*, 375 F. Supp. 3d 1085; *O'Bannon*, 802 F.3d 1049 at 1072.

[401] E.g., NCAA member institutions regularly feature college athletes on billboards, posters, and other promotions for attracting students and others to events.

[402] Kunkel, *supra* note 389.

to their NILs belong to the college athletes, and it stems from reputations that they cultivated through their own hard work and accomplishments. Similar to what was proposed in the White Paper, our proposal would constrain the institutions from assisting in locating sponsorships for college athletes. To offset that restriction, we would demand that the NCAA lift its regulation on athlete interaction with agent representatives. The college athletes should be free to market themselves for sponsorships, but there is no legitimate reason for why the schools should participate in the process, and their involvement could create a possibility for abuse. Similarly, agent involvement in this could result in abuse, so the NCAA should create an agency certification process that ensures that only reputable agents represent NCAA athletes. In this regard, the process would not be much different from what exists within the professional sports leagues. College athletes should be part of this process and representation at the table in deciding the constraints imposed on those who represent them.

We also build off of Professor Feldman's proposal by requiring athletes to seek out permission from their schools and the NCAA before representing the institution or the NCAA in any advertisements. This requirement would reflect what exists within professional sports and is grounded in the institution and the NCAA's right to control the use of their intellectual property (trademarks). Instead of the standardized NIL form suggested by Feldman, we propose that the NCAA create a model NIL agreement that satisfies its requirements as well as those of its member institutions. The reason for this is not to limit college athletes in their efforts to secure marketing deals and use their NILs as they see fit, but to protect them by incorporating clauses like a "reverse moral clause" that permits athletes to terminate endorsement relationships with controversial brands. Finally, our compromised proposal includes Professor Feldman's academic eligibility requirement so long as the same requirement exists for their continued involvement in commercial use of their NILs by the member institutions. The anticompetitive nature of this restraint is moderated by the school's interest in making sure that athletes are also students who are in good academic standing. The eligibility restraint also serves an important purpose of promoting athlete success in the classroom.

Our compromised proposal, however, deviates from what Professor Feldman suggested on some key issues. First, our proposal does not include the "non-game related" constraint on college athlete NIL use. The Ogunbowale and De La Haye examples demonstrate the arbitrariness of this requirement because there is no way to consistently discern whether the sponsorship stems from the athlete's involvement in NCAA athletics or is based on the athlete's own good will. Additionally, there is no legitimate basis for imposing a "non-game related" requirement because the NCAA and its members already use college athlete NILs in "game-related" uses.

The NCAA and its members should not be able to do with college athlete NILs what the athletes may not.

What we propose also does not adopt Professor Feldman's call for oversight in the form of an approval process from either the NCAA or its members prior to athlete NIL use. The only interest that either the NCAA or its members have in regard to its athletes and how they choose to use their NILs involves the use of intellectual property belonging to either the NCAA or its members. There is already recourse for member institutions in the case that an athlete is involved with a controversial brand to protect against the transfer of negative information from the brand to the school. That protection is found in the fact that the school does not have to renew the athlete's scholarship at the close of the academic year. Our proposal also deviates from Professor Feldman's in that it does not include a group licensing component. College athletes deserve their fair share of the monies mined by the NCAA and its members from media right management. Thus, our proposal is a compromise because it does not call for group licensing that shares revenues from extant and future media deals with the athletes. We advocate for and support college athlete efforts to demand fair compensation from the NCAA and its members. However, lifting the NIL restrictions would be a modest step in the right direction.

CONCLUSION

Drastic changes to the NCAA's NIL policy are on the way, and the NCAA needs them to protect its underlying mission. Currently, there is an illegal money laundering scheme occurring behind doors because the NCAA is restricting college athletes from the ability to receive compensation from their NILs.[403] Right of publicity cases, such as *Name & Likeness*, make it clear that the athletes own their NILs.[404] However, outdated NCAA bylaws prevent college athletes from profiting from their reputations.[405] If college athletes were able to benefit from their own use of NILs, secret deals with companies would no longer be necessary. Instead, athletes would be able to be directly compensated from the apparel company for their NILs.

Lifting the NIL restrictions may also help further the educational mission of the NCAA. In 2017, only 82% of college basketball and 78% of college football athletes received their degree,[406] and the average athlete graduation rate was 87%

[403] Baker, *supra* note 11.

[404] *In re* Nat'l Collegiate Athletic Ass'n Student-Athlete Name & Likeness Licensing Litig., 724 F.3d 1268 (9th Cir. 2013).

[405] NAT'L COLLEGIATE ATHLETIC ASS'N, *supra* note 71.

[406] NAT'L COLLEGIATE ATHLETIC ASS'N, TRENDS IN GRADUATION SUCCESS RATES AND FEDERAL GRADUATION RATES AT NCAA DIVISION I INSTITUTIONS NCAA RESEARCH

(the highest recorded average graduation rate).[407] The difference could be traced back to the high number of college athletes attempting to turn professional in order to legally earn money for their NILs.[408] If the restriction were removed, it provides an opportunity for college athletes who are not quite ready for the professional leagues to stay in college while also providing for themselves and their families. No athlete should be economically pressured to leave school early when that pressure could be relieved to a significant degree by the athlete's use of their own brand equity. Another educational benefit would result from the athlete's involvement with sponsor brands. College athletes would gain first-hand experience and knowledge of complex contract negotiations and the life lessons learned from entering commercial markets.

For those reasons we conclude that the NCAA should abandon the idea of instituting a modest change to its NIL policy and instead adopt what we propose in this article. We believe that our proposal draws the best aspects from Professor Feldman's (at the time) innovative proposal, but is different in how it expands what is permitted to comport with the recent decisions in *Grant-in-Aid* and *O'Bannon* and what has been proposed in recent legislation at state and federal levels. The NCAA no longer enjoys the substantial deference once afforded to it by the courts, lawmakers, and the general public.[409] The deference that once fortified the NCAA's amateurism model from scrutiny has eroded to the point that material change to college athlete regulations is inevitable. The NCAA must now choose whether it wants to lead in the creation of change to its regulation of college athletes, or be led.

PRESENTATION, 17 (2017), https://web3.ncaa.org/aprsearch/public_reports/instAggr2017/Fed_and_GSR_Trends_2017_Final.pdf.

[407] *Id.* at 18.

[408] *See generally id.*

[409] *See generally* O'Bannon v. Nat'l Collegiate Athletic Ass'n, 802 F.3d 1049 (9th Cir. 2015).

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FAILED STRATEGY: USING TRADE SECRET LAWS TO ASSERT OWNERSHIP OF EMPLOYEES' SOCIAL MEDIA ACCOUNTS IN THE JOURNALISM INDUSTRY

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It's the policy of an increasing number of news outlets to retain ownership of the professional social media accounts of their reporters. In the first case of its kind in the United States, one media company took a former employee to court over the question of ownership. The Roanoke Times in Virginia filed a suit in 2018 against a former sports reporter, alleging a breach of its social media policy. The reporter, who left his position at The Times for a competing news outlet, took with him the Twitter account he had used as part of his work with the outlet. This article explores a host of uncharted legal implications pertinent to this case and argues that utilizing trade secret laws to assert ownership of an employee's account(s), a strategy used in The Times case and several other lawsuits, is an ill-fitted approach. Social media accounts and their associated followers are not "secret," no matter the industry. A comprehensive policy could prevent legal action in the first place by providing employees with guidelines that address a myriad of issues discussed in this paper. The authors offer provisions of a policy that would protect news outlets while also acknowledging the importance of social media accounts to the livelihood of journalists and to the free flow of information from journalists to the public.

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INTRODUCTION

Andy Bitter posted to Twitter almost daily when he was a sports reporter at *The Roanoke Times* in Virginia.[1] Bitter's tweets kept his thousands of social media followers up-to-date about Virginia Tech sports and gave them an inside look at his reporting.[2] When Bitter left *The Times* in 2018 to work for another outlet, he took with him the Twitter account he used at *The Times* (@AndyBitterVT).[3] BH Media, the parent company of *The Times*, sued Bitter over what the news outlet called a

[1] *See* Jeff Sturgeon, *Roanoke Times sues former sportswriter over continued use of Twitter account*, THE ROANOKE TIMES (Aug. 7, 2018), https://www.roanoke.com/business/roanoke-times-sues-former-sportswriter-over-continued-use-of-twitter/article_8b425fa5-777c-54d4-b3f2-0e1c6ec34540.html.

[2] *See id.*; *see also* Complaint at 3, BH Media Grp., Inc. v. Bitter, No. 7:18-cv-00388-MFU (W.D. Va. Aug. 6, 2018).

[3] *See BH Media*, No. 7:18-cv-00388-MFU, at *6 (while working at *The Roanoke Times* the name of the account was @AndyBitter. It was then edited to include 'VT' (Virginia Tech) when he began working at another outlet.).

breach of its social media policy, misappropriation of trade secrets, and other claims.[4] BH Media claimed that the outlet retains ownership of reporters' social media accounts under its policy, and therefore Bitter should have turned over the account before leaving for his new job.[5]

At first glance, the premise of the case may appear straightforward: an employee breached an employer's policy. The suit, though, was centered not on a breach of contract but rather intellectual property laws.[6] In fact, BH Media asserted in the lawsuit that the account is a protectable interest because Twitter followers are equivalent to a customer list with significant economic value.[7] Competing factual details about who actually retained control of the Twitter account via access to log-in credentials was also a key element of this case.[8] Adding to the complexity, there is, as this article will outline, ambiguous legal precedent regarding ownership of social media accounts used by employees in a work capacity, and state lawmakers are taking note of the issue.[9] Twenty-six states have passed legislation concerning the social media accounts of current and prospective employees, and similar laws are pending in other states.[10]

What also makes this case novel is that it is the first known lawsuit in the United States involving a dispute over ownership of a journalist's social media account.[11] A journalist's role is to serve the public, and social media provides a conduit to do so.[12] Journalists are often considered public figures in their communities.[13] They are "followed" on social media because of the value assigned to their personal brands and personas as journalists.[14] While this article frames the

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[4] *See* Sturgeon, *supra* note 1.

[5] *See BH Media*, No. 7:18-cv-00388-MFU, at *6.

[6] *Id.* at *7-10.

[7] *Id.* at *7-8.

[8] *Id.* at *4, *6-7; Counterclaim, BH Media Grp., Inc. v. Bitter, No. 7:18-cv-00388-MFU, at *18-22 (W.D. Va. Aug. 30, 2018).

[9] Hugh McLaughlin, *You're Fired: Pack Everything but Your Social Media Passwords*, 13 NW. J. TECH. & INTELL. PROP. 87, 91 (2015).

[10] *See State Social Media Privacy Laws*, NAT'L CONF. OF ST. LEGISLATORS (May 22, 2019), http://www.ncsl.org/research/telecommunications-and-information-technology/state-laws-prohibiting-access-to-social-media-usernames-and-passwords.aspx.

[11] *See* Jonathan Peters, *Lawsuits over journalist Twitter accounts may become more common*, COLUM. JOURNALISM REV. (Sept. 10, 2018), https://www.cjr.org/united_states_project/roanoke-times-twitter.php.

[12] *See* Taylor Lorenz, *Personal Branding is More Powerful Than Ever*, NIEMANLAB, https://www.niemanlab.org/2018/12/personal-branding-is-more-powerful-than-ever/.

[13] *See id.*

[14] *See id.*

issue of ownership as it relates to the journalism industry, the legal and practical implications discussed are applicable to a myriad of other sectors. Given the dearth of legal and academic scholarship on the topic, this article fills a gap in the literature. It is the first of its kind to analyze a journalism-specific case involving social media ownership.

Section I discusses journalists' use of social media as part of their daily job responsibilities and how it's fundamentally different from the social media practices of employees in other industries that have been the focus of previous cases. The role of social media from a business perspective and newsrooms' social media policies are highlighted. Section II outlines cases relevant to the issue of ownership of employees' social media accounts, with particular attention to the role of trade secret laws. Finally, Section III provides an analysis of relevant legal issues and proposes how employers and employees can best protect their own interests.

I
SOCIAL MEDIA IN THE JOURNALISM INDUSTRY

This section provides context with regard to the impact of social networking platforms on the journalism industry and on individual reporters. In addition, it discusses how evolving journalistic norms associated with social media have led to new policies within newsrooms. This background information is intended to foster readers' understanding of the *BH Media* case and this article's analysis of it, given that the case involves the journalism industry.

A. Technological Disruption in the Journalism Industry

The use of social media by journalists is no longer a novelty. All one has to do is look through the latest journalism job postings and they'll notice how frequently social media skills are mentioned.[15] For journalists, social media savviness is now just as important as maintaining fundamental journalistic standards, such as verification, objectivity, and concise writing.[16] Newsroom managers expect their journalists to use social media on a daily basis in three main ways:

[15] Deb Halpern Wenger, Lynn C. Owens & Jason Cain, *Help Wanted: Realigning Journalism Education to Meet the Needs of Top U.S. News Companies*, 73(1) JOURNALISM & MASS COMM. EDUCATOR 18 (2018) (indicating that in a longitudinal study of more than 1,800 journalism job postings there was an increased demand for employee skills in social media and audience engagement).

[16] *See* Mark Stencel & Kim Perry, *Superpowers: The digital skills media leaders say newsrooms need going forward*, TOW-KNIGHT CTR. FOR ENTREPRENEURIAL JOURNALISM, https://drive.google.com/drive/u/1/folders/0B5lQbGE9zXC5VmJNaTRfVTV6eWc.

newsgathering, distribution of news, and interacting with the public.[17] Twitter, Facebook, and Instagram are among the most utilized social networking sites by journalists. In its social media guidelines, *The New York Times* underscores the vital role social media plays in contemporary journalism:

> On social platforms, our reporters and editors can promote their work, provide real-time updates, harvest and curate information, cultivate sources, engage with readers and experiment with new forms of storytelling and voice. We can effectively pull back the curtain and invite readers to witness, and potentially contribute to, our reporting. We can also reach new audiences.[18]

The journalism industry has always been shaped by technology.[19] From the printing press to computers to social media, new technological innovations impact where the public turns for news and how journalists perform their craft.[20] The public's shifting news consumption habits, fueled by the emergence of social media, has led to the commonplace use of these tools in journalism.[21] Social networking sites have disrupted the journalism industry arguably unlike other new technologies. Since the late 2000s, the public has increasingly turned online for news instead of relying on print newspapers.[22] In 2018, social media outpaced print newspapers in the U.S. as a news source for adults (18 years and older).[23] The combined loss of print subscriptions and advertising dollars has had a seismic impact on newspapers. For example, between 2007 and 2010 alone, the annual print newspaper advertising revenue was cut nearly in half, plunging from $42 billion to $22 billion.[24] Broadcast

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[17] *See* Anthony C. Adornato, *A Digital Juggling Act: New Media's Impact on the Responsibilities of Local Television Reporters*, 8(1) ELECTRONIC NEWS 3 (2014).

[18] *The Times Issues Social Media Guidelines for the Newsroom*, N.Y. TIMES (Oct. 13, 2017), https://www.nytimes.com/2017/10/13/reader-center/social-media-guidelines.html.

[19] Adornato, *supra* note 17, at 4 (citing Simon Cottle & Mark Ashton, *From BBC Newsroom to BBC Newscentre: On Changing Technology and Journalist Practices*, 5 CONVERGENCE: THE INT'L J. OF RES. INTO NEW MEDIA TECHNOLOGIES 22 (1999)).

[20] *Id.*

[21] *See id.* at 8.

[22] *See* Michael Barthel, *Despite subscription surges for largest U.S. newspapers, circulation and revenue fall for industry overall*, PEW RES. CTR. (June 1, 2017), https://www.pewresearch.org/fact-tank/2017/06/01/circulation-and-revenue-fall-for-newspaper-industry/.

[23] Elisa Shearer, *Social media outpaces print newspapers in the U.S. as a news source*, PEW RES. CTR. (Dec. 10, 2018), https://www.pewresearch.org/fact-tank/2018/12/10/social-media-outpaces-print-newspapers-in-the-u-s-as-a-news-source/.

[24] Michael Barthel, *Newspapers Fact Sheet*, PEW RES. CTR. 24, 27 (Apr. 29, 2015), http://www.journalism.org/2015/04/29/newspapers-fact-sheet.

news has also been impacted. From 2006 to 2012, the number of adults under 30 who regularly watched local TV news dropped from 42 percent to 28 percent.[25]

In order to remain viable, newsrooms have to meet the audience in spaces where they are now active: social media.[26] Journalists can no longer expect the audience to come directly to their reporting on a news website, television newscast, or radio broadcast.[27] Instead, a news consumer's first point of contact with journalists' reporting is increasingly via social media posts.[28] A social media user may then decide to click a link to a story they saw on social media, share a journalist's social media post about a news event or ask a question directly to a journalist on social media.[29] The hope is that the public will find value in the work of newsrooms and their reporters, no matter the platform. Keeping the audience coming back for more is important for attracting advertisers.[30] All that engagement with a news outlet's journalists and content is financially valuable.[31] It has the potential to attract digital advertisers and subscribers.[32] Armed with data about its social media followers, website traffic, mobile app downloads and subscribers, among other metrics, sales teams at news outlets approach companies focused on digital advertising.[33] Considering print advertising revenue in 2014 was less than half of what it was a decade before that, newspapers are attempting to make inroads

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[25] *In Changing News Landscape, Even Television is Vulnerable*, PEW RES. CTR. (Sept. 27, 2012), http://www.people-press.org/2012/09/27/in-changing-news-landscape-even-television-is-vulnerable (further indicating that the younger demographic (18-29 years old) has all but abandoned broadcast and print news in favor of staying up-to-date online resulting in an underlying business imperative, driven by the public's evolving news consumption habits from TV and print to digital, that has driven newsrooms and their journalists to be active on social media).

[26] *See* Aaron Smith, *Record shares of Americans now own smartphones, have home broadband*, PEW RES. CTR. (Jan. 12, 2017), https://www.pewresearch.org/fact-tank/2017/01/12/evolution-of-technology (demonstrating that, as of 2016, 70 percent of U.S. adults were social media users); *see also* Anthony Adornato, *Mobile and Social Media Journalism: A Practical Guide*, CQ PRESS 13, 26 (Aug. 2017), https://us.sagepub.com/en-us/nam/mobile-and-social-media-journalism/book253886 (stating that increasingly people end up at a news website by clicking on a link in a social media post, rather than directly typing in the web address, and social referrals—links that are shared on social networks—are a crucial source of website traffic).

[27] Adornato, *supra* note 26, at 26.

[28] *Id.*

[29] *Id.*

[30] *Id.* at 42.

[31] *See id.*

[32] *Id.*

[33] *Id.*

with marketers advertising on digital platforms.[34] From 2011 to 2017, the percentage of newspaper companies' advertising revenue that came from digital advertising nearly doubled.[35]

B. Use of Social Media by Individual Journalists

Newsrooms rely on their employees to execute their social media strategy, most notably through the individual journalists' activities on social media accounts that have their own names attached to them.[36] The two-way interaction between the public and journalists on social media is a distinguishing element of contemporary journalism. It is a conversation with a "real" person. Other industries rely almost exclusively on "branded" social media accounts to disseminate their messages. A branded account is typically affiliated with a company rather than a person or individual employee.[37] For example, @roanoketimes and @CocaCola on Twitter are considered branded accounts. News outlets employ social media editors to manage these branded accounts.[38]

Individual journalists, though, are responsible for and invested in sharing content on their social media accounts that they use as part of their work with a news organization.[39] For example, NBC News White House correspondent Hallie Jackson posts frequently to Twitter and Instagram directly from her own mobile device.[40] Along with sharing news and showing people a behind-the-scenes look at her reporting process, Jackson periodically shares information about her personal interests and hobbies.[41] Employees who manage NBC News' branded social media accounts may then choose to share what Jackson has posted. The fact that individual employees' activities on their own accounts is such an integral part of the journalism industry sets the *BH Media v. Bitter* case apart from those involving other fields.

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[34] Amy Mitchell, *State of the News Media 2015*, PEW RES. CTR. 4, 6 (2015), http://www.journalism.org/2015/04/29/state-of-the-news-media-2015.

[35] *Share of newspaper advertising revenue coming from digital advertising*, PEW RES. CTR. (June 13, 2018), http://www.journalism.org/chart/sotnm-newspapers-percentage-of-newspaper-advertising-revenue-coming-from-digital (indicating that the percentage increased from 17 to 31).

[36] *See* Adornato, *supra* note 26, at 57-58.

[37] *See, e.g.*, *Social Media Policy*, TEGNA, at 2 (May 2017), https://drive.google.com/file/d/1AQMaADAGnKmxHEI_pRN4Vhpc4U8Xr4F8/view.

[38] *See, e.g.*, *id.* at 1.

[39] *See, e.g.*, Adornato, *supra* note 26, at 17-18.

[40] *Id.*

[41] *Id.*

The "social" nature of social networking platforms affords journalists the opportunity to create direct connections with the public.[42] Those relationships are built over time through a journalist's sustained activity on their individual social media accounts.[43] It's not uncommon for a journalist to amass a social media following because of their work related to a particular story or reporting beat.[44] This was the case for Andy Bitter: when he worked for *The Roanoke Times*, he covered Virginia Tech athletics, and his Twitter feed was the go-to-source for news about the university's sports teams.[45]

Prior to the rise of online platforms, journalists needed to be employed by a news organization to build a portfolio of work and reputation.[46] That's no longer the case as online platforms, most notably social networking sites, allow journalists to build their brand regardless of their affiliation with a news outlet, whether they're a freelancer or a full-time newsroom employee.[47] A journalist's brand with its associated followers—a tribe—is highly valuable to current and potential employers.[48] A journalist who builds such a brand is an asset to a newsroom: she not only has a solid journalistic reputation, but also a built-in audience that will follow her under the umbrella of a new newsroom.[49] Among the questions this scenario raises is whether a reporter who is hired by a news outlet and brings with her a previous account retains ownership of it. After all, she built the following. So, should all that hard work fall under the legal ownership of an employer?

C. Social Media Policies in Newsrooms

Many newsrooms claim ownership of social media accounts used by journalists as part of their job responsibilities.[50] In a 2017 study, two-thirds of local television news managers in the United States indicated that it is the policy of their outlets to "own" the social media accounts of their reporters.[51] The policies are typically reviewed and signed by employees during the onboarding process.[52] In some instances, journalists are allowed to create social media accounts on their own

[42] Adornato, *supra* note 17, at 20-21; Adornato, *supra* note 26, at 20.

[43] Adornato, *supra* note 17, at 20-21; Adornato, *supra* note 26, at 61.

[44] *See, e.g.*, Sturgeon, *supra* note 1.

[45] *See id.*

[46] *See* Adornato, *supra* note 17, at 4.

[47] *See generally* Adornato, *supra* note 17.

[48] *See* Adornato, *supra* note 17, at 14; *see* Adornato, *supra* note 26, at 58.

[49] Adornato, *supra* note 17, at 20-21; *see* Adornato, *supra* note 26, at 58.

[50] *See* Anthony C. Adornato & Suzanne Lysak, *You Can't Post That!: Social Media Policies in U.S. Television Newsrooms*, 11(2) ELECTRONIC NEWS 80, 94 (2017).

[51] *Id.*

[52] *See* Adornato & Lysak, *supra* note 50, at 89.

but are required to submit their passwords to newsroom management. In others, the outlet creates the accounts on behalf of the journalist and provides them the login credentials.

We encounter the question of whether an employee is allowed to keep the account and its followers when employment with an outlet ends. Some policies directly state that the journalist will no longer have access to the account—similar to what happens with a company email address.[53] The E.W. Scripps Company, which operates newsrooms in 18 states, makes this clear in its social media policy: "Your professional account is the company's property and the name and contents remain company property if you leave Scripps. Scripps reserves the right to edit, monitor, promote or cancel a professional account."[54]

Other news outlets offer flexibility surrounding the issue. Gray Television, owner of stations in nearly 100 local U.S. television markets, allows its station managers to determine on a case-by-case basis whether employees can take social media accounts with them.[55] Gray Television station's social media policy indicates that the company owns any employee work accounts.[56] However, managers can transfer ownership of accounts to a journalist when they leave for a new job, as long as their new employer does not compete against a Gray Television station.[57] This approach is directed at preventing a competitor from reaping the benefits of an employee who has amassed a social media following. The policy of TEGNA, another U.S. media company, states that the company "has the right to claim and maintain any social media username" that includes the TEGNA corporate brand or that of one of its television stations.[58] For example, @JohnSmithWZZM and Susan Smith's KARE-TV Facebook page would fall under this category.[59] If an employee

[53] Adornato, *supra* note 26, at 145.

[54] Jim Romenesko, *E.W. Scripps Co. Issues Social Media Policy*, POYNTER (June 30, 2011), http://www.poynter.org/2011/e-w-scripps-announces-social-media-policy-to-staff/137564.

[55] *See* email from Amber Smith, Digital Director of the 10/11 NOW news team, to Anthony Adornato, Associate Professor of Journalism (Jan. 15, 2019) (on file with NYU JIPEL).

[56] *See Employee Handbook*, GRAY TELEVISION 1, 37 (Apr. 1, 2014) (stating that "All Work Accounts must be

established with an official Company email account (for example, "jsmith@wctv6.com" or "j.jones@kktv.com").

Existing Work Accounts that were created with an email address other than a work email address should be

transferred, converted, or re-registered with a work email address.").

[57] *See* Amber Smith email, *supra* note 55.

[58] TEGNA, *supra* note 37, at 2.

[59] *Id.*

leaves the company, he or she is allowed to take the account(s) with them as long as they remove all branding related to TEGNA and its outlets.[60]

The definition of "professional" can be ambiguous. The E.W. Scripps Company's policy pertains to its employees' professional accounts "which are intended to promote and expand the company's brand, products and activities."[61]

One might argue that if a journalist created an account prior to working at the outlet, the outlet could retain ownership of that account if the journalist uses it for professional purposes. In other words, any account on which you're sharing information as part of your position with the outlet or representing yourself as a staff member of the outlet could be deemed professional.[62] Rachel Barnhart learned this lesson when she was a reporter for WHAM-TV in Rochester, New York.[63] Barnhart attracted tens of thousands of Facebook and Twitter followers combined.[64] When Sinclair Broadcasting purchased WHAM-TV, she was faced with a choice: use new company-issued accounts, or continue to use the accounts she had created and risk losing them if her employment with the station ended.[65] According to Sinclair's policy, the company owns the social media accounts of its on-air personalities.[66] Barnhart decided to use new social media accounts for work purposes only.[67] In a statement to her followers, she wrote: "At this juncture, I am retaining ownership of my existing Facebook and Twitter pages. Therefore, the company has started new social media accounts in my name for me to use during work hours when I am covering stories. The company has administrative control over these accounts."[68]

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[60] *Id.* (stating "[t]his includes changing the name of your branded social media accounts and removing information from your bio that indicates you are a current employee").

[61] Romenesko, *supra* note 54.

[62] GRAY TELEVISION, *supra* note 56, at 37 ("The Company owns any social media accounts and related databases created by employees or by a Station for use primarily in the performance of employee job functions ("Work Accounts"). Employees retain ownership of all social media accounts not created for use primarily in the performance of employee job functions ("Personal Accounts")."); *see generally* Adornato, *supra* note 17.

[63] Diane Marszalek, *Who Owns, Controls Social Media Activity?*, TVNEWSCHECK (Jan. 29, 2013, 10:58AM), http://www.tvnewscheck.com/article/65102/who-owns-controls-social-media-activity.

[64] *Id.*

[65] *Id.*

[66] *Id.*

[67] *Id.*

[68] *Sinclair Broadcasting 'Owns' Social Media Accounts Of Its On-air* Talent, AIRCHECKER, http://www.airchecker.ca/2013/01/24/sinclair-broadcasting-owns-social-media-accounts-of-its-on-air-talent/.

II
CASES AND RELEVANT ISSUES INVOLVING SOCIAL MEDIA OWNERSHIP AND WORKERS

Case law addressing novel questions of ownership of social media accounts is still in the nascent stages of development. Most judicial opinions are the result of motions to dismiss based on the pleadings or focus only on whether there are triable issues of fact, but not the substantive merits of the legal claims.[69] In one bench opinion, the court in *Eagle v. Morgan* articulated conclusions of law on only three of eight causes of action alleged by a former employee.[70] In the meantime, cases settle out of court with the ultimate question unanswered: who owns the social media account?

The landscape is therefore rife for testing various common law and statutory claims. And litigants are casting a wide net, alleging causes of action based on misappropriation of trade secrets, conversion, interference with contractual and economic interests, violations of rights to privacy and publicity, identity theft, and computer crimes, among other claims.[71] Looming over the fate of these theories is the struggle the parties encounter when alleging damages, that is, articulating the value of the social media account, the components that make up one's social media presence (i.e., followers, friends, likes, clicks, traffic, visibility, etc.), and the harm in depriving the account from the purported owner.

It is most notable for this article that existing case law has involved disputes among employees and employers of businesses where the sale of goods or services made up the principle commercial activity of the business.[72] In these contexts, the followers of social media accounts have been likened to lists of customers, future customers, professional connections, and sales leads through which the business is able to maintain an online relationship that is expected to yield an economic

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[69] *See, e.g.*, *BH Media*, No. 7:18-cv-00388 (Aug. 6, 2018).

[70] Eagle v. Morgan, No. 2:11-cv-04303-RB, 2013 U.S. Dist. LEXIS 34220, at *10-22 (E.D. Pa. Mar. 12, 2013).

[71] *See Eagle*, 2013 U.S. Dist. LEXIS 34220, at *14; *see also BH Media*, No. 7:18-cv-00388 (Aug. 6, 2018); *see also* PhoneDog v. Kravitz, No. 3:11-cv-03474-MEJ, 2011 U.S. Dist. LEXIS 129229, at *1 (N.D. Cal. Nov. 8, 2011).

[72] *Eagle*, 2013 U.S. Dist. LEXIS 34220, at *1; *PhoneDog*, 2011 U.S. Dist. LEXIS 129229, at *1; Maremont v. Susan Fredman Design Group, Ltd., No. 1:10-cv-07811, 2014 U.S. Dist. LEXIS 26557, at *2 (N.D. Ill. Mar. 3, 2014).

benefit.[73] Legal disputes over ownership of one's social media account had not involved the journalism industry until the 2018 lawsuit of *BH Media v. Bitter*.[74] Discussed in detail below, this case unleashes the question of ownership on an industry whose principal activity is not the sale of goods or services but instead the gathering and dissemination of news for the purposes of educating a public audience through traditional media (i.e., newspaper, radio, and television) and new media (i.e., web-based content, social media, and blogs).[75] There is undoubtedly vital relevance of social media to the journalism industry, which has seen business models upended and news outlets transformed by the proliferation of smartphones, social media platforms, and the 24-hour news cycle at one's fingertips.

As with similar cases, the parties in *BH Media v. Bitter* settled their dispute, leaving the industry to consider how might a court have resolved issues of ownership between a journalist and a news outlet.[76] Before discussing the relevant legal issues on the topic, this article looks at cases whose facts and analysis are helpful to advance this inquiry.

A. BH Media v. Bitter

In 2011, Andy Bitter was hired to fill a role previously held by a sports journalist who departed *The Roanoke Times*.[77] Bitter's main responsibility was reporting on Virginia Tech athletics, and he used the Twitter account in question to carry out this function.[78] It was alleged that the sports journalist who previously held this position at *The Times* created the Twitter account.[79] Shortly after being hired by *The Times*, Bitter was given access to the account.[80] He updated the account profile to include his own name.[81] In July 2018, Bitter left *The Times* to work for The Athletic Media Group.[82] Despite being asked by *The Times* to relinquish the login information of the Twitter account, Bitter refused to do so and continued to use the

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[73] *Eagle*, 2013 U.S. Dist. LEXIS 34220, at *2; *BH Media*, No. 7:18-cv-00388, at *3 (Aug. 6, 2018); *PhoneDog*, 2011 U.S. Dist. LEXIS 129229, at *1; *Maremont*, 2014 U.S. Dist. LEXIS 26557, at *2.

[74] *See generally BH Media*, No. 7:18-cv-00388 (Aug. 6, 2018).

[75] *See generally id.*

[76] *Id.*

[77] *Id.* at *3.

[78] *Id.* at *3-4.

[79] *BH Media*, No. 7:18-cv-00388, at *2 (Aug. 30, 2018).

[80] *BH Media*, No. 7:18-cv-00388, at *4 (Aug. 6, 2018).

[81] *Id.*

[82] *Id.* at *6.

account.[83] BH Media Group, which owns *The Times*, filed a complaint against Bitter.[84] BH Media contends that The Athletic, a sports news outlet, is a direct competitor and that Bitter is working for the outlet in a similar if not identical capacity.[85] That's where the role of this Twitter account comes into play.

BH Media's suit alleged seven causes of action: misappropriation of trade secrets under the Defend Trade Secrets Act (DTSA), misappropriation under Virginia Uniform Trade Secrets Act (VUTSA), violations of the Computer Fraud and Abuse Act (CFAA), violation of the Stored Communications Act (SCA), violation of the Virginia Computer Crimes Act (VCCA), conversion, and breach of fiduciary duty.[86] It also filed a temporary restraining order and sought that Bitter relinquish control of the account to BH Media.[87]

BH Media's perceived competitive advantage of owning and maintaining the Twitter account is a key factor in the lawsuit.[88] It highlighted what it considered the value of the account's list of approximately 27,100 followers.[89] BH Media outlined how the company promoted its work and generates page views to its websites, including that of *The Times*, through the use of social media.[90] The company claimed that attracting website visitors depends heavily on BH Media's ability to communicate with current and potential readers, such as Twitter followers, and that advertising revenue is partially dependent on those page views.[91] The loss of advertising revenue because of the alleged misappropriation is difficult if not impossible to calculate, according to the suit.[92] BH Media estimated it would have to dedicate a full-time employee to build a similar account and re-engage with the followers, with no guarantee that they would be able to recreate the previous configuration.[93] This, BH Media alleged, would take seven years and a cost of at least $150,000 to recreate the account.[94]

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[83] *BH Media*, No. 7:18-cv-00388, at *3(Aug. 30, 2018) ("Bitter admits he has refused to give access to his Twitter account to BH Media, because it does not, and never has, belonged to BH Media.").
[84] *BH Media*, No. 7:18-cv-00388, at *1 (Aug. 6, 2018).
[85] *Id.* at *6-7.
[86] *BH Media*, No. 7:18-cv-00388, at *1 (Aug. 6, 2018).
[87] BH Media Grp. Inc. v. Bitter, No. 7:18-cv-00388 (W.D. Va. Aug. 7, 2018).
[88] *BH Media*, No. 7:18-cv-00388, at *5 (Aug. 6, 2018).
[89] *Id.* at *8-9.
[90] *Id.* at *5.
[91] *Id.* at *2-3.
[92] *Id.* at *8.
[93] *Id.* at *8-9.
[94] *Id.* at *9.

BH Media argues that the account constitutes a trade secret under the federal Defend Trade Secrets Act (DTSA) and the Virginia Uniform Trade Secrets Act (VUTSA) because it derives "independent economic value from not being generally known by and not being readily ascertainable by BH Media's competitors. . ."[95] It also alleged that the manager (or those with rights to access it) of the Twitter account had access to nonpublic information, or trade secrets, including: (i) the list of followers, (ii) the feed of tweets from those followers, and (iii) the ability to direct message them on Twitter.[96] BH Media asserted that the list of followers is equivalent to a curated client list and subsequently alleged that Bitter is utilizing it for direct marketing on behalf of a direct competitor.[97] These facts also give rise to BH Media's claim that Bitter's alleged misappropriation constitutes a breach of fiduciary duty owed to his employer.[98] BH Media does not allege the login credentials constitute a trade secret.[99]

BH Media claims it took precautions to protect these trade secrets, which is a requirement under DTSA and VUTSA.[100] One such way, according to the lawsuit, was by limiting individuals with access to the Twitter account in question.[101] BH Media also has written policies in its company handbook that include confidentiality obligations for its employees of intellectual property.[102] BH Media alleged that social media accounts provided by BH Media to employees are property of the company.[103] However, in a counterclaim, Bitter alleged that BH Media was inconsistent in its application of its social media policy, noting that "[n]umerous other reporters and sportswriters have left jobs at BH Media and have continued to maintain the same Twitter accounts they used while employed by BH Media at their new employers."[104] In addition, the counterclaim asserts that the former employee who set up the Twitter account, not *The Times*' management, provided him the login information to the account.[105] Bitter maintains that the account was never in

[95] *BH Media*, No. 7:18-cv-00388, at *7 (W.D. Va. Aug. 7, 2018).
[96] *BH Media*, No. 7:18-cv-00388, at *4 (W.D. Va. Aug. 6, 2018).
[97] *Id.* at *7.
[98] *Id.* at *15.
[99] Zoe Argento, *Whose Social Network Account? A Trade Secret Approach to Allocating Rights*, 19 MICH. TELECOMM. & TECH. L. REV. 201, 221 (2013).
[100] *BH Media*, No. 7:18-cv-00388, at *7 (W.D. Va. Aug. 6, 2018).
[101] *Id.* at *5.
[102] *Id.* at *5-6 (plaintiff contends that on numerous occasions the defendant signed an acknowledgement of receipt of the handbook).
[103] *Id.*
[104] *BH Media*, No. 7:18-cv-00388, at *17 (Aug. 30, 2018).
[105] *Id.* at *2, *10, *13-14 (Bitter alleged defamation by the plaintiff in its reporting of the lawsuit in *The Times*).

possession of *The Times* because no manager had ever requested login information to the Twitter account and that the former employee who created the account never transferred account ownership to *The Times*.[106] In fact, in its claim BH Media states, "[Bitter] has retained sole access to the Account."[107] Even if only some of the aforementioned counterclaims are true, it could indicate that BH Media did not take sufficient action to maintain control and oversight of the account (for example, through knowledge of the account's password), thus failing to protect trade secrets. Additionally, it would be difficult for BH Media to demonstrate how it took measures to protect the list of followers, given that it's visible to the public. There are also readily accessible tools that allow the download of a user's followers, a tactic that is utilized by competing businesses.[108]

Beyond the misappropriation claims, BH Media alleged five other causes of action.[109] Three surround Bitter's unauthorized use of and access to BH Media's computing equipment, software, and information.[110] To support its claimed violations of the Computer Fraud and Abuse Act (CFAA), the Stored Communication Act (SCA), and the Virginia Computer Crimes Act (VCCA), BH Media contends that the Twitter account is a protected computer and that Bitter lacked authority to access the accounts after his employment with BH Media terminated.[111] It's unclear how Bitter's access was revoked if BH Media never had control over the account.

By refusing to relinquish the account, BH Media argued that Bitter wrongfully converted the account to his own use.[112] In Virginia, where conversion (i.e., the civil claim of theft) of intangible property is recognized, BH Media must prove both ownership or right to possession of the Twitter account at the time of the conversion

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[106] *Id.* at *13-14 (Bitter contended there was an email exchange where his predecessor offered to give Bitter the login credentials to the account and noted, "[w]hen Bitter became the sole owner of the Account, it had less than 4,000 followers. Over the last seven years, Bitter has worked tirelessly to grow the Account to its current total of over 27,600 followers . . . Bitter grew the Account through his own efforts. He built a readership among fans of Virginia Tech athletics and college football generally by posting personal insights, opinions, and comments. Bitter posts about Virginia Tech athletics and college football, but he also posts about completely unrelated matters. In fact, many of Bitter's most 'liked' tweets are about being a father.").

[107] *BH Media*, No. 7:18-cv-00388, at *4 (Aug. 6, 2018).

[108] Sara J. O'Connell, *Can a Reporter's Twitter Account Be a Newspaper's Trade Secret?*, PILLSBURY (Aug. 16, 2018), https://www.internetandtechnologylaw.com/reporter-twitter-account-trade-secret/.

[109] *BH Media*, No. 7:18-cv-00388, at *10-16 (Aug. 6, 2018).

[110] *Id.*

[111] *Id.* at *11.

[112] *Id.* at *14-15.

and the wrongful use or control of the account by Bitter, thus depriving BH Media of possession.[113] While BH Media alleged that it has legal control and ownership of the account, Bitter contended that the disputed facts would likely have created a triable issue.[114]

As a result of an out-of-court settlement, both sides agreed to drop their claims and no legal precedent based on substantive law was established.[115] The settlement allowed Bitter to retain control of the Twitter account.[116] Shortly after the hearing, he shared this message with his followers: "The Roanoke Times and I have agreed to drop our claims against each other and get on with our lives. I'll continue to tweet from my account as I always have since I started covering Virginia Tech. If you're inclined, consider following my successor at the Roanoke Times, Mike Niziolek, at @VTSportsRT. I look forward to continuing to report Virginia Tech football for The Athletic."[117]

B. PhoneDog v. Kravitz

BH Media used a strategy similar to that pursued by the employer in the 2011 case of *PhoneDog v. Kravitz*, who also alleged misappropriation of trade secrets over a disputed social media account.[118] The subject of the *PhoneDog* case is a Twitter account used by a former employee of PhoneDog, an online cell phone news and reviews website, and the dispute centered on who owns the account, its login credentials, and its followers.[119]

During the course of his employment as a product reviewer and video blogger for PhoneDog, Noah Kravitz built and cultivated a following of approximately 17,000 Twitter followers using the @PhoneDog_Kravitz handle.[120] Kravitz used the account to promote PhoneDog's services on behalf of PhoneDog until he voluntarily

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[113] *See, e.g.*, Fax Connection, Inc. v. Chevy Chase Bank, F.S.B., 73 Va. Cir. 263, 264 (Cir. Ct. 2006).

[114] *BH Media*, No. 7:18-cv-00388, at *9 (Aug. 30, 2018).

[115] *See* Michael Phillips, *Andy Bitter, Roanoke Times Settle Lawsuit over Virginia Tech Twitter account*, THE ROANOKE TIMES (2018), https://www.richmond.com/sports/college/schools/virginia-tech/andy-bitter-roanoke-times-settle-lawsuit-over-virginia-tech-twitter/article_3ebce8af-ee8f-5a65-82e6-7c3f0c3979bb.html.

[116] *Id.*

[117] *Id.*; Andy Bitter (@AndyBitterVT), TWITTER (Nov. 15, 2018, 4:34 PM), https://twitter.com/AndyBitterVT/status/1063183578215931910.

[118] *PhoneDog*, 2011 U.S. Dist. LEXIS 129229, at *2.

[119] *Id.* at *1-2.

[120] *Id.* at *2.

ended his employment in 2010.[121] Kravitz refused PhoneDog's request to relinquish control over the account and instead changed the handle to @noahkravitz.[122]

PhoneDog's federal lawsuit alleged misappropriation of trade secrets under California's Uniform Trade Secrets Act (UTSA), intentional interference with prospective economic advantage, negligent interference with prospective economic advantage, and conversion.[123]

In an early motion to dismiss various legal claims, the court found that PhoneDog pled with sufficient particularity misappropriation in violation of the UTSA despite Kravitz's attempt to argue (i) that he, not PhoneDog, initially created the password, (ii) that PhoneDog did not make any reasonable efforts to maintain the secrecy of the password, (iii) that the followers of the account are not secrets because they are publicly available, and (iv) that the password to the account did not derive any actual or potential economic value.[124] However, the court warned that PhoneDog's original claim could be challenged at future summary judgement by the conclusion of discovery.[125]

PhoneDog's claim of conversion also survived Kravtiz's motion to dismiss because it sufficiently alleged that the company owned or had the right to own the account and that Kravitz's act of conversion was done knowingly or intentionally.[126]

PhoneDog successfully reinstated claims for intentional interference with an economic advantage and negligent interference with an economic advantage in an amended complaint that alleged "it had economic relationships with (1) the approximately 17,000 followers of the Twitter account at issue; (2) its current and prospective advertisers; and (3) CNBC and Fox News, and that each of these economic relationships were actually disrupted by Kravitz's conduct."[127] Similar to BH Media's counterclaims in the *Bitter* case, PhoneDog alleged that Kravitz's Twitter account generated traffic to its website and that a decrease in traffic would

[121] *Id.*
[122] *Id.*
[123] *PhoneDog*, 2011 U.S. Dist. LEXIS 129229, at *2.
[124] *Id.* at *8-9.
[125] *Id.* at *10.
[126] *Id.* at *14.
[127] PhoneDog v. Kravitz, No. 3:11-cv-03474-MEJ, 2012 WL 273323, at *1 (N.D. Cal. Jan. 30, 2012).

cause a drop in the number of visitors, discouraging advertisers from paying for space.[128]

Although PhoneDog settled out of court during discovery, this case is cited in later cases and commentary as an early, albeit 2011, case that sought to refine the contours of ownership of social media accounts in an employment setting.

C. Eagle v. Morgan

The 2011 case of *Eagle v. Morgan* provides insightful analysis of claims alleging (i) misappropriation of trade secrets and (ii) tortious interference of a contractual relationship.[129]

The plaintiff, Dr. Linda Eagle, co-founded Edcomm, Inc., "a banking education company that provides services on-line and in person to the banking community."[130] In May of 2009, Eagle created her own LinkedIn account using her Edcomm email address.[131] Eagle "was well-published in banking industry publications, was quoted in newspapers and magazines, and presented at industry conferences around the world."[132] Eagle, like other LinkedIn users, displayed and promoted her professional experience, achievements, skills, and other details to "connect" and communicate directly with others.[133] Edcomm established a policy that encouraged employees to use LinkedIn and provided guidelines regarding online content.[134] However, Edcomm's policy was silent on ownership of employees' LinkedIn accounts.[135] During the course of her employment, Eagle shared her LinkedIn password with other Edcomm employees so they could respond to invitations to connect and post account updates.[136]

On June 20, 2011, Eagle was involuntarily terminated from Edcomm after the October 2010 sale and relaunch of the company, which named defendant, Sandi Morgan, as interim CEO.[137] Upon Eagle's termination, Edcomm employees accessed her LinkedIn account, changed its password, and held exclusive control of

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[128] *Id.*
[129] *See generally Eagle*, 2013 U.S. Dist. LEXIS 34220.
[130] *Id.* at *1.
[131] *Id.* at *2.
[132] *Id.* at *1.
[133] *Id.* at *2.
[134] *Id.* at *2-3.
[135] *Id.* at *4.
[136] *Id.* at *4-5.
[137] *Id.* at *2, *6.

the account until July 7, 2011, at which time LinkedIn intervened and returned exclusive access to Eagle on July 14, 2011.[138]

Eagle sued Morgan, Edcomm, and other defendants alleging 11 causes of action.[139] Early in the case's pre-trial motion phase, the court disposed of the notion that Eagle's LinkedIn account connections could form the basis of a misappropriation claim by defendants, stating "to the extent [Edcomm] alleges misappropriation of a trade secret, its claim must necessarily fail [because] . . . the LinkedIn account connections [do not] qualify as trade secrets, as [they] are . . . generally known in the wider business community or capable of being easily derived from public information."[140] A claim for misappropriation of trade secrets did not reach the bench trial and final decision of the case.[141]

Relative to Eagle's claim alleging tortious interference with a contract, the court inferred that Eagle "had in fact entered into a contractual relationship with LinkedIn" vis-à-vis the terms of the User Agreement.[142] Edcomm's position on the ownership of an employee's LinkedIn account does not acknowledge the LinkedIn User Agreement, which states that "[i]f you are using LinkedIn on behalf of a company or other legal entity, you are nevertheless individually bound by this Agreement even if your company has a separate agreement with us."[143] (As of February 16, 2019, LinkedIn's User Agreement more succinctly stated, "[a]s between you and others (including your employer), your account belongs to you.")[144]

The fact that Eagle may have created her LinkedIn profile using her Edcomm email address, on an Edcomm computer, on Edcomm's time, and at Edcomm's direction, did not persuade the court, which stated "the LinkedIn User Agreement clearly indicated that the individual user owned the account."[145] The court also found that Edcomm's conduct of accessing Eagle's account and changing the password was done with purpose or intent to harm Eagle by disrupting her contractual relationship with LinkedIn from continuing.[146]

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[138] *Id.* at *5.
[139] *Id.* at *9.
[140] Eagle v. Morgan, No. 2:11-cv-04303-RB, at *23 (E.D. Pa. Dec. 22, 2011).
[141] *See id.*
[142] *Eagle*, 2013 U.S. Dist. LEXIS 34220, at *19.
[143] *Id.* at *2, n.1.
[144] *See User Agreement*, LINKEDIN, https://www.linkedin.com/legal/user-agreement#rights (last visited Feb. 16, 2019).
[145] *Eagle*, 2013 U.S. Dist. LEXIS 34220, at *19.
[146] *Id.*

III
ANALYSIS

A. Trade Secrets on Shaky Ground

Utilizing theories of trade secret protection to assert ownership of a social media account is a risky strategy and would likely not favor the employer asserting the claim. To prevail on a claim alleging misappropriation of trade secrets, a party must show: (i) the existence of a trade secret, and (ii) the acquisition of a trade secret as a result of a confidential relationship, or (iii) the unauthorized use of a trade secret.[147]

Under the Uniform Trade Secrets Act (UTSA), in order for information to qualify as a trade secret:

- it must derive independent economic value, actual or potential, from not being generally known to, or readily ascertainable through proper means by, people who can obtain economic value from its disclosure or use,
- and it must be the subject of reasonable efforts to maintain its secrecy.[148]

None of the features of a journalist's social media followers or social media accounts conforms to these basic elements, and as a threshold matter, followers on social media are not "trade secrets" for the purposes of the UTSA as detailed below.

1. Social media followers are not "trade secrets" because they are "generally known" to the public.

As a threshold matter, it is difficult to establish that a list of social media followers is a secret. Lists of followers are in the public domain online, not to mention that in the digital marketplace a business has many tools at its disposal to identify competitors' lists of followers and target those followers.

Some practitioners assert that *Veronica Foods Co. v. Ecklin* "held that a customer list was *not* a trade secret under the federal Defend Trade Secrets Act because the company had announced the names of many of its customers and suppliers on its website and social media accounts, meaning that its full customer

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[147] *See, e.g.,* Unif. Trade Secret Act prefatory note, 14 U.L.A. 433 (1985) ("For liability to exist under this Act, . . . trade secret must exist and either a person's acquisition of the trade secret, disclosure of the trade secret to others, or use of the trade secret must be improper.").

[148] *Id.*

list was not 'secret.'"[149] The court in *Eagle* squarely recognized early in that case that LinkedIn account followers are "generally known in the wider business community or capable of being easily derived from public information."[150] The same should be true of the lists of Twitter followers at issue in the *Bitter* and *PhoneDog* cases. Though a customer list is traditionally considered a protectable trade secret, when the list is public, the information can no longer form the basis of a misappropriation claim.[151] In its 2017 *Art & Cook, Inc. v. Haber* order, the United States District Court for the Eastern District of New York noted that misappropriation of a customer list consisting of publicly available information is not likely to give rise to a claim under the DTSA.[152]

Furthermore in the *Bitter* case, BH Media would also have had to show that it took steps to protect Andy Bitter's list of Twitter followers in order to minimize the risk of that list being acquired by competitors. Implementing such protections is nearly impossible and counterintuitive in the open sphere of social media. *Art & Cook, Inc. v. Haber* further sheds light on this issue. The court's order denying a preliminary injunction shows that even when information could be considered a secret under DTSA, low-level security measures are not sufficient to afford DTSA protection.[153]

2. The "value" paradox: social media followers do not derive "independent economic value."

Relative to "value," a paradox exists. There is a clear social value of attracting and accumulating followers on social media platforms. More followers means greater visibility of one's social profile, the content he or she creates, the products he or she promotes, and the general influence and expertise he or she generates in a specific field. Social value can lead to economic value, and it is undeniable that the

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[149] O'Connell, *supra* note 108.

[150] *Eagle*, 2013 U.S. Dist. LEXIS 34220, at *23.

[151] *See, e.g.*, Veronica Foods Co. v. Ecklin, 2017 U.S. Dist. LEXIS 101325, at *25-26 (N.D. Cal. June 29, 2017) (citing Ultimax Cement Mfg. Corp. v. CTS Cement Mfg. Corp., 587 F.3d 1339, 1355 (Fed. Cir. 2009)) (determining that a customer list was *not* a trade secret under the Defend Trade Secrets Act because the company had announced the names of many of its customers and suppliers on its website and social media accounts, meaning that its full customer list was not "secret").

[152] *See* Art & Cook, Inc. v. Haber, No. 17-cv-1634 (LDH) (CLP), 2017 WL 4443549, at *5 (E.D.N.Y. Oct. 3, 2017) (finding plaintiff failed to demonstrate a likelihood of success on the merits with regards to spreadsheets containing the names, phone numbers, and email addresses of customers).

[153] *Id.* at *7-8.

drive for visibility, engagement, and conversion from social follower to customer has transformed the digital marketing and consumer industries, among others.[154]

The value generated through social media is enjoyed by both employer and employee alike.[155] The court in *Maremont v. Susan Fredman Design Group, Ltd. (SFDG)*, a case involving an employee of an interior design company, referenced this value as an employee's "commercial interest" in his or her social media persona and affirmed an individual's right to protect it.[156] Specifically, "[a] social network account not only serves the worker's interest by facilitating contact with her network, but also helps the worker to build her reputation and market herself to potential employers."[157] Social media allows journalists to build their own brand that can attract not only followers, but also future employers.[158] In short, social media can attract job prospects. A reporter's brand—with its built-in audience of followers—is "capital" to some hiring managers. Therefore, journalists have a social and commercial interest in their own social media identity.[159]

For purposes of trade secret law, the inquiry turns only on whether the information one claims to be a trade secret derives *independent economic value, which is derived* when secrecy of the information provides a "substantial business advantage."[160] Both the news outlet in *Bitter* and the employer in *PhoneDog* alleged that a follower list on Twitter was information that fell into the definition of a trade secret and that the ancillary information available to the account-holder—such as followers' traits and the ability to direct message them—would have value in the hands of a competitor.[161]

The trade secret disputes will be centered on whether a list of followers and any ancillary information available provides a "substantial business advantage," and the outcome will likely be determined by the specific facts and circumstances. Is the list of followers, alone, generating economic value to the news outlet or the journalist? Does the mere existence of a list of followers provide companies with a

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[154] *See* Argento, *supra* note 99, at 221.
[155] *Id.* at 222.
[156] *Maremont*, 2014 U.S. Dist. LEXIS 26557, at *7-8 (quoting Argento, *supra* note 99, at 221).
[157] *Id.* at *13 (quoting Argento, *supra* note 99, at 221).
[158] Argento, *supra* note 99, at 221.
[159] *See id.*
[160] *See* Morlife, Inc. v. Perry, 56 Cal. App. 4th 1514, 1522 (Ct. App. 1997); *BH Media*, No. 7:18-cv-00388, at *4 (Aug. 6, 2018); *PhoneDog*, 2011 U.S. Dist. LEXIS 129229, at *8-9.
[161] *See BH Media*, No. 7:18-cv-00388, at *4 (Aug. 6, 2018); *see also PhoneDog*, 2011 U.S. Dist. LEXIS 129229, at *8-9.

business advantage over competitors? Or does the value lie in the knowledge and data collected from the followers' activity?

Not to be ignored, especially in the context of the journalism industry, is that a key factor in a court's determination of independent economic value is whether the employer made substantial efforts to create the disputed list.[162] Facts evidencing the amount of time, expenses, and resources in establishing the list can inform whether the employer's efforts to cultivate the list are "substantial."[163] In the news industry, lists of social media followers exist by virtue of audience members who "opt-in" to follow a journalist. The decision to "follow" is personal and largely the result of journalists' reputation, persona, and brand he or she develops and cultivates over time. The effort, if any, by news outlets to create a list of social media users who follow an individual journalist defies the norms of social media interaction. News outlets don't create lists of social media followers. In fact, no one affirmatively creates a list of followers; but rather, such a list is cultivated by the journalist in the opt-in/opt-out environment of social media.

Courts have routinely acknowledged that lists developed by an employee do not fall into the definition of trade secret.[164] In *Robert S. Weiss Associates, Inc. v. Wiederlight*, the Supreme Court of Connecticut addressed the issue by stating that, "a former employee will not be said to have misappropriated that secret if he or she was in charge of cultivating the information."[165] According to the court, Wiederlight, a former employee of an insurance company, did not steal the firm's client list given that it was his direct relationship with the customers on the list that "allowed him to meet their particular needs."[166]

PhoneDog also alleged that the password to Kravitz's Twitter account was a trade secret.[167] But courts have found that the methods used to protect trade secrets, like passwords and login credentials, are not themselves trade secrets because their value is derivative of the item that they are intended to protect and therefore have

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[162] *See* Barney v. Burrow, 558 F. Supp. 2d. 1066, 1081 (E.D. Cal. 2008) (customer list was not a trade secret where the former employees "built up their clientele through their efforts . . . ."); *see also* McKesson Med.-Surgical, Inc. v. Micro Bio-Medics, Inc., 266 F. Supp. 2d 590, 596 (E.D. Mich. 2003).

[163] *See id.*

[164] *See id.*

[165] Jasmine McNealy, *Who Owns Your Friends?: PhoneDog v. Kravitz and Business Claims of Trade Secret in Social Media Information*, 39 RUTGERS U. COMPUTER & TECH. L. J. 30, 44 (2013).

[166] *Id.* (citing Weiss v. Wiederlight, 546 A.2d. 216 (Conn. 1988)).

[167] *PhoneDog*, 2011 U.S. Dist. LEXIS 129229, at *2.

"no independent economic value."[168] Also, "[w]here a plaintiff has not alleged that its passwords are the product of any special formula or algorithm that it developed, the passwords are not trade secrets."[169] Kravitz and Bitter created the passwords to the disputed Twitter accounts, so it cannot be said that they were created as part of a special formula or algorithm.[170]

B. Social Media Policies: Balancing the Interests of Employers and Employees

What is striking about the *Bitter* case is that contract law is not the basis of BH Media's lawsuit, even though the company had a social media policy.[171] As an alternative to trade secret claims, companies should turn to contract law—both social media policies and employment agreements—to help resolve issues related to ownership of social media accounts. Comprehensive social media policies could prevent legal action in the first place by providing clear cut guidelines that address a myriad of potential questions and that would guide disputing parties and courts through available policy terms and intentions.

A policy should protect the company while also acknowledging the importance of a social media account to the livelihood of a journalist and to the free flow of information from journalists to the public. A conflict can be avoided by addressing the following items in a policy:

- If a company requires a journalist to maintain a social media presence as part of the job responsibility tied to his or her employment, then the company owns any account used primarily for the performance of the employee's job functions.

- Accounts that were previously created by an employee, including those that are more personal in nature, can be used as part of a journalist's professional capacity with the company. However, in these cases, the company will become owner of the account(s). As such, the employee must give login credentials to management. In addition, they must update the email address associated with the account(s) so that the employee's company email is linked to the account(s). An addendum, which transfers ownership from the

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[168] *See* Bellwether Cmty. Credit Union v. Chipotle Mexican Grill, 353 F. Supp. 3d 1070, 1087 (D. Colo. 2018); *see also* State Analysis, Inc. v. Am. Fin. Servs. Ass'n, 621 F. Supp. 2d 309, 321 (E.D. Va. 2009).

[169] State Analysis, Inc., 621 F. Supp. 2d at 321.

[170] *PhoneDog*, 2011 U.S. Dist. LEXIS 129229, at *2; *BH Media*, No. 7:18-cv-00388, at *2.

[171] *BH Media*, No. 7:18-cv-00388, at *4.

employee to the employer, to the social media policy is required for these cases.

- "Professional capacity" must be defined.

- Alternatively, if the employee desires to keep his or her previous account, then a separate account is set up for the employee to use in his or her professional capacity. Social media accounts used for professional purposes must be set up with a company email address.

- There should be no ambiguity in terms of who is responsible for the creation of new accounts: either the individual employee or management. To provide consistency, select one or the other but not a mix of both. If an employee is charged with creating the accounts, the employee must immediately deliver the account log-in credentials to management.

- After the account is created, an employee must consult with management if he or she wishes to change the account name, known as a handle. Updated passwords must be given to management immediately upon the change.

- Management is permitted to access employees' social media accounts, and indeed should access the accounts from time to time, in order to establish shared access. In addition, management is allowed to edit or delete posts, but will first make a reasonable effort to communicate with the employee to discuss the changes (for example, if there is a factual error in a post).

- The company will transfer ownership of a social media account(s) to a departing employee as long as that person is not going to work for a direct competitor. In the case of ownership transfer, the departing employee will remove any reference of the company from his or her account handle so that it is clear the person no longer works for the company.

- In cases in which the employee goes to work for a direct competitor, the company will retain ownership of the account. The employee will no longer be able to access the account(s). This provision applies to any account that was created and/or used by the employee prior to his or her employment at the company and then transferred to the company.

- "Direct competitor" must be defined.

The inclusion of a trade secrets provision is also commonplace in some company employee handbooks.[172] As an example, in the journalism industry, TEGNA and Gray Television both include guidelines about maintaining the privacy of confidential information, including trade secrets.[173] According to TEGNA's policy, employees "are expected to maintain the confidentiality of TEGNA's trade secrets as well as all non-public information that might be of use to competitors, or harmful to the Company or its customers, if disclosed."[174] This includes information regarding projects employees are working on, business activities, and news content that has not been published.[175] Gray Television's policy explicitly states that sharing of this type of information on social media is forbidden.[176] Neither policy includes social media followers or lists of followers as a confidential item or trade secret.[177] A company could attempt to protect its interests by explicitly doing so in a social media policy and/or employee handbook. However, as previously noted, even a contract provision of this nature would be difficult to defend in a legal case.

Finally, expanding on the question of what happens to accounts when a reporter leaves an outlet, companies should make a good faith effort to balance the interests of employer and employee. If retained by a newsroom once employment ends, reporters' social media accounts become virtually useless for a number of reasons. Chiefly among these is that transitioning a journalist's account to another journalist defies the fundamentals of social media. People follow an individual reporter's social media accounts because of that person. The practical effect of followers being pivoted away from a journalist whom they have chosen to follow is unproductive to the company. Therefore, it would be a shortsighted strategy to transfer one journalist's account to another. Another approach that newsrooms use in handling the social media accounts of a former employee is to let the accounts remain dormant, essentially never to be used again.

A more reasonable practice would be to allow a former employee to retain control of the account as long as he or she does not work for a competitor of the company. As noted previously in this article, Gray Television utilizes this approach.[178] In cases in which a former journalist goes to work for a non-competing outlet, there is no clear cut economic advantage of a news outlet retaining control of

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[172] *See, e.g.*, GRAY TELEVISION, *supra* note 56, at 37-42.
[173] TEGNA, *supra* note 37; GRAY TELEVISION, *supra* note 56, at 40.
[174] TEGNA, *supra* note 37.
[175] *Id.*
[176] GRAY TELEVISION, *supra* note 56.
[177] TEGNA, *supra* note 37; *id.*
[178] GRAY TELEVISION, *supra* note 56.

that account, particularly when one considers that the account could remain dormant and that the list of followers is publicly available. Such an approach undermines an employer's case in claims that are based on the economic imperative of retaining control of a social media account. Furthermore, a journalist who knows that his or her account will be taken from them if they leave a news outlet could feel less compelled to use the account to build a robust following and report important information on it that links back to the outlet's website, thus, undermining a station's stance that retaining control of the account is critical to the company's bottom line.

C. Other Legal Issues

1. Terms of Service

The legal framework of these cases may get more complicated when the terms of service, also called user agreements, form the basis of a contractual relationship between the employee and the social media platform. As seen in *Eagle v. Morgan*, the court interpreted the language of LinkedIn's user agreement to infer that a contractual relationship existed between LinkedIn and Eagle.[179] LinkedIn's user agreement language states that the person who creates the account is entering into a legally binding agreement with LinkedIn even if they are using the service on behalf of a company, and that person retains ownership of said account.[180] Therefore, the court reasoned that Eagle's employer's disruption of her access to her LinkedIn account satisfied the core elements of a claim for tortious interference with a contract.[181] Given this type of provision in a user agreement, a social media policy that either requires or recommends an employee transfer their rights of an account to an employer could force an employee to breach the terms of service, leading to a company's tortious interference with contractual relations.

The analysis of a tortious interference claim favored the employer in the 2014 case of *Mattocks v. Black Entertainment Television*.[182] There, Black Entertainment Television ("BET") entered into a contract with the plaintiff, Mattocks, upon taking notice of Mattocks' success in building a robust online community of followers in a Facebook "fan page" and Twitter feed centered around one of BET's television shows. Mattocks gave BET access to the Facebook and Twitter accounts vis-à-vis login credentials, and BET supplied Mattocks with branded content to share online.[183] In exchange for Mattocks' efforts, BET compensated Mattocks and, at one

[179] *Eagle*, 2013 U.S. Dist. LEXIS 34220, at *19.
[180] *See* LINKEDIN, *supra* note 144.
[181] *Eagle*, 2013 U.S. Dist. LEXIS 34220, at *19.
[182] Mattocks v. Black Entm't Television L.L.C., 43 F. Supp. 3d 1311, 1319 (S.D. Fla. 2014).
[183] *Id.* at 1316.

point, explored whether to hire Mattocks as a full-time employee.[184] During discussions of Mattock's employment, the relationship began to deteriorate and Mattocks changed the log-in and access information to the accounts.[185] BET successfully persuaded Facebook to migrate page "likes" away from Mattocks' fan page over to BET's page.[186] Litigation followed and Mattocks alleged that BET's intervention with Facebook constituted a tortious interference with the terms of her user agreement with Facebook.[187]

When evaluating this claim, Florida's Southern District Court focused on the claim's fourth element to consider "whether any justification or privilege supported BET's requests to terminate the [Facebook] Page and Mattocks' Twitter account."[188] The court reasoned that a defendant's interference is justified when it has a potential financial interest in how a contract is performed.[189] The record showed that BET was not a stranger to Mattocks' user agreements with Facebook and Twitter because Mattocks was hired by BET to promote a television series on the disputed social media accounts.[190] BET exercised control of the content and its economic interests were therefore impacted by Mattocks' use of the account, releasing it from liability under a tortious interference claim.[191]

2. State Laws Governing Social Media

An increasing number of states have passed or are in the process of enacting laws that govern social media in the workplace.[192] The laws include account-access and privacy statutes.[193] In Virginia, for example, the legislation states that an employer may not require current or prospective employees to turn over login information to their social media accounts.[194] However, this law does not include social media accounts that are (i) opened by an employee at the request of an

[184] *Id.* at 1315-16.
[185] *Id.* at 1316.
[186] *Id.* at 1316-17.
[187] *Id.* at 1317.
[188] *Id.* at 1318-19.
[189] *Id.* at 1319.
[190] *Id.*
[191] *Id.*
[192] McLaughlin, *supra* note 9, at 91, 109; NAT'L CONF. OF ST. LEGISLATORS, *supra* note 10.
[193] NAT'L CONF. OF ST. LEGISLATORS, *supra* note 10.
[194] Social Media Accounts of Current and Prospective Employees, VA. CODE ANN. § 40.1-28.7:5 (2015).

employer; (ii) provided to an employee by an employer; or (iii) set up by an employee on behalf of an employer.[195]

Similar language is used in a majority of other state laws on the issue. In several states, though, there is a broader definition of social media accounts to which an employer can request access. For example, Oklahoma's law includes "[a]ny accounts or services provided by the employer or by virtue of the employee's employment relationship with the employer or that the employee uses for business purposes."[196] According to this definition, one could argue that employers can legally ask for information to accounts that an employee previously opened and then uses for the purposes of his or her employment.

CONCLUSION

If the *Bitter* case had gone to trial, it would have been unlikely that BH Media could have prevailed on the basis of trade secret laws. Plaintiffs have a high burden of proof in cases of trade secrets, particularly when they involve the question of whether a list of social media followers is equivalent to that of a "secret" curated customer list. We argue that social media followers are not trade secrets, no matter the industry. Therefore, utilizing trade secret laws in order to gain control of a social media account is an ill-fitted legal strategy. Even if someone is the rightful owner of a social media account, the associated followers are not trade secrets. A better approach to establishing and defining ownership—and avoiding litigation in the first place—is through well-articulated policies and practices. A newsroom social media policy should (i) define the terms of ownership while also recognizing social media companies' user agreements, and (ii) balance the interests of the employer and its employees.

[195] *Id.*; Prohibited Actions Regarding Personal Social Media Accounts, OKLA. STAT. ANN. tit. 40 § 173.2 (West 2014).

[196] OKLA. STAT. ANN. tit. 40 § 173.2.

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OF COASE AND COPYRIGHTS: THE LAW AND ECONOMICS OF LITERARY FAN ART

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INTRODUCTION

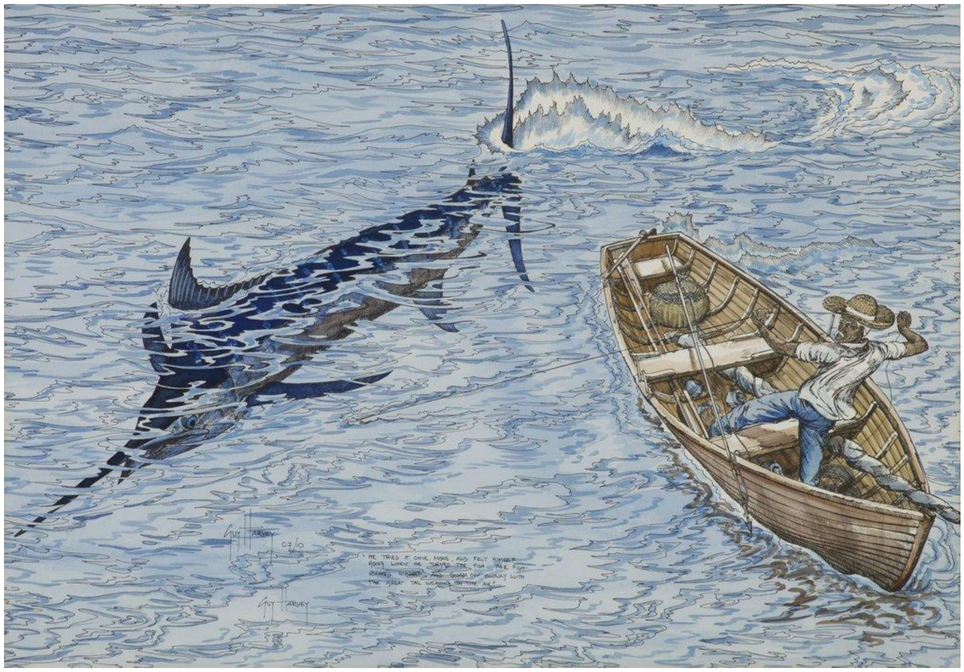
This Article explores the law and economics of "literary fan art"—unauthorized derivative works by third parties that are based on someone else's literary work product. What is the legal status of such fan art? Because copyright laws extend to derivative works, the legal question often boils down to this: When does fan art constitute "fair use"? Literary fan art also poses a larger legal and economic puzzle: how far should property rights extend in the domain of literature?

The remainder of this paper is organized as follows. To motivate the paper, Part I presents some notable examples of contemporary literary fan art inspired by Ernest Hemingway's classic novella *The Old Man and the Sea*. Part II then restates the legal puzzle this paper will attempt to solve. Next, Part III shows why the traditional fair use standard is utterly unhelpful in solving the fan art puzzle, while Part IV will sketch an alternative Coasean solution. Part V concludes with two cheers for fan art.

I
MOTIVATING EXAMPLES

Literary fan art comes in all shapes and sizes, as devotees of literature find new ways of reimagining their favorite works of fiction, whether it be a poem by Sylvia Plath, a short story by Junot Diaz, or a novel by J. K. Rowling, just to name a few notable examples. Ernest Hemingway's *The Old Man and the Sea*, however, is one of the best-known examples of this practice. The character and story of Hemingway's masterpiece have over the years been reimagined by countless "fan artists" in a wide variety of media. Here are just a few salient examples of fan art based on Hemingway's classic novella:

A. Guy Harvey Pen and Ink Drawings



The original pen and ink drawing pictured above was painted by Guy Harvey, a marine-scientist-turned-wildlife-artist.[1] Dr. Harvey painted this work, along with 43 others, for his first art show, which took place on the island of Jamaica in 1985.[2] All 44 of these pen and ink paintings were inspired by *The Old Man and the Sea*, and based on the positive reviews he received during his first art show, Dr. Harvey then decided to devote himself full time to painting.[3] In 1999, with permission from Hemingway's family, he self-published a book-length compilation of 59 pen and ink drawings of the Cuban fisherman's heroic ordeal.[4] To my knowledge, however, none of Guy Harvey's Hemingway-inspired paintings and drawings were commissioned or authorized by Scribner, the publishing house that owns the legal rights to Hemingway's novella.

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[1] *Guy Harvey Awards and Accomplishments*, GUY HARVEY, https://www.guyharvey.com/Guy-Harvey-Heritage.pdf (noting that Dr. Harvey received his doctoral degree in marine biology from the University of the West Indies).

[2] *Id.*

[3] *Id.*

[4] *Id.*; Guy Harvey, SANTIAGO'S FINEST HOUR (1999) (this book of illustrations also contains a short foreword by Mina Hemingway, one of the Ernest Hemingway's grandchildren).

B. Corban Wilkin Graphic Novel

Pictured above is another beautiful derivative work based on *The Old Man and the Sea*—the first panel of an open-access graphic novel created by Corban Wilkin, a contemporary British illustrator and comic book artist.[5] Beginning with Santiago's dream sequence, this graphic adaptation of Hemingway's classic novella retells Santiago's story in visual or comic book form via 80 black-and-white panels and just 385 words, or to quote from the artist Mr. Wilkin himself: "I compressed 100 pages of text down into 22 pages of comics, and with the story being something of a fable this [compression] allowed the strength of the plot to shine through in its most distilled form."[6]

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[5] Corban Wilkin, *Ernest Hemingway's The Old Man and the Sea*, https://corbanwilkin.com/ernest-hemingways-the-old-man-and-the-sea/ (last visited on May 26, 2019).

[6] See Corban Wilkin, *Doing Adaptations* (May 25, 2011, 11:54PM), https://corbanwilkin.com/2011/05/25/doing-adaptations/. By comparison, Hemingway's novella contains 26,601 words. See Lawrence J. Epstein, *Word Counts in Novels* (Mar. 20, 2016), https://blog.bestamericanpoetry.com/the_best_american_poetry/2016/03/word-counts-in-novels-by-lawrence-j-epstein.html.

Wilkin begins his version of Hemingway's story with Santiago's dream sequence.[7] In particular, the first page of his graphic novel (pictured above) consists of a single full-page panel that pictures a large fishing boat at sea along with the words "He no longer dreamed of storms."[8] The second page contains a close-up of the fishing boat along with the words "nor of women" on top and the words "nor of great occurrences" on the bottom.[9] The third page, which contains five panels, then concludes this dream sequence with the words "nor of great fish" on the top panel, "nor of great feats of strength" in the middle panel, and the words "nor of his wife" on the bottom left panel.[10] The last two panels on the bottom right side of the page state, "He only dreamed of places now/and of the lions on the beach."[11]

The fourth page of Wilkin's graphic novel shows the old man urinating outside his shack and going over to wake Manolin, and the fifth page, which contains four panels, pictures them drinking coffee and contains some dialogue between them.[12] The sixth page (seven panels) shows Santiago rowing out to sea, and the top panel on the seventh page displays a flying fish in the foreground and Santiago and his skiff in the background, while three smaller panels on the bottom of this page contain a sequence showing a close-up of the pull on one of his fishing lines.[13] The next two pages (pp. 8-9) contain ten panels of various shapes and angles, while pages 10 and 11 contain a large central circular panel along with ten additional panels along the outer circumference of the circle, depicting the first stages of Santiago's long ordeal.[14]

Page 12, a full-page panel, then pictures the giant marlin flying above water, and page 13, another full-page panel, pictures Santiago in three action poses struggling with the fishing line across his shoulders.[15] Neither page contains a single word.[16] Pages 14 and 15 contain seven panels and show the giant marlin tied up along the skiff.[17] Here (pp. 14-15), Wilkin breaks up Santiago's melancholic observation in the novel "I am only better than him [the giant marlin] through trickery and he

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[7] Wilkin, *supra* note 5.
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *Id.* In Hemingway's version of the story, the old man runs four separate fishing lines before combining them into a single line. Ernest Hemingway, THE OLD MAN AND THE SEA (LIFE 1952).
[14] Wilkin, *supra* note 5.
[15] *Id.*
[16] *Id.*
[17] *Id.*

meant me no harm" into two separate sentences.[18] The bottom right panel on page 14 contains the trenchant words, "I am only better than you through trickery."[19] The bottom left panel on page 15, the poignant words: "He meant me no harm."[20]

Pages 16 and 17 contain nine panels that portray Santiago's futile battle with the sharks, while pages 18 and 19 depict Santiago's solitary return voyage.[21] Although these two pages (pp. 18-19) contain 11 separate panels, just five words appear here: "I went out too far."[22] Page 20 contains four panels of dialogue between Manolin and Santiago, and page 21 (one full-page panel) contains an aerial view of Santiago and Manolin from afar along with the carcass of the marlin washed up against the tide.[23] The last page (p. 22) zooms in on the carcass along with the hopeful words: "But we will fish together now, for we still have much to learn."[24]

C. Bob the Angry Flower Webcomic

The two cartoon panels pictured above are from a *The Old Man and the Sea*-inspired webcomic created by Stephen Notley, a contemporary Canadian cartoon

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[18] *Id.*; Hemingway, *supra* note 13.
[19] Wilkin, *supra* note 5.
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.* In Hemingway's novella, these words are uttered by Manolin: "we will fish together now, for I still have much to learn." In Wilkin's version of the story, Wilkin replaces the singular "I" in the second clause of the sentence with the plural "we," so the identity of the speaker is ambiguous. Hemingway, *supra* note 13.

artist.[25] This particular parody, which is titled tongue-in-cheek "Bob's Classic Literature Sequels: The Old Man and the Sea 2," is part of Notley's "Bob the Angry Flower" series of webcomics.[26] It is also living proof that there is but one step from the sublime to the ridiculous.

In summary, Notley's "The Old Man and the Sea 2" contains eight panels and features two characters: an old, dignified, and silent Santiago and Bob the Angry Flower, who does all the talking.[27] The webcomic begins with the two characters standing aboard the bow of an enormous ocean liner in the middle of the ocean.[28] Bob has his arm around Santiago in the first panel and begins the comic thus: "So when I heard about your story I just HAD to come!"[29] Bob then summarizes Santiago's ordeal and then retells the story of *The Old Man and the Sea* in the second and third panels: "… you went out on the sea, made a supreme effort of mental and physical will, and somehow caught the biggest marlin EVER! AND THEN THE SHARKS ATE IT!!!"[30]

Bob the Angry Flower then reassures Santiago that "Bob's gonna make it all better!"[31] How? Bob informs Santiago that "this boat's got every shark-lasering gadget ever made!" and adds that, "we've located a marlin four times bigger than the one you caught."[32] All Santiago has to do to catch the massive marlin and fend off any possible sharks is to press a button.[33] Bob then urges Santiago in the penultimate panel to "Go for it, man!!! Win it all back!!!"[34] The last panel contains a close-up of Santiago against a black backdrop.[35] Although Stephen Notley's tongue-in-cheek sequel to Hemingway's novella contains only eight panels, it

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[25] *Stephen Notley*, THE NIB, https://thenib.com/stephen-notley (last visited Sept. 13, 2019) (indicating that Stephen Notley has published nine collections of cartoons and now lives in Seattle, Washington).

[26] Stephen Notley, *The Old Man and the Sea 2*, http://www.angryflower.com/357.html (last visited May 26, 2019).

[27] *Id.*

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.*

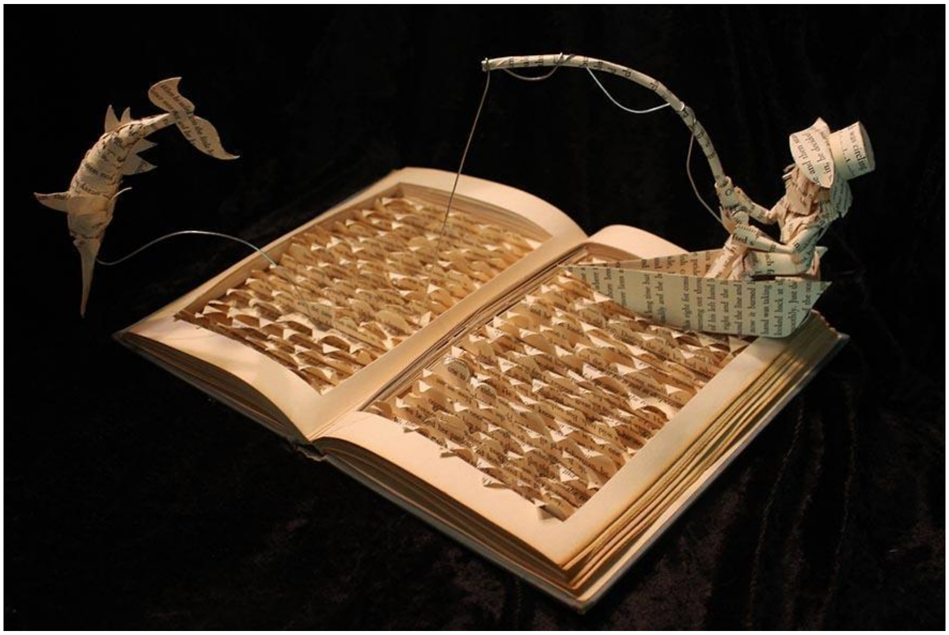
[33] *Id.*

[34] *Id.*

[35] *Id.*

nevertheless captures the quiet dignity and tenacious spirit of Hemingway's Santiago. He utters not a single word and refuses to hit the button.[36]

D. Jodi Harvey-Brown Book Sculpture



The 3D "book sculpture" of *The Old Man and the* Sea pictured above was created by Pennsylvania-based book artist Jodi Harvey-Brown, who alters old books and gives them a second life by making paper sculptures out of their pages.[37] In the words of Ms. Harvey-Brown, "[t]he books that we love to read should be made to come to life. Characters … should come out of the pages to show us their stories. What we see in our imaginations as we read should be there for the world to see."[38] In the particular piece pictured here, the old fisherman's epic battle with the noble marlin is brought to life from the pages of an old copy of the actual novella.

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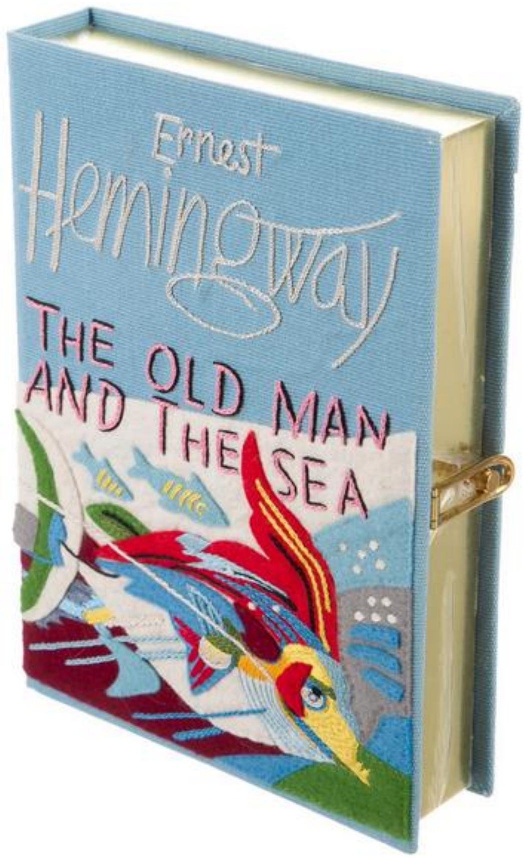
[36] *Id.*
[37] *Making Stories Come to Life*, JODI HARVEY, hhttps://www.jodiharveyart.com/ast visited May 26, 2019).
[38] *Id.*

E. Olympia Le-Tan Canvas Book Clutch Bags



The canvas clutch bag pictured above is part of Olympia Le-Tan's collection of luxury book clutches.[39] This particular piece recreates the cover art of the first edition of *The Old Man and the Sea*.[40]

To sum up: Guy Harvey's pen and ink drawings, Corban Wilkin's graphic novel, Stephen Notley's webcomic, Jodi Harvey-Brown's book sculptures, and Olympia Le-Tan's book clutches are just a few notable examples of the many forms of fan art inspired by Ernest Hemingway's *The Old Man and the* Sea. The art lover in me appreciates these whimsical works of literary fan art for their own sake. The business law professor in me, however, is perplexed and puzzled: what is the legal

[39] I thank my wife Sydjia Robinson for bringing this beautiful piece to my attention. *Book Clutch The Old Man And The Sea*, OLYMPIA LE-TAN, https://olympialetan.com/product/book-clutch-the-old-man-and-the-sea/ (last visited May 26, 2019).

[40] *Id.*

status of these works? Assuming these works of literary fan art were made without authorization of the copyright owner, they appear to come very close to the copyright infringement line, but that begs a deeper question: Where should we draw that line?

II
THE LEGAL PUZZLE

We may contrast unauthorized literary fan art with art that has been commissioned by the copyright owner. Various publishers of The Old Man and the Sea, by way of example, have themselves commissioned a number of artists to illustrate Ernest Hemingway's timeless story, beginning with the editors of Life magazine, who commissioned Noel Douglas Sickles to illustrate the initial publication of Hemingway's novella in 1952.[41] In all, Mr. Sickles contributed 18 two-tone drawings to illustrate Hemingway's novella.[42] Likewise, the Reprint Society of London commissioned two noted wildlife artists, Raymond Sheppard and C. F. Tunnicliffe, for the first British edition of The Old Man and the Sea.[43] Now, fast forward to the present. The cover art on the most recent trade paperback edition of *The Old Man and the Sea* was illustrated by Aleksandr Petrov, who directed an award-winning short animated film with the same title in 1999.[44]

These artworks were either commissioned or licensed by the publishers of Hemingway's novella. By contrast, literary fan art—i.e., unauthorized secondary works that reimagine the characters, events, and storyline of the original work—poses a puzzle. To the extent such fan art constitutes a derivative work, copyright owners have legally-protected veto rights over subsequent visualizations of their

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[41] Hemingway, *supra* note 13.

[42] *Id.*

[43] Ernest Hemingway, THE OLD MAN AND THE SEA (Reprint Society of London 1953). According to a Publishers' Note in the front-matter section of the original 1953 Reprint Society edition of Hemingway's novella, the drawings of Sheppard and Tunnicliffe were "[o]riginally commissioned as alternatives," but "the Publishers considered that [readers] would find these two artists' different interpretations of the story so excellent and so interesting in their varying styles that both have been included." In all, Mr. Sheppard contributed 18 illustrations to the Reprint Society edition, while Mr. Tunnicliffe contributed 16 drawings, including the original cover art for the dust jacket.

[44] Ernest Hemingway, THE OLD MAN AND THE SEA (First Scribner Trade 2003); THE OLD MAN AND THE SEA (Direct Source Label 1999). This animation, which won the Academy Award for Best Animated Short Film, is also available in the DVD format.

works.[45] But at the same time, the fair use doctrine carves out a significant exception to this general rule.[46] Thus the legal puzzle posed by literary fan art is this: How far should property rights extend in the domain of literature?

III
THE FOG OF FAIR USE

Because copyright laws extend to derivative works, and because derivative works are defined broadly, the legal status of literary fan art boils down to the following question: When does fan art constitute fair use?[47] Alas, trying to predict ahead of time whether a particular piece of fan art or other derivative work constitutes fair use is almost like the inscrutable task of an ancient augur, who must somehow divine the future by the minute inspection of the entrails of a goose,[48] or in the words of one copyright lawyer: "Unfortunately, the only way to get a definitive answer on whether a particular use is a fair use is to have it resolved in federal court."[49]

Simply put, there is often no way of knowing ahead of time with any degree of certainty whether any particular derivative work constitutes fair use or not.[50] Why is the fair use test so fuzzy, so foggy? Because this test does not consist of a simple, clear-cut, bright-line rule, e.g., you may use up to 10% of another person's work.[51] Instead, fair use is a standard consisting of general guidelines.[52] Specifically, when courts are deciding whether a particular piece of fan art constitutes fair use, they must weigh four general guidelines or fair use factors.[53] What are these factors? In a case involving literary fan art, we can restate them as four separate questions:

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[45] 17 U.S.C. §101 (2019) (defining a "derivative work" broadly to include "a work based upon one or more preexisting works, such as a translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgment, condensation, *or any other form in which a work may be recast, transformed, or adapted*" (emphasis added)).

[46] 17 U.S.C. §107 (2019).

[47] 17 U.S.C. §106(2) (2019); 17 U.S.C. §101.

[48] *Cf.* Coase, *The Coase Theorem and the Empty Core: A Comment*, 24 J.L. & ECON. 183, 187 (1981) (source of the ancient augur metaphor).

[49] *See* Rich Stim, *Measuring Fair Use: The Four Factors*, STAN. U. LIBR., https://fairuse.stanford.edu/overview/fair-use/four-factors/ (last visited May 26, 2019).

[50] *Id.*

[51] 17 U.S.C. §107.

[52] *Id.*

[53] *Id.*

- How "transformative" is the fan art?
- Is the fan art based on an original work of fiction (like a play or novel) or on an original work of non-fiction (like a biography), and in either case, has that original work been published yet?
- How much material is the creator of the fan art stealing or borrowing, as the case may be, from the original work?
- Does the fan art help to increase or decrease sales of the original work?

What weight should be attached to each factor, i.e., which factor is the most important one? Or, if the factors are to be equally weighed, what happens when two of the factors point in one direction and the other two point in the other direction? Alas, courts are often coy when it comes to fair use. Although some courts have emphasized the first factor, they generally refuse to assign explicit weights to these fair use factors.[54] Therefore, instead of wasting any additional effort attempting to unlock the legal mysteries of the fair use doctrine, this Article will present an alternative approach to literary fan art.

IV
COASE TO THE RESCUE

One reason the fair use standard is so nebulous is that fair use is not only about "fairness"; it is also about finding the optimal level of copyright infringement, and more often than not, the optimal level of infringement is a contested issue.

Now, before we proceed any further, one might well be asking, "How can an illegal act like infringement ever be optimal?" To answer this query, we must first take morality out of the copyright equation because, from an economic or Coasean perspective, copyright disputes are not really about right and wrong.[55] Instead, fair use is about *balancing* the interests of both creators and copiers, of both innovators

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[54] *See, e.g.*, Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569 (1994); *see Fair Use*, JUSTIA, https://www.justia.com/intellectual-property/copyright/fair-use/ (last visited Nov. 25, 2019). As an aside, if I were declared "copyright law emperor" for a day, I would eliminate the first three factors and ask courts to focus on the last one. That is, I would simplify the fair use test as follows: no infringement unless the owner of the original work can produce credible evidence of lost sales.

[55] That is, by the way, why I disdain such judgmental terms like "piracy" and "theft" in this area of law. *Cf.* Floris Kreiken & David Koepsell, *Coase and Copyright*, 2013 U. ILL. J.L. TECH. & POL'Y 1, 29-30 (2013) (discussing how the music and movie industries have reframed copyright infringers as "pirates" and copyright infringement as "stealing").

and imitators, of both intellectual property owners and intellectual property squatters.[56]

Although the outer contours of the fair use defense are fuzzy at best, the fact that fair use even exists at all reveals something very important about the law: creators, innovators, and intellectual property owners are not the only ones who are morally worthy or legally deserving of copyright protection; so too are copiers, imitators, and intellectual property squatters.

To see why, let us set aside the fan art puzzle and focus instead on a more crass and clear-cut case of intellectual theft, like one of First Lady Melania Trump's plagiarized speeches.[57] Plagiarism involves two parties: an original creator owner on the one hand, whose words are being copied without authorization, and a mere copier on the other, who is partaking in the plagiarizing. Plagiarism thus looks like a wrongful act (i.e., one whose optimal level is zero), but as the late economist Ronald Coase once wrote in another context, even disputes between creators and copiers have a "reciprocal nature."[58]

Coase made this important yet counter-intuitive observation in two papers, one on the FCC and another on "The Problem of Social Cost."[59] In both papers he reframed legal disputes involving harms, such as traditional common law cases involving nuisances, as reciprocal problems.[60] The social cost paper, for example, begins by considering a "standard example" in economics and law, the problem of factory smoke.[61] In brief, a factory emits smoke and pollutes the air.[62] Neighbors who live downwind from the factory are harmed (e.g., foul air, quality of life, decrease in property values, etc.), so they decide to sue the owners of the factory for the harm thus caused.[63]

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[56] *See* 17 U.S.C. §107.

[57] *See, e.g.*, Erik Pederson, *Melania Trump's "Plagiarism" Of Michelle Obama Ignites Firestorm; Campaign Responds; Fox News Ignores Story*, DEADLINE (July 18, 2016, 9:40 PM), https://deadline.com/2016/07/melania-trump-rnc-speech-michelle-obama-2008-dnc-1201788566/. For a legal defense of plagiarism, see generally Brian L. Frye, *Plagiarism Is Not a Crime*, 54 DUQ. L. REV. 133 (2016).

[58] R. H. Coase, *The Federal Communications Commission*, 2 J.L. & ECON. 1, 26 (1959).

[59] *Id.* at 26-27; R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 2 (1960).

[60] Coase, *supra* note 58, at 26-27; Coase, *supra* note 59, at 1-2.

[61] Coase, *supra* note 59, at 1-2.

[62] *Id.*

[63] *Id.*

According to Coase, if one were to take a step back from this situation, one would see that the factory smoke problem is, in fact, a reciprocal one for two reasons.[64] One is that the problem is caused not just by the factory smoke; it is also caused by the neighbors' decision to live next to a factory.[65] The other reason is that one of the parties to this case is going to be harmed no matter how the case is decided.[66] If the court decides to dismiss the case or to rule in favor of the factory, then the neighbors are going to continue to be harmed, but *vice versa*, if the court rules for the neighbors by issuing an injunction or ordering the factory to pay damages, then it is the owners of the factory who are going to be harmed, since they will have to shut down the factory, relocate it somewhere else, or pay the neighbors money damages.[67]

For Coase, then, the key question is not, "Who is harmed?" Both sides are. Nor is it, "How do we avoid harm?" Harm is unavoidable. The key question for Coase is, "How do we decide which side to harm?"[68]

Before proceeding, I wish to make a brief digression regarding John Stuart Mill's famous harm principle. In Mill's immortal words: "The only purpose for which power [i.e., law] can be rightfully exercised over any member of a civilized community, against his will, is to prevent *harm* to others."[69] But in reality, Mill's harm principle is logically incoherent. Why? Because as Coase has taught us, harm is unavoidable.[70] To say "do no harm" or "your right to swing your fist ends where my nose begins" is unhelpful. Instead, we should ask, what legal rule or legal interpretation produces less harm.

Once the reciprocal nature of copyright disputes has been established, the literary fan art puzzle becomes soluble. Simply put, Coase's reciprocal analysis of the factory smoke case also applies to literary fan art. For example, if the law were to define fair use too broadly, making it easy for fans to produce any and all

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[64] *Id.* at 2; F. E. Guerra-Pujol, *Coase's Paradigm: First Principles of the Economic Analysis of Law*, 1 INDIAN J. L. & ECON. 1, 15-17 (2010) (summarizing Coase's analysis of reciprocal harms). For an overview of justified versus unjustified harms in the domain of law, see F. E. Guerra-Pujol, *Breaking Bad Promises* 1, 34-36 (Nov. 25, 2019) (providing a definition of legal harms and discussing justified versus unjustified harms) (on file with NYU JIPEL).

[65] *Id.*

[66] *Id.*

[67] *Id.*

[68] *Id.*

[69] John Stuart Mill, ON LIBERTY 14 (Prometheus Books 1986) (emphasis added).

[70] Coase, supra note 59, at 2.

derivative works, then original creators will be harmed. But at the same time, if the law were to define fair use too narrowly, making it easy for copyright owners to veto fan art, then it is the fans who are going to be harmed. The question here is thus analytically identical to the question in the factory smoke case: Which group should we harm?

Once the fan art problem is formulated this way—in terms of reciprocal harms—the solution becomes apparent: *we should choose that legal rule or legal interpretation of an existing rule that minimizes the overall level of harm*. In the case of literary fan art, my lawyerly intuition tells me that a narrow reading of the fair use doctrine would do more harm than a broad reading would.[71] In the extreme case, courts would produce a greater degree of harm if they granted copyright owners unlimited veto rights over fan art than if they allowed fans a reasonable amount of leeway in reimagining and reinterpreting established works of art.[72] And I would further venture to speculate that—to the extent that fan art rekindles interest in the underlying literary works that are being depicted or introduces those original works to new audiences—literary fan art may generate new sales and expand the market for those underlying works.[73]

Returning to the various revisualizations of Hemingway's *The Old Man and the Sea*, these examples of literary fan art illustrate the thesis of this Article. Imagine a world without Olympia Le-Tan's The Old Man and The Sea clutch bags, or a world without Guy Harvey's collection of The Old Man and the Sea watercolors, or a world without Jodi Harvey-Brown's The Old Man and the Sea book sculptures. None of

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[71] Of course, my intuition could be wrong. It needs to be tested empirically. Perhaps a scholar engaged in the field of empirical law and economics could design an empirical test of my theoretical claim. In the meantime, the larger point of this Article should not be missed: the optimal level of fair use is not zero.

[72] To take an extreme example in the opposite direction, consider the rise and fall of Napster from 1999 to 2001, which facilitated the sharing of massive amounts of music files without authorization. *See* John Alderman, SONIC BOOM: NAPSTER, MP3, AND THE NEW PIONEERS OF MUSIC (Basic Books 2001). Even in this extreme case, empirical work is unable to prove conclusively whether the illegal downloading of music files was the main culprit for the decline in CD sales during this period of time. *See, e.g.,* Patrick Mooney, et al., *Napster and its Effects on the Music Industry: An Empirical Analysis*, 6 J. OF SOC. SCI. 303, 303 (2010).

[73] Again, as I noted in a previous footnote (n. 72), this claim is subject to empirical testing; nevertheless, the theoretical rationale in support of my claim is based on signaling theory. Whether literary fan art brings the original work to the attention of potential new fans, or whether fan art generates higher levels of interest in the underlying work to existing fans of the original work, either way the very existence of fan art sends a credible signal to both new fans and old fans about the quality of the original work.

these derivative works syphons off new sales of Hemingway's book or dissuades people from reading the novella. On the contrary, these works breathe new life into Hemingway's story and invite us to read or reread, as the case may be, the old Cuban fisherman's futile struggle with the creatures of the sea.

CONCLUSION: TWO CHEERS FOR FAN ART

This Article has reframed copyright disputes in general—and the problem of literary fan art specifically—in economic or Coasean terms. Specifically, under what conditions do copyright owners get to have veto rights over fan art, and by the same reciprocal token, when do fans get to veto the veto rights of copyright owners when they revisualize or reimagine their favorite literary works? In plain English, who gets to harm whom?

Stated this way, the optimal level of fair use becomes a tractable problem: *we should choose that rule or legal interpretation that minimizes the overall level of harm*. Fan art harms creators who wish to maintain control or veto rights over derivative works, but the potential benefits of fan art far outweigh these potential harms. So, two cheers for fan art: one for rousing our collective imaginations and creating new worlds of beauty; another for expanding freedom and markets.

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DOES IT STILL TAKE TWO TO TANGO? A MODERN INTERPRETATION OF THE BPCIA'S PATENT DANCE

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INTRODUCTION

Since 1996, the annual spending on drugs per capita in the U.S. has been the highest among all the developed countries.[1] In 2017, the number reached $1220 per person in the U.S., making the U.S. pharmaceutical industry a $400 billion market.[2] One of the fastest growing segments of the pharmaceutical industry is biologic drugs, accounting for almost 40% of the U.S. prescription drug spending in 2015.[3] Unlike traditional small-molecule drugs, which are chemically synthesized, most biologic drugs are protein-based macromolecules produced by living cells.[4] In an effort to control the high price of biologics, Congress enacted the Biologics Price Competition and Innovation Act ("BPCIA") in 2009, which provides an abbreviated pathway for follow-on versions of the biologics to enter the market.[5] The BPCIA has initiated a new patent dispute resolution process that has subsequently been termed "the patent dance."[6] The patent dance demands the exchange of information and negotiation before litigation as well as divides the litigation into two phases.[7] Such a carefully calibrated scheme strives to achieve a balance between the interest of incentivizing innovators and the interest of providing more affordable medicine to consumers.[8]

There are normally two parties in biosimilar litigation: the Sponsor who holds patent(s) on a biologic drug and the Applicant who aims to market a follow-on version of the biologic. This Note focuses on the effects of the Supreme Court's recent decision that offers the Applicant the freedom to opt-out of the BPCIA's

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[1] Pharmaceutical spending (indicator), OECD, https://www.oecd-ilibrary.org/social-issues-migration-health/pharmaceutical-spending/indicator/english_998febf6-en (last visited Aug. 20, 2019).

[2] *Id.*

[3] Michelle Hoffmann, *Biosimilars: the cure for sky-high drug prices or a stake in the heart of innovation?*, STAT (Feb. 8, 2018), https://www.statnews.com/2018/02/08/biosimilars-biologics-drug-prices-innovation/.

[4] Thomas Morrow, *Defining the Difference: What Makes Biologics Unique*, BIOTECHNOLOGY HEALTHCARE 24, 25-26 (Sept. 2004).

[5] 42 U.S.C. § 262(k) (2017).

[6] Dennis Crouch, *BPCIA: Patent Dance Steps Becoming a Bit Clearer*, PATENTLY-O (Aug. 16, 2017), https://patentlyo.com/patent/2017/08/patent-becoming-clearer.html.

[7] 42 U.S.C. § 262(l).

[8] Jon Tanaka, "Shall" We Dance? Interpreting the BPCIA's Patent Provisions, 31 BERKELEY TECH. L.J. 659, 680 (2016).

patent dance. Since the Applicant can strategize whether to comply with the patent dance based on the nature of the biologic product, this Note advocates that the district courts should restore the carefully calibrated balance by applying a more lenient pleading standard and facilitating the discovery process. Part I of this Note provides background information on the Hatch-Waxman Act designed for small-molecule drugs, the differences between small-molecules and biologics, the reasons why the Hatch-Waxman Act would prove insufficient for biologics, and the BPCIA's patent dance. Part II analyzes the Supreme Court's interpretation of the patent dance in *Sandoz*. By refusing to order injunctive relief against the Applicant who failed to participate in the patent dance, the Court made the patent dance an optional choice. Part III outlines the strategies on whether and when the Applicant should skip or comply with the patent dance and analyzes the advantages and disadvantages of opting out of the patent dance. Part IV discusses how the foreclosure of the patent dance affects the Sponsor and suggests that the district courts are likely to apply a more lenient pleading standard when the patent dance is abandoned by the Applicant and analyzes the consequences of such a lenient standard. Part V concludes this Note.

I
BACKGROUND OF THE BPCIA AND THE PATENT DANCE

A. The Hatch-Waxman Act

As early as the 1980s, Congress tried to grapple with the growing problem of increasing pharmaceutical costs by passing the Drug Price Competition and Patent Restoration Act of 1984, often referred to as the Hatch-Waxman Act, to make small-molecule drugs more affordable.[9] Since 1938, every new drug must receive FDA approval before commercialization by filing a New Drug Application ("NDA") wherein an innovator company must submit full reports of investigations on the safety and efficacy of a new drug.[10] This requires that innovator companies conduct years of clinical trials and spend millions of dollars on these studies. In contrast, under the Hatch-Waxman Act, generic drug manufacturers only need to file an Abbreviated New Drug Application (ANDA), which permits them to bypass the requirement for safety and efficacy.[11] Instead, generic manufacturers can piggyback on the safety and efficacy data previously submitted by the innovator

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[9] Drug Price Competition and Patent Term Restoration Act of 1984, Pub. L. No. 98-417, 98 Stat. 1585 (codified as amended in scattered sections of 21 U.S.C. & 35 U.S.C.).

[10] 21 U.S.C. § 355(b)(1) (2018).

[11] *Id.* § 355(j)(2)(A).

companies.[12] Generally, an ANDA only requires data to show that the generic drug is bioequivalent to the branded drug and has the same conditions of use, active ingredient, route of administration, dosage form, dosage strength, and labeling as the branded drug.[13]

The Hatch-Waxman Act has proven quite successful in making small-molecule drugs more affordable for patients.[14] Before the passage of the Hatch-Waxman Act, only 35% of the top-selling branded drugs whose patents had expired had generic counterparts.[15] By contrast, the generic drugs' share of U.S. prescriptions reached 85% in 2016.[16] The competitive pressure asserted by generic drugs causes the price of a branded drug to decline by an average of 80% within one year of the generic drug's introduction into the market.[17] Yet, even in 2016, people in the U.S. were spending far more on branded drugs compared to generic drugs, as branded drugs are much more expensive: total spending on generic drugs was only $50 billion compared to $334 billion on branded drugs.[18]

B. Biologics and the BPCIA

In addition to small-molecule drugs, biologic drugs have continued to grow rapidly and play an increasingly significant role in the modern therapeutic market. The BPCIA defines biologics as viruses, therapeutic serums, toxins, antitoxins, vaccines, blood, blood components or derivatives, allergenic products, and proteins that are designed to combat a variety of diseases and disorders.[19] Most modern biologics are protein-based macromolecules that are produced in genetically engineered living cells.[20] For instance, adalimumab, a blockbuster drug sold under the brand name Humira, is a monoclonal antibody targeting tumor necrosis factor-

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[12] *Id.*

[13] *Id.* at §§ 355(j)(2)(A)(i)-(v).

[14] Ryan Timmis, The Biologics Price Competition and Innovation Act: Potential Problems in the Biologic-Drug Regulatory Scheme, 13 NW. J. TECH. & INTELL. PROP. 215, 217 (2015).

[15] Garth Boehm et al., Development of the generic drug industry in the US after the Hatch-Waxman Act of 1984, 3 ACTA PHARMACEUTICA SINICA B 297, 298 (2013).

[16] Avik Roy, *The Competition Prescription: A Market-Based Plan for Affordable Drugs*, FREOPP (May 16, 2017), https://freopp.org/a-market-based-plan-for-affordable-prescription-drugs-931e31024e08.

[17] *Id.*

[18] *Id.*

[19] 42 U.S.C. § 262(i)(1) (2017).

[20] Andrew W. Mulcahy et al., *Biosimilar Cost Savings in the United States*, 7 RAND HEALTH Q. 3 (2018), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC6075809/.

alpha (TNFα) to primarily treat rheumatoid arthritis and Crohn's disease.[21] In general, biologic drugs are much more expensive than small-molecule drugs.[22] For example, to treat arthritis, the biologic drug Enbrel costs $20,000 per year while the most expensive small-molecule drug only costs $300 per year.[23] In 2015, almost 40% of U.S. prescription drug spending was for biologic drugs.[24] In 2017, eight out of the fifteen globally best-selling drugs were biologics.[25] Since 2013, Humira alone has contributed more than $10 billion annually to biologics sales and this number has continued to rise, approaching $20 billion in 2018.[26]

Like the generic drugs of small-molecules, the lucrative market of biologics continually attracts follow-on versions to compete with the branded biologics, which is likely, in turn, to reduce the high price of biologics.[27] However, the Hatch-Waxman Act failed to provide a remedy for the high biologics prices by boosting competition for two reasons: the structural complexity of biologics and the intrinsic uniqueness of their manufacturing processes.[28] First of all, it is impossible for a competitor to manufacture an identical version of the active ingredient in the branded biologic drug as required by the Hatch-Waxman Act.[29] Protein-based biologics are made of amino acid sequences, which can be hundreds of times larger than small-molecule drugs.[30] For instance, adalimumab, the active ingredient in Humira, has a molecular weight of 144,190.3 g/mol while the small-molecule drug to treat Hepatitis C, under the brand name Sovaldi, has a molecular weight of 529.5

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[21] *Adalimumab*, WIKIPEDIA, https://en.wikipedia.org/wiki/Adalimumab (last visited Aug. 30, 2019).

[22] Ude Lu, Note, Biologics Price Competition and Innovation Act: Striking a Delicate Balance Between Innovation and Accessibility, 15 MINN. J.L. SCI. & TECH. 613, 633 (2014).

[23] *See id.*; *see also* Tori Marsh, *With No Humira Generic in Sight, Here's How You Can Save Now*, GOODRX (Sept. 22, 2018), https://www.goodrx.com/blog/humira-generic-availability-how-to-save/.

[24] Hoffmann, *supra* note 6.

[25] *See* Alex Philippidis, *The Top 15 Best-Selling Drugs of 2017*, GENETIC ENGINEERING & BIOTECHNOLOGY NEWS (Mar. 12, 2018), https://www.genengnews.com/a-lists/the-top-15-best-selling-drugs-of-2017/.

[26] Bob Herman, *Humira sales approach $20 billion*, AXIOS (Jan. 25, 2019), https://www.axios.com/abbvie-humira-2018-sales-20-billion-e4039176-baeb-44ff-b4fe-1b63005283b9.html.

[27] Mulcahy, *supra* note 20, at 3.

[28] *See* Dov Hirsch, *The Riddle of the Mysterious Patent Dance Wrapped in an Enigma: Is the Patent Dance of the BPCIA Optional or Mandatory?*, 27 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 645, 660-61 (2017).

[29] *Id.* at 654.

[30] Jason Kanter & Robin Feldman, *Understanding and Incentivizing Biosimilars*, 64 HASTINGS L.J. 57, 63-64 (2012).

g/mol.[31] Furthermore, the three-dimensional protein structure resulting from correct folding of the amino acid chain adds more complexity to the structure.[32] Due to their structural complexity, biologics cannot be synthesized from known substances by traditional chemical maneuvers like the small-molecule drugs.[33] Instead, they are produced by relying on living cells' inherent abilities to catalyze five to ten thousand biochemical reactions, compared to the five to ten chemical reactions necessary to synthesize small-molecule drugs.[34] Moreover, biologics "tend to be heat sensitive and susceptible to microbial contamination."[35] Therefore, it is almost impossible to obtain two identical biologics from different manufacturing batches.[36] Even if this were possible, current analytical techniques may not be able to detect all the structural differences between two biologics to satisfy a Hatch-Waxman equivalency requirement of biologics.[37] However, a biologic follow-on that is highly similar to the branded biologic drug might be sufficient to treat patients without any clinically meaningful differences in terms of safety, purity, and potency.[38] Thus, the correct terminology for these follow-on versions of biologics is "biosimilars," rather than "generics."[39]

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[31] Alexej Ladonnikov, Comment, *The Biosimilar Patent Dance – If You Don't Dance, You're No Friend of Mine*, 35 SANTA CLARA HIGH TECH. L.J. 135, 138-39 (2018).

[32] Kanter & Feldman, *supra* note [30], at 65.

[33] Hirsch, *supra* note [28], at 651.

[34] Felix Shin, *Leaping from the "Patent Cliff" into the "Global Drug Gap": Overcoming Exclusivity To Provide Affordable Biosimilars*, 37 LOY. L.A. INT'L & COMP. L. Rev. 419, 423 (2016).

[35] *What Are "Biologics" Questions and Answers*, FDA: CENTER FOR BIOLOGICS EVALUATION AND RESEARCH (CBER) (Feb. 2, 2018), https://www.fda.gov/about-fda/center-biologics-evaluation-and-research-cber/what-are-biologics-questions-and-answershttps://www.fda.gov/aboutfda/centersoffic.

[36] Hirsch, *supra* note [28], at 661.

[37] U.S. FOOD & DRUG ADMIN., SCIENTIFIC CONSIDERATIONS IN DEMONSTRATING BIOSIMILARITY OF A THERAPEUTIC PROTEIN DRUG TO A REFERENCE PRODUCT: GUIDANCE FOR INDUSTRY 5 (2015).

[38] U.S. FOOD & DRUG ADMIN., QUESTIONS AND ANSWERS ON BIOSIMILAR DEVELOPMENT AND THE BPCI ACT: GUIDANCE FOR INDUSTRY 5 (2018) ("Differences between the formulation of a proposed biosimilar product and the reference product may be acceptable. A 351(k) application must contain information demonstrating that the biological product is highly similar to the reference product notwithstanding minor differences in clinically inactive components.").

[39] *See* 42 U.S.C. § 262(i)(2) (2017) (stating that a biological product gains biosimilar status when "there are no clinically meaningful differences between the biological product and the reference product in terms of the safety, purity, and potency of the product"); *see also* Kanter & Feldman, *supra* note [30], at 59.

Another reason for the inapplicability of the Hatch-Waxman Act to biologics is that process patents cannot be litigated under the Hatch-Waxman Act.[40] Under the Hatch-Waxman Act, innovator companies are required to list all patents covering their new drugs in a publication known as the "Orange Book" after their drugs are approved by the FDA.[41] As a result, generic manufacturers are put on notice about which patents the innovator companies intend to assert, and the parties can litigate any patents from the Orange Book.[42] However, process patents, claiming how a drug is made or manufactured, cannot be listed in the Orange Book, and thus, cannot be litigated under the Hatch-Waxman Act.[43] This is because small-molecule drugs are made in a relatively straightforward manner so that the process patents would not be that important as several alternative processes could feasibly arrive at the equivalent final small-molecule drug.[44] In contrast to small-molecule drugs, process patents are vital for biologic innovators to maintain their exclusive protection under patent law.[45] Unlike small-molecule drugs, merely claiming the structure of a biologic would not give the inventor sufficient intellectual property protection because there are more potential design-arounds for biologics.[46] As discussed earlier, a biologic drug is usually hundreds of times larger than a small-molecule drug, and hence, there are more opportunities for competitors to design minor modifications of a branded biologic without changing the therapeutic effect.[47] Although broadening the claim scope might cover these design-arounds, the inventor would face challenges in proving that they had possession of the entire claimed invention and the disclosure enabled another to make or use the entire claimed invention at the time of filing the patent application.[48] By contrast, process claims can solve this problem because a small variation in the manufacturing process of a biologic may bring about dramatic changes to the purity, safety, and efficacy of the resulting product.[49] Such drastic

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[40] *See* Nathan Mannebach, Comment, *We Shall Dance, Unless You Choose Not To*, 65 KAN. L. REV. 687, 695 (2017).

[41] *See* 21 U.S.C. § 355(b)(1) (2018); *see also* Kate S. Gaudry, *Exclusivity Strategies and Opportunities in view of the Biologics Price Competition and Innovation Act*, 66 FOOD & DRUG L.J. 587, 602 (2011).

[42] *See* Mannebach, *supra* note [40], at 695-96.

[43] *See id.* at 696; *see also* 21 C.F.R. § 314.53(b)(1) (2019).

[44] *See* Mannebach, *supra* note [40], at 696.

[45] *Id.* at 697.

[46] Gaudry, *supra* note [41], at 614.

[47] *Id.*

[48] *Id.* at 590.

[49] *Id.* at 627.

changes occurred in Eprex, a biologic drug primarily sold in Europe.[50] It is a synthetic version of human erythropoietin protein, which stimulates the production of red blood cells to treat anemia.[51] The original process entailed Eprex being formulated, stored, and shipped in human serum albumin.[52] In 1998, the human serum albumin was replaced with polysorbate 80 and glycerin to avoid potential risk of contamination by the causative agent of Creutzfeldt-Jakob disease.[53] Unfortunately, such a shift in the process caused an unexpected immune response in many patients, meaning that the administration of the drug caused the patients' bodies to generate antibodies that began to attack the patients' own erythropoietin, leading to exacerbated anemia.[54] Therefore, it would be very challenging for a follow-on competitor to design-around a process patent to result in a biosimilar product while avoiding potentially deleterious effects of process changes.[55] Moreover, a process patent can also protect analytical testing methods that are done at key checkpoints during the manufacturing process to ensure that process intermediates are suitable to carry on to the next step.[56] Accordingly, new legislation would be needed not only to model the success of the Hatch-Waxman Act, but also to take into account the differences of composition and process between the small-molecule drugs and biologic drugs.

In 2009, Congress passed the BPCIA to provide an abbreviated approval pathway for a follow-on biological product that is sufficiently similar to a branded biologic to enter the market.[57] Before a new biologic drug can be introduced into the market, the innovator company must submit a Biologic License Application ("BLA") to the FDA to prove that the drug is safe, pure, and potent.[58] Under the BPCIA, a follow-on manufacturer, referred to as the "Biosimilar Applicant" ("Applicant"), can file an abbreviated Biologic License Application ("aBLA") to show its product is biosimilar to or interchangeable with the branded biologic, referred to as the "reference product."[59] Therefore, the Applicant can significantly

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[50] *See* Kanter & Feldman, *supra* note [30], at 66.

[51] *Eprex*, CANOE.COM, https://chealth.canoe.com/drug/getdrug/eprex (last visited Aug. 30, 2019).

[52] Kanter & Feldman, supra note [30], at 66.

[53] *Id*.

[54] *Id.* at 66-67.

[55] Gaudry, *supra* note [41], at 627.

[56] Hirsch, *supra* note [28], at 656.

[57] *See* 42 U.S.C. § 262(k) (2017).

[58] *See* 42 U.S.C. § 262(a)(2); *see also* 21 C.F.R. § 601.2(a) (2016).

[59] A biological product is interchangeable to a reference product when "the biological product may be substituted for the reference product without the intervention of the health care

save on the cost of getting their biologics approved by piggybacking on the data submitted to the FDA from the innovator company, known as the "Reference Product Sponsor" ("Sponsor").[60] For example, the cost of developing a biosimilar drug ranges from $100 million to $250 million, compared to $1.9 billion to develop a new biologic.[61]

C. The Patent Dance Provision

The BPCIA provides a carefully calibrated scheme to facilitate patent litigation between the Applicant and the Sponsor before the traditional infringing activities take place, such as making, using, offering to sell, selling, or importing.[62] This allows either for the Applicant to clear the roadblocks before marketing or for the Sponsor to stop the Applicant before actual damages occur.[63] Unlike the Hatch-Waxman Act, under which the branded company can sue any patent under the Orange Book all at once, the BPCIA steers the parties towards two phases of patent litigation.[64] The first phase follows the Applicant's submission of the aBLA to the FDA and the second phase is triggered by the Applicant's commercial marketing.[65]

To initiate the first phase of litigation, the Applicant and the Sponsor are required to engage in an elaborate back-and-forth process of information exchange, referred to as the "patent dance" by practitioners (See Figure 1).[66] First, after the FDA accepts the Applicant's application for review, within 20 days the Applicant should provide the Sponsor with a copy of the application and confidential information that describes the manufacturing process of the Applicant's biosimilar product.[67] Such information allows the Sponsor to determine whether the biosimilar would infringe the patents that the Sponsor owns pertaining to the

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provider who prescribed the reference product," 42 U.S.C. § 262(i)(3). The difference between a biosimilar and an interchangeable is when a patient is switched to a biosimilar product from the reference product, the patient's health care providers must take affirmative action whereas such action is not required to switch to an interchangeable product. *See id.*; 42 U.S.C. § 262(k)(2).

[60] 42 U.S.C. § 262(l)(1)(A).

[61] Erwin A. Blackstone & Joseph P. Fuhr, *The Economics of Biosimilars*, 6 AM. HEALTH & DRUG. BENEFITS 469, 471-73 (2013).

[62] *See* 42 U.S.C. § 262(l).

[63] *See* 35 U.S.C. § 271(e)(2)(C) (2018) (making the submission of the biosimilar application an artificial act of infringement).

[64] *See id.* at §§ 262(l)(6), (8).

[65] *See id*.

[66] Hirsch, *supra* note [28], at 664.

[67] 42 U.S.C. § 262(l)(2)(A).

reference product.[68] Thereafter, the Sponsor is given 60 days to provide the Applicant with a list of patents that they believed to be infringed by the biosimilar or by the process of manufacturing the biosimilar and a list of patents that the Sponsor is willing to license.[69] Then, within 60 days of receiving the list from the Sponsor, the Applicant is required to respond with a detailed statement explaining why they are not liable, assuming they believe this to be true, by asserting that the Sponsor's patents are invalid, unenforceable, or not infringed, or that the biosimilar product will not enter the market until the patents expire.[70] The Applicant is also required to respond to the Sponsor's licensing offer.[71] In addition, the Applicant may, but need not, supplement an additional list of patents which are relevant to the biosimilar product, but omitted by the Sponsor.[72] Next, the Sponsor is given an opportunity to provide its own contentions of validity, enforceability, or infringement on each of the identified patents within 60 days.[73]

Following this exchange, the Applicant and the Sponsor should "engage in good faith negotiations" to determine which patents, if any, will be litigated immediately.[74] The BPCIA also contemplates scenarios in which the parties fail to reach an agreement. In this case, the parties will simultaneously exchange lists of patents that they would like to litigate in the first phase.[75] The Applicant should inform the Sponsor of the number of patents it wants to litigate in the first phase, thereby setting a ceiling for how many patents the Sponsor can list.[76] If the Applicant does not list any patent to be litigated immediately, the Sponsor can list one patent.[77]

Only after the patent dance ends can the first phase of litigation begin.[78] Within 30 days of reaching an agreement or exchanging patent lists, the Sponsor must file a complaint to proceed with the first phase of litigation.[79] The BPCIA

[68] *Id.* at § 262(l)(1)(D).
[69] *Id.* at § 262(l)(3)(A).
[70] *Id.* at § 262(l)(3)(B)(ii).
[71] *Id.*
[72] *Id.* at § 262(l)(3)(B)(i).
[73] *Id.* at § 262(l)(3)(C).
[74] *Id.* at § 262(l)(4)(A).
[75] *Id.* at § 262(l)(5)(B)(i).
[76] *Id.* at §§ 262(l)(5)(A), (B)(ii).
[77] *Id.* at § 262(l)(5)(B)(ii).
[78] *See id.* at § 262(l)(6).
[79] *Id.*

treats the submission of the biosimilar application to the FDA as an artificial infringement act.[80]

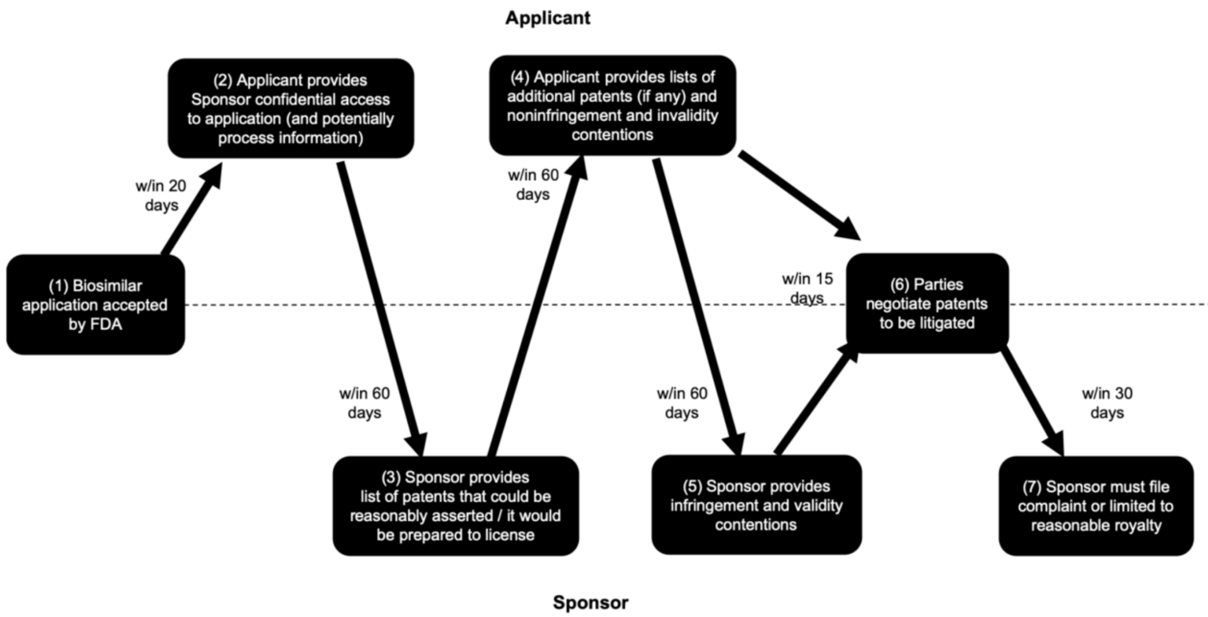

Figure 1. Overview of the patent dance.

The first phase of litigation allows the parties to tackle the most important patents while the biosimilar application is still under FDA review.[81] The patents that are enumerated on the original § 262(l)(3) lists, but not litigated in the first phase, can be litigated in the second phase.[82] The second phase of litigation is triggered by the Applicant's notice of commercial marketing to the Sponsor.[83] The Applicant must provide such notice no later than 180 days before the date of the first commercial marketing of the biosimilar product.[84] Moreover, this phase enables the Sponsor to seek a preliminary injunction to prevent the Applicant from launching the biosimilar "until the court decides the issue of patent validity, enforcement, and infringement."[85]

The BPCIA also provides incentives to comply with the patent dance by establishing the consequences for those failing to participate. If the Applicant fails the first step of the patent dance by refusing to disclose its aBLA application and/or manufacturing information to the Sponsor, the Sponsor can bring a

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[80] *Id.* at § 262(e)(2)(C)(i).
[81] *See* Hirsch, *supra* note [28], at 674.
[82] *Id.*
[83] 42 U.S.C. § 262(l)(8)(A).
[84] *Id.*
[85] *Id.* at § 262(l)(8)(B).

declaratory judgement action on any patent that claims the biologic or a use of the biologic.[86] Meanwhile, if the Applicant provides the application and manufacturing information but fails to participate in a subsequent step, such as providing noninfringement or invalidity contentions, the Sponsor can bring a declaratory judgement action on any patent identified on the Sponsor's § 262(l)(3)(A) list.[87]

An illustrative example of a successful patent dance comes from the recent litigation between AbbVie Inc. ("AbbVie") and Boehringer Ingelheim International GmbH ("Boehringer Ingelheim"). AbbVie is the Sponsor for the best-selling biologic drug, adalimumab, under the brand name Humira.[88] On October 27, 2016, Boehringer Ingelheim applied to the FDA for its own biosimilar based off adalimumab.[89] Four days after the FDA accepted Boehringer Ingelheim's aBLA, on January 13, 2017, Boehringer Ingelheim provided AbbVie with confidential access to documents related to the application.[90] On March 13, 2017, AbbVie sent the § 262(l)(3) list of seventy-two patents as potentially infringed if Boehringer Ingelheim intended to bring Boehringer Ingelheim's aBLA product into the market.[91] Shortly after, Boehringer Ingelheim responded with a statement claiming either noninfringement or invalidity of the identified patents.[92] After AbbVie responded with rebuttal arguments, the parties exchanged lists of five patents on each side.[93] This list exchange led to eight chosen patents due to two patents in common between both of the lists.[94] On August 2, 2017, AbbVie filed a complaint on the eight patents in the District Court of Delaware.[95] Although the parties settled before finishing the first phase of litigation, if Boehringer Ingelheim provided the 180-day commercial market notice, the parties could have resolved the disputes over the remaining 64 patents in the second phase of litigation.[96]

Although Congress is silent on why the BPCIA includes such an intricate patent dance procedure, a feature absent from the Hatch-Waxman Act, the legislative history suggests that the purpose of the patent dance is to efficiently

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[86] *Id.* at § 262(l)(9)(C).
[87] *Id.* at § 262(l)(9)(B).
[88] Complaint at 3, AbbVie Inc. v. Boehringer Ingelheim Int'l GmbH, No. 17-cv-01065 (D. Del. Aug. 2, 2017).
[89] *Id.* at 12.
[90] *Id.* at 13.
[91] *Id.* at 14.
[92] *Id.*
[93] *Id.* at 19.
[94] *Id.*
[95] *Id.* at 1, 21.
[96] *Id.* at 20.

resolve patent disputes before marketing the biosimilar product.[97] Aiming to balance the interest of incentivizing innovators and the interest of providing affordable medicine to consumers, the patent dance is also a compromise between the Sponsors and Applicants.[98] Both sides agreed that the patent dance, necessary for timely dispute resolution, would be beneficial.[99] The patent dance ensures that only the most pertinent patents will be litigated in the first phase.[100] On one hand, the Sponsor can fire its strongest arguments against the Applicant, and if it wins, the Sponsor can efficiently halt the Applicant through an injunction without the need to defend all of its patents at once, saving money and time.[101] Even if it loses, the Sponsor has another chance to fight on other patents in the second phase.[102] On the other hand, the patent dance bestows upon the Applicant more control over which patents, or at least how many patents, will be litigated immediately.[103] The Applicant can better prepare its arguments by concentrating resources on the narrow set of patents. In addition, the patent dance may take up to 230 days, during which time no suit may commence.[104] Hence, the Applicant could exploit the adversary's information from the patent dance "while protected by the statute's safe harbor from litigation."[105] Moreover, compared to traditional litigation, the Applicant has more flexibility to delay commercial marketing to protect its investment based on information gathered from the patent dance and the result of the first phase of litigation.[106]

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[97] *See* Hirsch, *supra* note 28, at 681-82. In a congressional hearing, Representative Anna Eshoo stated that the patent dance provision was intended "to ensure that litigation surrounding relevant patents will be resolved expeditiously and prior to the launch of the biosimilar product, providing certainty to the applicant, the reference product manufacturer, and the public at large." *Id.*

[98] *See* Tanaka, *supra* note 8.

[99] *Id.* at 680-81. In a House hearing, Dr. David Schenkein from Genentech, arguing on behalf of the Biotechnology Innovation Organization, noted the importance of resolving patent disputes prior to marketing approval. *Id.* In the same hearing, Bruce Downey, CEO of a generic manufacturer, argued on behalf of the Generic Pharmaceutical Association and echoed the importance of early patent resolution. *Id.* at 681.

[100] Hirsch, *supra* note 28, at 674.

[101] *Id*.

[102] *Id*.

[103] Tanaka, *supra* note 8, at 683.

[104] Hirsch, *supra* note 28, at 675.

[105] Amgen Inc. v. Sandoz Inc. (*Amgen I*), No. 14-cv-04741-RS, 2015 WL 1264756, at *6 (N.D. Cal. Mar. 19, 2015), *aff'd in part, vacated in part, remanded*, 794 F.3d 1347 (Fed. Cir. 2015), *rev'd in part, vacated in part*, 137 S. Ct. 1664 (2017), and *aff'd*, 877 F.3d 1315 (Fed. Cir. 2017).

[106] *Id.*

II
SANDOZ V. AMGEN

Sandoz Inc. v. Amgen Inc. 137 S. Ct. 1664 (2017) is a landmark case interpreting the BPCIA's patent dance. The Supreme Court's holding that failure to complete the patent dance would not lead to injunctive relief has offered the Applicant the freedom to opt out of the patent dance.[107] The foundations of the biotechnology industry have been shaken ever since.

A. Factual Background

Amgen Inc. ("Amgen") has been producing and selling the biologic drug filgrastim under the brand name Neupogen since 1991.[108] Filgrastim is produced by recombinant-DNA technology to treat low blood neutrophils in patients.[109] In May 2014, Sandoz Inc. ("Sandoz"), a generic manufacturer, filed an aBLA with the FDA seeking approval of its own biosimilar of filgrastim under the brand name Zarxio.[110] Shortly after receiving notice that the FDA had accepted its application, Sandoz notified Amgen that it had filed a biosimilar application that was anticipated to receive FDA approval in the first or second quarter of 2015.[111] Importantly, Sandoz informed Amgen of its intention to opt out of the patent dance, thereby refusing to provide its application and manufacturing information to Amgen.[112] In October 2014, Amgen filed a patent infringement suit against Sandoz in the Northern District of California.[113] One of Amgen's claims was unlawful competition for unlawful business practices under California state law because Sandoz allegedly violated the BPCIA by failing to comply with the patent dance established in 35 U.S.C. § 262(l).[114] Based on this state law claim, Amgen further sought injunctive relief to prevent Sandoz from launching its biosimilar product.[115]

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[107] *See generally* Sandoz Inc. v. Amgen Inc., 137 S. Ct. 1664.
[108] Amgen Inc. v. Sandoz Inc. (*Amgen II*), 794 F.3d 1347, 1352 (Fed. Cir. 2015).
[109] *Filgrastim*, WIKIPEDIA, https://en.wikipedia.org/wiki/Filgrastim - cite_note-AHFS2016-1 (last visited Aug. 30, 2019).
[110] *Amgen II*, 794 F.3d at 1352-53.
[111] *Id.*
[112] *Id.* at 1353.
[113] *Id.*
[114] *Id.*
[115] *Id.*

B. The Federal Circuit's Decision

The Federal Circuit affirmed the District Court's dismissal of Amgen's motion for injunctive relief because the Applicant is not required under the BPCIA to disclose its biosimilar application and manufacturing information.[116] Judge Lourie explained that the language stating "the subsection (k) applicant *shall* provide to the reference product sponsor a copy of the application" in 42 U.S.C. § 262(l)(2)(A) could not be read in isolation (emphasis added).[117] When interpreting this paragraph in connection with 42 U.S.C. § 262(l)(9)(C) and 35 U.S.C. § 271(e)(2)(C)(ii), the term "shall" does not mean "must."[118] 42 U.S.C. § 262(l)(9)(C) sets forth a direct consequence of failing to comply with the patent dance, providing that, "[i]f a subsection (k) applicant fails to provide the application and information required under paragraph (2)(A)," then the Sponsor, but not the Applicant, can bring a declaratory judgment action on "any patent that claims the biological product or a use of the biological product."[119] Furthermore, 35 U.S.C. § 271(e)(2)(C)(ii) makes the Applicant's failure to disclose the information required by the first step of the patent dance an artificial "act of infringement" of "a patent that could be identified" by the Sponsor in the patent dance.[120] Based on 35 U.S.C. § 271(e)(4), Judge Lourie concluded both 42 U.S.C. § 262(l)(9)(C) and 35 U.S.C. § 271(e)(2)(C)(ii) provide only one remedy for failing to disclose and that is a claim of patent infringement.[121] Moreover, if the term "shall" is construed as "must," 42 U.S.C. § 262(l)(9)(C) and 35 U.S.C. § 271(e)(2)(C)(ii) would be superfluous, and statutes should be interpreted to avoid rendering any provision superfluous.[122] Thus, drafters of the BPCIA contemplated a scenario where the

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[116] *Id*. at 1362.

[117] *Id*. at 1354-55.

[118] *Id*. at 1355.

[119] *Id.* at 1356 (quoting 42 U.S.C. § 262(l)(9)(C)).

[120] 35 U.S.C. § 271(e)(2)(C)(ii) provides that "[i]t shall be an act of infringement to submit" a biosimilar or interchangeable application "if the applicant for the application fails to provide the application and information required under" 42 U.S.C. § 262(l)(2)(A); *Amgen II*, 794 F.3d at 1356.

[121] 35 U.S.C. § 271(e)(4) provides that remedies prescribed in this paragraph "are the only remedies which may be granted by a court for an act of infringement described in paragraph (2)[.]"; *Amgen II*, 794 F.3d at 1356.

[122] *Id.*

Applicant failed to disclose the application and manufacturing information, and the sole remedy for the Sponsor is declaratory judgment.[123]

However, Judge Newman dissented and concluded that compliance with the patent dance is mandatory.[124] Judge Newman stated that 42 U.S.C. § 262(l)(9)(C) and 35 U.S.C. § 271(e)(2)(C)(ii) just provide one relief for non-compliance, but "do not ratify non-compliance." [125] Judge Newman noted that 42 U.S.C. § 262(l)(9)(C) only provides declaratory action by the Sponsor for a "patent that claims the biological product or a use of the biological product," but not a patent that claims manufacturing process.[126] As discussed in Part I, process patents are the most important patents for biologics, and thus, 42 U.S.C. § 262(l)(9)(C) cannot be understood to provide the sole remedy.[127] Further, Judge Newman noted that several provisions in the same paragraph use the term "may" to indicate the act is permissive, thereby leaving the term "shall" to refer to a mandatory act.[128] More importantly, Judge Newman believed that the BPCIA was enacted to achieve the balance of obligations and benefits.[129] When the Applicant benefits from piggybacking on the Sponsor's data submitted to the FDA, the Applicant should not circumvent its obligations of complying with procedures designed by the BPCIA.[130] Therefore, declining injunctive relief when the Applicant fails its obligation would strike the balance envisioned by the BPCIA.[131]

C. The Supreme Court's Decision

Amgen timely appealed from the Federal Circuit's affirmance of the denial of a preliminary injunction and the Supreme Court granted certiorari.[132] The Supreme Court affirmed the Federal Circuit's decision that injunctive relief was not available under federal law to enforce the patent dance, but based on slightly different reasons.[133] First, the Supreme Court found the interpretation of 35 U.S.C. § 271(e)(2)(C) by the Federal Circuit was incorrect.[134] The Court concluded that it

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[123] *Id.*
[124] *Id.* at 1363 (Newman, J., concurring in part, dissenting in part).
[125] *Id.* at 1366.
[126] *Id.* at 1364.
[127] *Id.*
[128] *Id.* at 1365 (citing Anderson v. Yungkau, 329 U.S. 482, 485 (1947)).
[129] *Id.* at 1366.
[130] *Id.*
[131] *Id.*
[132] Sandoz Inc. v. Amgen Inc., 137 S. Ct. at 1673.
[133] *Id.* at 1674.
[134] *Id.*

was the Applicant's submission of a biosimilar application to the FDA, rather than its failure to disclose, that constituted an act of infringement.[135] It follows that 35 U.S.C. § 271(e)(2)(C) does not provide an exclusive remedy for failure to disclose.[136] Rather, the Court relied on 42 U.S.C. § 262(l)(9)(C), which provides immediate declaratory judgment action as a remedy for the Sponsor when the Applicant refuses to engage in the patent dance.[137] The Court reasoned that this action is an appropriate remedy because it shifts the control over the scope and timing of litigation from the Applicant to the Sponsor.[138] More importantly, this action deprives the Applicant of the certainty of the legal consequences prior to marketing, thereby putting the Applicant at risk of losing its marketing investment without knowing if its commercial activities would be barred as a result of the litigation.[139] This reasoning indicates that BPCIA not only benefits the Applicant by abbreviating the regulatory pathway, but also reprimands the Applicant for failing to comply with its procedures, which responds to Judge Newman's dissenting opinion that declining injunctive relief would strike a balance between the BPCIA's benefits and obligations.

Furthermore, the Court concluded that an expressive remedy in 42 U.S.C. § 262(l)(9)(C), declaratory judgment by the Sponsor, "excludes all other federal remedies, including injunctive relief."[140] The Court cited the canon of statutory interpretation that when "a statute expressly provides a remedy, courts must be especially reluctant to provide additional remedies."[141] Therefore, the statute's explicit mention of declaratory judgment action and silence on any other remedies indicates that Congress acted intentionally to deny injunctive relief under federal law.[142]

Finally, the Court held that Amgen's state claims of unfair competition should be remanded to consider whether noncompliance with the patent dance would be treated as "unlawful" under California law.[143] On remand, the Federal

[135] *Id.*
[136] *Id.* at 1675.
[137] *Id.*
[138] *Id.*
[139] *Id.*
[140] *Id.*
[141] *Id.* (quoting Karahalios v. Fed. Emps., 489 U.S. 527, 533 (1989)).
[142] *Id.*
[143] *Id.* at 1676.

Circuit held that BPCIA preempts state law remedies, and thus, injunctive relief is also not available under state law.[144]

III
EFFECTS OF *SANDOZ* ON THE APPLICANT SIDE –WHETHER TO DANCE

The decision of *Sandoz* has effectively made the patent dance optional because the Sponsor's only remedy is to bring a declaratory judgment action when the Applicant opts out of the patent dance.[145] The Applicant is granted two options: either to disclose all relevant information to the Sponsor and divide the litigation into two phases or to leave the Sponsor in the dark and force the Sponsor to bring suits on all patents against the Applicant at once. Therefore, the Applicant can strategize and decide whether or not it is advantageous to engage in the patent dance under certain circumstances.

Indeed, companies do not always adhere to the same position on whether to fully comply with the patent dance. They often alter their attitudes towards the patent dance based on their financial stake, their role as either the Sponsor or the Applicant, and the specific biosimilars being litigated.[146] For instance, in *Amgen, Inc. v. Genentech, Inc.*, No. CV 17-7349, 2018 WL 910198 (C.D. Cal. Jan. 11, 2018), Amgen, who was the Sponsor and who previously insisted on enforcing the patent dance in *Sandoz*, was the Applicant in this biosimilar litigation. The dispute was initiated by Amgen's application of its biosimilar product, which was based on Genentech Inc. ("Genentech")'s cancer therapy biologic.[147] The parties participated in multiple steps of the patent dance as outlined by the BPCIA.[148] However, when both parties failed to reach an agreement about which patents should be litigated immediately, Amgen, the Applicant, did not provide a list of patents that it believed needed to be litigated in the first phase as required by 42 U.S.C. § 262(l)(5)(A).[149] As a result, Amgen failed to fully abide by the patent dance even though it demanded full compliance by its adversary in *Sandoz*.[150] Additionally, Sandoz, the Applicant who failed to engage in the patent dance in *Sandoz*,

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[144] Amgen Inc. v. Sandoz Inc. (*Amgen III*), 877 F.3d 1315, 1326 (2017).

[145] Sandoz Inc. v. Amgen Inc., 137 S. Ct. at 1674-75.

[146] Sanya Sukduang & Thomas J. Sullivan, *The Patent Dance*, FINNEGAN (July 2018), https://www.finnegan.com/en/insights/the-patent-dance-article.html.

[147] Amgen Inc. v. Genentech, Inc., No. CV 17-7349-GW(AGrx), 2018 WL 910198, at *1 (C.D. Cal. Jan. 11, 2018).

[148] *Id.* at *2.

[149] *Id.*

[150] *Id.*

maintained the role of Applicant in the litigation against AbbVie and fully complied with patent dance in this infringement suit.[151]

A. The Benefits of Skipping the Patent Dance

The biggest incentive for the Applicant to forego the patent dance is to expedite market entry.[152] As of July 2019, twenty-six suits related to biosimilars have been filed.[153] Of these suits, only five Applicants completely opted out of the patent dance (i.e., refused to provide access to aBLA and/or manufacturing information), but many of the Applicants engaged in a partial dance (i.e., provided access to aBLA and/or manufacturing information but failed to participate in subsequent steps).[154] Despite the differences of the allegedly infringing products and parties, all the Sponsors in these litigations have relatively small, known patent portfolios.[155] Therefore, there would be no need to separate the litigation into two phases. Rather than waiting for 230 days to finish all the steps required by the patent dance, it is in the Applicant's best financial interest to accelerate the litigation to clear the roadblocks barring its market entry, especially when the Applicant anticipates its biosimilar will gain FDA approval in the short-term.[156] Secondly, this strategy may shelter the Applicant from an infringement claim against some of its patents.[157] Since the Sponsor would have no idea how the Applicant's biosimilar is manufactured, the Sponsor may forego asserting a patent that would have been otherwise asserted had the Sponsor been privy to the information.[158] However, as will be discussed in Part IV, the Sponsor may choose

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[151] Complaint at 17-23, AbbVie Inc. v. Sandoz Inc., No. 18-cv-12668 (D.N.J. Aug. 10, 2018).

[152] Tanaka, *supra* note [8], at 684-85.

[153] *BPCIA Litigations*, BIG MOLECULE WATCH (last visited July 29, 2019), https://www.bigmoleculewatch.com/bpcia-patent-litigations.

[154] *See id.* The five biosimilar litigations in which the Applicants skipped the patent dance are: Sandoz v. Amgen over the biosimilar of filgrastim (Neupogen), Janssen v. Samsung Bioepis over the biosimilar of infliximab (Remicade), Genentech v. Sandoz over the biosimilar of rituximab (Rituxan), Amgen v. Adello over the biosimilar of filgrastim (Neupogen), and Immunex v. Samsung Bioepis over the biosimilar of etanercept (Enbrel).

[155] *See Amgen I*, 2015 WL 1264756, at *3 (N.D. Cal. Mar. 19, 2015) (asserting only one patent against Sandoz); Complaint at 7-8, Janssen Biotech, Inc. v. Samsung Bioepis Co., No. 17-cv-03524 (D.N.J. May 17, 2017) (asserting three patents against the Applicant); Complaint at 11-13, Immunex Corp. v. Samsung Bioepis Co., No. 19-cv-11755 (D.N.J. Apr. 30, 2019) (asserting five patents against the Applicant).

[156] *See* Complaint at 3-4, *Immunex*, No. 19-cv-11755 (pointing out that the biosimilar product was approved by the FDA within two years after the aBLA submission).

[157] *See* Hirsch, *supra* note [28], at 677-78.

[158] *See id.* at 678.

to list all patents and then amend the complaint at a later date once it obtains more information through discovery. Thirdly, foreclosure of the patent dance can help the Applicant protect sensitive trade secrets regarding the manufacturing process.[159] However, this benefit may be counterbalanced by the Sponsor's use of discovery to obtain these trade secrets. Lastly, foregoing the patent dance can save the Applicant from the obligation of disclosing early contentions of non-infringement and invalidity, which could be exploited by the Sponsor as admissions in later litigation.[160]

B. The Disadvantages of Opting Out of the Patent Dance

There are also many disadvantages for the Applicant if it opts out of the patent dance. As recognized by the *Sandoz* Court, the adverse consequences of failing to participate in the patent dance include the loss of control over the scope and timing of the litigation.[161] Moreover, participating in, or at least partially participating in, the patent dance would force the Sponsor to list all patents during the patent dance or lose the right to assert them.[162] 42 U.S.C. 262(l)(3)(A) obligates the Sponsor to provide a list of patents that could reasonably be asserted.[163] As a result, the Sponsor is precluded from litigating any patent not on the § 262(l)(3)(A) list since 35 U.S.C. § 271(e)(6) provides that "[t]he owner of a patent that should have been included in the list, . . . but was not timely included in such list, may not bring an action under this section for infringement of the patent with respect to the biological product."[164]

The Applicant's biggest nightmare resulting from skipping the patent dance may occur if the Sponsor holds a number of patents on a biologic product and the District Court grants a preliminary injunction against the Applicant.[165] For example, AbbVie owns more than 100 patents related to its blockbuster drug, Humira.[166] In the biosimilar litigations, AbbVie identified sixty-one patents against Amgen on the 42 U.S.C. § 262(l)(3)(A) list, eighty-four patents against Sandoz,

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[159] *Id.* at 676.

[160] Brian D. Coggio, *Biosimilars: "The Patent Dance" "I Won't Dance/Don't Ask Me"*, 27TH ANNUAL FORDHAM IP CONFERENCE (Apr. 25-26, 2019), http://fordhamipinstitute.com/wp-content/uploads/2019/02/Goggio-Brian_-Biosimilars_27th-Annual-Fordham-IP-Conference.pdf.

[161] Sandoz Inc. v. Amgen Inc., 137 S. Ct. at 1675.

[162] Coggio, *supra* note [160].

[163] 42 U.S.C. § 262(l)(3)(A).

[164] 35 U.S.C. § 271(e)(6).

[165] *See* Coggio, *supra* note [160].

[166] Complaint at 1, AbbVie Inc. v. Amgen Inc., No. 16-cv-00666 (D. Del. Aug. 4, 2016).

and seventy-two patents against Boehringer Ingelheim.[167] Each of the three Applicants participated in the patent dance and exchanged a list of a smaller number of patents to be litigated in the first phase in an attempt to avoid a preliminary injunction.[168] Had the patent dance not occurred in these three litigations, AbbVie would have filed an infringement suit on at least sixty patents. The district court is likely to be overwhelmed by the large number of patents and the complexity of the technology, and thus, the likelihood of granting a preliminary injunction would be high. Moreover, in a footnote of *Sandoz*, the Supreme Court noted that its holding "express[ed] no view on whether a district court could take into account an applicant's violation of § 262(l)(2)(A) (or any other BPCIA procedural requirement) in deciding whether to grant a preliminary injunction."[169] The Court further cited precedent to suggest considering a "balance of equities" in deciding whether to issue a preliminary injunction.[170] It seems that the Court left it to the district court's discretion to consider the Applicant's failure to engage in the patent dance as a factor in deciding whether to grant injunctive relief when the Sponsor seeks declaratory judgment under 42 U.S.C. § 262(l)(9)(C).[171] Such a preliminary injunction can be disastrous for the Applicant.[172] For example, many Applicants settled with AbbVie on the Humira litigation, which allows these Applicants to enter the U.S. market in 2023.[173] Meanwhile, if a new Applicant files an application, opts out of the patent dance, gets sued by AbbVie, and faces a preliminary injunction, AbbVie would have incentives to stall the litigation.[174] Considering the number of patents involved, it is possible that the dispute may not be resolved until after 2023, the time when other companies are entitled to sell their biosimilar versions of Humira, thereby foreclosing the market of the new

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[167] *Id.* at 11; Complaint at 18, AbbVie Inc. v. Sandoz Inc., No. 18-cv-12668 (D.N.J. Aug. 10, 2018); Complaint at 14, AbbVie Inc. v. Boehringer Ingelheim Int'l GmbH, No. 17-cv-01065 (D. Del. Aug. 2, 2017).

[168] *See* Complaint at 10-16, AbbVie Inc. v. Amgen Inc., No. 16-cv-00666; *see also* Complaint at 16-23, AbbVie Inc. v. Sandoz Inc., No. 18-cv-12668; *see also* Complaint at 12-20, AbbVie Inc. v. Boehringer Ingelheim Intl GmbH, No. 17-cv-01065.

[169] Sandoz Inc v. Amgen Inc., 137 S. Ct. at 1677, n.2.

[170] *Id.* (citing Winter v. NRDC, Inc., 555 U.S. 7, 20 (2008)).

[171] Ladonnikov, *supra* note [31], at 146-47.

[172] Bruce Wexler, Partner, Paul Hastings, LLP, Address at N.Y.U. Sch. Of Law: Life Sci. and Patent Law (Mar. 27, 2019) (on file with author).

[173] *See AbbVie and Boehringer Ingelheim Settle Over Biosimilar Adalimumab*, CTR. FOR BIOSIMILARS (May 14, 2019), https://www.centerforbiosimilars.com/news/abbvie-and-boehringer-ingelheim-settle-over-biosimilar-adalimumab.

[174] Wexler, *supra* note [172].

Applicant.[175] On the contrary, if the Applicant would have fully complied with the patent dance, the likelihood of suffering from a preliminary injunction would have been diminished.[176] Under 42 U.S.C. § 262(l)(8)(B), a preliminary injunction is only available after the Applicant provides the Sponsor with a notice of commercial marketing.[177] Normally, a preliminary injunction is off the table in the first phase of litigation, during which time the district court can attempt to comprehend the technology and sort out the disputes on representative patents. Thus, when the Sponsor floods the court with a large number of patents in the second phase, the district court would be in a better position to tackle the difficult issues and may not so easily grant a preliminary injunction against the Applicant.[178]

Another disadvantage of skipping or failing to fully complete the patent dance is the Applicant's loss of the right to file a declaratory judgment action.[179] Although the Supreme Court in *Sandoz* did not explicitly deny the Applicant's action, many district courts later held that the Applicant's declaratory relief is conditioned on full compliance with the patent dance.[180] In *Celltrion, Inc. v. Genentech, Inc.*, the Applicant did not fulfill the 5(A) step required by 42 U.S.C. § 262(l)(5) when it refused to exchange with the Sponsor the number of patents to be immediately litigated.[181] Instead, the Applicant served a notice of commercial marketing and then filed a declaratory judgment lawsuit against the Sponsor.[182] The Northern District of California subsequently dismissed the Applicant's action for failure to state a claim for relief.[183] The court held that the Applicant's right to file a declaratory action after sending a notice of commercial marketing is conditioned on compliance with every step of the patent dance.[184] In addition, the Central District of California also dismissed the Applicant's declaratory judgment lawsuit in *Genentech* when the Applicant attempted to bypass the step of exchanging the

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[175] *Id.*
[176] *Id.*
[177] 42 U.S.C. § 262(l)(8)(B).
[178] Wexler, *supra* note [172].
[179] *See* Stacie L. Ropka et al., *A Hard Choice for Abbreviated Biologics License Applicants*, LAW360 (Feb. 4, 2019, 2:36 PM), https://www.law360.com/articles/1125158/a-hard-choice-for-abbreviated-biologics-license-applicants.
[180] *See* Celltrion, Inc. v. Genentech, Inc. (*Celltrion*), No. 18-cv-00274-JSW, 2018 WL 2448254, at *2 (N.D. Cal. May 9, 2018), *appeal dismissed*, No. 2018-2160, 2018 WL 7046651 (Fed. Cir. Nov. 30, 2018); *see also* Amgen Inc. v. Genentech, Inc., 2018 WL 910198, at *3.
[181] *Celltrion*, 2018 WL 2448254, at *3.
[182] *Id.*
[183] *Id.* at *5.
[184] *Id.* at *8.

number of patents to be asserted in the first phase of litigation.[185] The court concluded that allowing such an action would "override congressional intent and do away with the 'carefully calibrated scheme for preparing to adjudicate, and then adjudicating, claims of infringement' set out in the BPCIA."[186]

Furthermore, total foreclosure of the patent dance would cost the Applicant the opportunity to obtain the Sponsor's early contentions on infringement and validity issues,[187] which may help the Applicant flesh out legal and factual arguments, reduce the chance for an unexpected ambush, and make investment decisions.

C. Legislative Attempts to Encourage Compliance with the Patent Dance

On June 27, 2019, the Senate Judiciary Committee passed the Affordable Prescription for Patients Act of 2019 (S. 1416), which limits the number of patents that can be litigated under the BPCIA.[188] This bill proposes to reward the Applicant's compliance with the patent dance by limiting the Sponsor to assert no more than twenty patents in a patent infringement claim.[189] Sponsors of the bill aim to help the Sponsor and the Applicant resolve the patent disputes faster, with the goal of decreasing drug prices for consumers.[190] Moreover, the court has the discretion to increase the number of patents to be asserted if the Applicant "fails to provide information . . . that would enable the . . . [S]ponsor to form a reasonable belief with respect to whether a claim of infringement under this section could reasonably be asserted."[191] Therefore, if this bill becomes the law, the Applicant would have more incentives to fully engage in the patent dance since full compliance is the prerequisite condition to expedite the resolution of patent disputes and to clear the roadblocks for market entry.

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[185] Amgen Inc. v. Genentech, Inc., 2018 WL 910198, at *4.
[186] *Id.* (citing Sandoz Inc. v. Amgen Inc., 137 S. Ct. at 1670).
[187] Coggio, *supra* note 160.
[188] Affordable Prescription for Patient Act, S. 1416, 116th Cong. § 3 (2019) (as passed by S. Comm. on the Judiciary, June 27, 2019).
[189] *Id.* at § 3(a)(2).
[190] *See* Bruce Wexler et al., *Biosimilar Patent Litigation Bill Would Change BPCIA Strategy*, LAW360 (July 11, 2019, 12:54 PM), https://www.law360.com/articles/1176215/biosimilar-patent-litigation-bill-would-change-bpcia-strategy.
[191] S. 1416 at § 3(a)(2).

IV
EFFECTS OF *SANDOZ* ON THE SPONSOR SIDE - PLEADING STANDARD

As discussed in Part III, *Sandoz* has granted the Applicant the freedom to opt out of the patent dance when it is more beneficial to do so. However, this may put the Sponsor at a disadvantage because if the Sponsor cannot access the Applicant's manufacturing information, the Sponsor may not be able to state plausible factual allegations for a claim of patent infringement.[192] This is especially true with process patents because there is no way for the Sponsor to know how the Applicant intends to manufacture its biosimilar product and whether the Applicant's manufacturing process infringes the Sponsor's process patents.[193] Even if the Sponsor were able to pass the initial hurdle of a pleading requirement, there is a concern of whether the missing information, caused by the Applicant's failure to comply with the patent dance, is obtainable through discovery.[194]

A. Pleading Standard for a Patent Infringement Claim

Federal Rule of Civil Procedure 8(a) governs the pleading standard, which requires only "a short and plain statement of the claim showing that the pleader is entitled to relief" in order to "give the defendant fair notice."[195] The defendant may challenge the sufficiency of a complaint by filing a motion to dismiss under Rule 12(b)(6).[196] Under *Ashcroft v. Iqbal*, 556 U.S. 662 (2009) and *Bell Atlantic Corp. v. Twombly*, 550 U.S. 570 (2007), in order to survive such a motion, the plaintiff must plead "sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'"[197] To reach the facial plausibility bar, the complaint must contain "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."[198]

"Direct infringement under § 271(a) occurs where all steps of a claimed method are performed by or attributable to a single entity."[199] To survive the motion to dismiss, the plaintiff of an infringement claim must "place the alleged

[192] Hirsch, *supra* note [28], at 677.
[193] *Id.*
[194] *Id.* at 678.
[195] Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007).
[196] Fed. R. Civ. P. 12(b)(6).
[197] Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (quoting *Twombly*, 550 U.S. at 570).
[198] *Id.*
[199] Akamai Techs., Inc. v. Limelight Networks, Inc. 797 F.3d 1020, 1022 (Fed. Cir. 2015) (citing BMC Res., Inc. v. Paymentech, L.P., 498 F.3d 1373, 1379–81 (Fed. Cir. 2007)); *see* 35 U.S.C. § 271(a).

infringer 'on notice of what activity . . . is being accused of infringement.'"[200] With the abrogation of Form 18 in the newly amended Federal Rules of Civil Procedure in 2015, a direct infringement complaint is now governed by the facial plausibility standard.[201] Although the change is recent, some Federal Circuit cases have begun to shed some light on what is required in a complaint.[202] First of all, the plaintiff should identify the specific allegedly infringing product or activity.[203] For instance, in *Disc Disease Solutions Inc. v. VGH Solutions, Inc*., 888 F.3d 1256, 1260 (2018), the Federal Circuit found the complaint sufficient as it identified "the three accused products—by name and by attaching photos of the product packaging as exhibits[.]" By contrast, the Federal Circuit affirmed the district court's dismissal of a patent infringement claim in *Artrip v. Ball Corp.*, 735 Fed. Appx. 708 (2018). The court distinguished *Artrip* from *Disc Disease* because the plaintiff, Artrip, only pleaded that his patents were infringed "by use of one or more of the machines" at the defendant's plant.[204] Although Mr. Artrip's counsel toured the defendant's factory and photographed the defendant's equipment, the complaint contained broad functional language rather than identifying any particular machine.[205]

Secondly, whether the complaint requires an explanation of how the defendant's product or activity infringes the plaintiff's patent may depend on the complexity of the technology.[206] For example, in *Disc Diseases*, although the complaint identified specific allegedly infringing products, it did not explain how these products infringed the plaintiff's patents.[207] Rather, the plaintiff asserted that these products meet "each and every element of at least one claim of" the patents-in-issue, "either literally or equivalently."[208] Despite the broad language in the complaint, the Federal Circuit held that the complaint satisfied the facial plausibility standard because the patents-in-issue are related to a spinal brace, which was deemed to be "simple" technology by the court, and the number of

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[200] Lifetime Indus., Inc. v. Trim–Lok, Inc., 869 F.3d 1372, 1379 (Fed. Cir. 2017) (quoting K-Tech Telecomms., Inc. v. Time Warner Cable, 714 F.3d 1277, 1284 (Fed. Cir. 2013)).

[201] *See* Jonathan J. Fagan & Jason E. Stach, *Life After Form 18: A One-Year Retrospective on Pleading Direct Infringement*, FINNEGAN (Jan./Feb. 2017), https://www.finnegan.com/en/insights/life-after-form-18-a-one-year-retrospective-on-pleading-direct.html.

[202] *See* Steven J. Corr & Louis L. Touton, *Pleading Patent Infringement in the United States: Evolving Standards,* JONES DAY (Nov. 2018), https://www.jonesday.com/en/insights/2018/11/pleading-patent-infringement-in-the-united-states.

[203] *See id.*; *see also* Artrip v. Ball Corp., 735 F. App'x. 708, 715 (Fed. Cir. 2018).

[204] Artrip v. Ball Corp., 735 F. App'x at 714.

[205] *Id.* at 715.

[206] *See* Corr & Touton, *supra* note 202.

[207] Disc Disease Sols. Inc. v. VGH Sols., Inc., 888 F.3d 1256, 1258 (Fed. Cir. 2018).

[208] *Id.*

independent claims involved was small.[209] However, this opinion may not apply when the technology is relatively complex or the number of independent claims is large.[210] Indeed, many district courts require details explaining how the asserted claims are infringed upon by the accused products.[211] For example, in *Atlas IP LLC v. Pacific Gas & Electric Co.*, No. 15-cv-05469-EDL, 2016 WL 1719545, at *4. (N.D. Cal. Mar. 9, 2016), the Northern District of California held that a complaint was insufficient because the asserted claims recited an apparatus' "power off" by "using cycle establishing information" and the complaint only stated that the accused product had the ability to power off, but failed to mention the limitation "by using cycle establishing information."

B. How Does the Sponsor Plead When the Applicant Refuses to Engage in the Patent Dance?

When the Applicant refuses to disclose or insufficiently discloses its manufacturing information, the Sponsor can still identify the specific infringing product, the biosimilar, which is readily ascertained from the aBLA. However, as discussed in Part I, the biosimilar could be a designed-around version of the branded biologic, thereby circumventing the patent(s) claiming the biologic product. Thus, the Sponsor may have to rely on the Applicant's infringing activities, such as certain steps in the manufacturing process, which are, however, secret from the Sponsor. Failing to pinpoint the specific infringing activity, the Sponsor would not satisfy the pleading requirement under *Artrip*.[212] Even if the Sponsor is able to identify specific infringing activities, it would still be difficult to explain why the Sponsor's patent(s) is (are) infringed without knowing the specific details of the Applicant's manufacturing process. Unfortunately, such an explanation might be necessary to pass the *Iqbal*/*Twombly* standard given the fact that the biotechnology field is relatively complex and unpredictable, and the biologic invention is usually covered by a large number of patent claims.

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[209] *Id.* at 1260.

[210] *See* Uniloc USA, Inc. v. Avaya Inc., No. 6:15-cv-1168-JRG, 2016 WL 7042236, at *3 (E.D. Tex. May 13, 2016) ("[C]ases involving more nebulous, less tangible inventions such as computer software methods may require a higher degree of specificity to provide proper notice to the defendant.").

[211] *See e.g.*, Modern Telecom Sys., LLC v. TCL Corp., No. 17-583-LPS-CJB, 2017 WL 6524526, at *3 (D. Del. Dec. 21, 2017) ("Plaintiff must have some basis to believe that compliance with certain portions of" the accused product "require the practice of each of the limitations of claim 18 of the patent-in-suit[.]").

[212] *See* Artrip v. Ball Corp., 735 Fed. Appx. at 715.

However, it seems unfair to punish the Sponsor for failing to provide sufficient factual matter to state a claim since the Sponsor was left with no alternative. Rather, it is the Applicant, who strategically chose to skip the patent dance that caused the Sponsor's insufficiency of factual content. Perhaps courts should apply a more lenient pleading standard when the plaintiff cannot access the infringing information.[213] For example, in *DermaFocus LLC v. Ulthera*, Inc., 201 F. Supp. 3d 465, 470 (D. Del. 2016), the court denied the motion to dismiss an infringement claim. Although the plaintiff identified the specific infringing product and explained how the product used the patented technology, the defendant complained that the plaintiff failed to specify which particular combinations of components of the defendant's product infringed the patent or how the claimed method steps were performed.[214] Quoting the Federal Circuit, the court emphasized that "[a] defendant cannot shield itself from a complaint . . . by operating in such secrecy that the filing of a complaint itself is impossible."[215] Because the court was unable to determine whether the factual allegations demanded by the defendant were reasonably accessible to the plaintiff, the court held "that plaintiff has given the defendant reasonable notice of a plausible claim for direct infringement."[216] However, one cannot infer from past examples of such leniency that there is no limit. In *Panduit Corp. v. Corning Inc.*, No. 5:18-CV-229-FL, 2019 WL 189817, at *5 (E.D.N.C. Jan. 14, 2019), the court dismissed a direct infringement claim because the plaintiff did not identify the specific infringing product, service, or activity, thereby failing to put the defendant on notice of what was accused.

In the context of biosimilar litigation, it is possible that the district court could lower the pleading standard even more if key information is withheld from the Sponsor. For instance, in the Federal Circuit's decision of *Amgen Inc. v. Sandoz Inc.* (*Amgen II*), 794 F.3d 1347, 1356 (2015), Judge Lourie noted that once the Sponsor sued the Applicant for infringement, the Sponsor could access the information that was foreclosed by the Applicant's failure to engage in the patent dance through discovery. Judge Lourie provided a solution to obtain information that would have otherwise been available from the patent dance without addressing the pleading standard, suggesting that specific information only available from the patent dance would not be a hurdle for the Sponsor to meet the pleading standard.

[213] *See* Fagan & Stach, *supra* note [201].
[214] DermaFocus LLC v. Ulthera, Inc., 201 F. Supp. 3d 465, 470 (D. Del. 2016).
[215] *Id.* at 469 (quoting K-Tech Telecomms., Inc. v. Time Warner Cable, Inc., 714 F.3d at 1286).
[216] *Id.* at 470.

Two years later, the Federal Circuit clarified its position on the pleading requirement.[217] In *Amgen Inc. v. Hospira, Inc.*, 866 F.3d 1355 (Fed. Cir. 2017), Amgen was the Sponsor of a biologic product under the brand name Epogen. The Applicant, Hospira, Inc. ("Hospira"), filed a biosimilar application with the FDA seeking approval of a biosimilar product of Epogen. In an attempt to comply with the patent dance, Hospira sent a copy of its application to Amgen and asserted that the application contained all the manufacturing information.[218] Amgen contended that Hospira failed to comply with the patent dance because the composition of the cell-culture medium used in the manufacture was missing, while Hospira maintained that such composition was provided in its application.[219] Despite their disagreement, the parties proceeded to the subsequent steps of the patent dance.[220] Amgen listed three patents that it believed to be infringed by Hospira's biosimilar product.[221] None of the three patents claimed the specific cell-culture medium used in the manufacturing process, because without knowing Hospira's cell-culture medium, Amgen claimed it could not assess the reasonableness of asserting infringement claims on the cell-culture medium.[222] Ultimately, Amgen brought an infringement suit on two of the three patents and sought to obtain information on the composition of Hospira's cell-culture medium during discovery.[223] After Hospira's refusal, Amgen filed a motion to compel discovery, but the district court denied it.[224]

The Federal Circuit affirmed the district court's denial of the motion to compel discovery pursuant to Federal Rule of Civil Procedure 26(b)(1), which governs discovery, and noted that, "discoverable information must be relevant to any party's claim or defense."[225] Since Amgen didn't sue any patent related to the cell-culture medium, information of Hospira's cell-culture medium is not relevant to any infringement claim asserted by Amgen or any defense that was raised by Hospira.[226]

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[217] *See* Amgen Inc. v. Hospira, Inc., 866 F.3d 1355 (Fed. Cir. 2017).
[218] *Id.* at 1357.
[219] *Id.*
[220] *Id.* at 1358.
[221] *Id*.
[222] *Id.*
[223] *Id*.
[224] *Id*.
[225] *Id*. at 1361.
[226] *Id*.

Furthermore, the Federal Circuit offered some guidance on what Amgen or any similarly situated Sponsor should have done: Amgen should have listed all the patents it believed to be infringed in the patent dance even without any specific information, including the ones covering cell-culture medium, and then asserted these patents in the subsequent infringement action.[227] Amgen argued that blindly listing and suing the patents on cell-culture medium would make Amgen vulnerable to sanctions under Federal Rule of Civil Procedure 11 or antitrust liability for baseless claims.[228] The Federal Circuit responded that the BPCIA merely required the Sponsor to list patents that it believed could reasonably be asserted and such a reasonableness requirement did not prohibit the Sponsor from listing a patent when the Applicant failed to provide information that could be related to the patent.[229] Furthermore, the Federal Circuit held that the Rule 11 sanction would not be applicable here because the Sponsor's inquiry was limited by the Applicant's withholding of information.[230] In summary, the Sponsor should simply add all patents that could be potentially infringed in a complaint and then use discovery to amend the complaint.[231]

Although the Federal Circuit did not directly rule on the pleading standard, the court's suggestion to include a patent in a complaint even without facts to support an infringement claim implies the court's tolerance of less sufficient factual allegations. Therefore, the pleading difficulty without the patent dance might be cured by the court's adoption of a lower standard than *Iqbal*/*Twombly*. The Sponsor can carefully document its request for manufacturing information, detailing both why it is necessary and the Applicant's refusal to disclose to ward against any sufficiency attack.[232] However, the uncertainty inherent to this more lenient standard may still put the Sponsor at a disadvantage because it is hard to predict which district court may follow the more lenient standard and how lenient the standard would be.

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[227] *Id*.
[228] *Id.*
[229] *Id*. at 1362.
[230] *Id*.
[231] Ladonnikov, *supra* note [31], at 152.
[232] Linda A. Wadler & Barbara R. Rudolph, *Practical Implications of the Federal Circuit's Decision in Amgen v. Hospira on Biosimilars Patent Litigation*, 29 INTELL. PROP. & TECH. L.J. 16, 17 (2017).

C. Consequences of the Lenient Pleading Standard

Under *Hospira*, an Applicant who fails to fully abide by the patent dance is likely to be punished by allowing the Sponsor to proceed with an infringement claim under a lenient pleading standard. However, the Sponsor has to assert all patents that might be potentially infringed since there is no way to determine the ultimate scope of the Applicant's infringement without access to the Applicant's detailed manufacturing information.[233] Thus, the Sponsor is forced to litigate blindly in order to protect its rights.[234] This is certainly inconsistent with the essence of the BPCIA, which aims to expedite the resolution of patent disputes prior to the entry of the biosimilar into the market.[235] The BPCIA purposely divides litigation into two phases with the hope that parties will gain some clarity after the first phase, which would curtail seemingly endless patent infringement litigation.[236] Unfortunately, requiring the Sponsor to assert all patents would run against the BPCIA's spirit because unnecessary patents will be litigated, thereby wasting judicial resources as well as both parties' money and time.

Listing everything will not serve as a cure-all since the over-inclusion exposes a risk that at least some patents may be invalidated.[237] Without the Applicant's detailed manufacturing information, the Sponsor faces a dilemma of whether to list a patent. On one hand, if the Sponsor does not list a patent which ultimately turns out to be infringed by the Applicant's activity, the Sponsor forever loses its right to exclude the Applicant from practicing the invention covered by the patent. On the other hand, if the Sponsor does list a patent which later turns out to be irrelevant during discovery, the Sponsor will have to assume the risk of losing the battle of the subsequent invalidity attack on the patent.[238]

Furthermore, the requirement of listing everything also imposes a financial burden on the Sponsor because the information that could have otherwise been available can now only be obtained through costly discovery.[239] Although such information, or part of it, may be subject to the initial disclosure or pretrial disclosure obligations under Federal Rule of Civil Procedure 26(a), which, in

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[233] Rithika Kulathila, *BPCIA Update: Entropy Is the Price of an Ordered Framework*, 33 BERKELEY TECH. L.J. 1277, 1299 (2018).
[234] *Id.*
[235] Ladonnikov, *supra* note [31], at 153.
[236] *Id.*
[237] *See* Hirsch, *supra* note [28], at 677.
[238] *Id.*
[239] *Id.*

theory, reduces the Sponsor's cost of discovery, the Applicant can use attorney-client privilege or relevance to block discovery. Since the BPCIA does not address a scenario in which the Sponsor has to heavily rely on discovery to state a claim and the law on this topic has not been settled, it is the district courts' job to fill these gaps.[240] The district courts should not reward the Applicant's gamesmanship if it purposely stalls discovery of the information that could have otherwise been obtained from the patent dance. Rather, the courts should allow the Sponsor's motion to compel if the Sponsor can articulate what information is missing from the failure to fully comply with the patent dance and explain why the information is relevant to the infringement claim. Only this would put the parties back on track for efficiently resolving the patent disputes, which embodies the goals of the BPCIA: creating more transparency and reducing litigious gamesmanship.

CONCLUSION

The BPCIA creates a finely calibrated balance between the biologic innovators who are motivated to solve new therapeutic problems through huge investment of money and time and biosimilar manufacturers who are likely to bring more affordable therapeutics to patients by piggybacking on the innovators' data.[241] The Supreme Court's holding in *Sandoz* bestows on the Applicant the freedom to choose whether to participate in the BPCIA's patent dance.[242] On one hand, when the Sponsor holds a small patent portfolio and the FDA approval for a new biosimilar is anticipated to be quick, it is more beneficial for the Applicant to opt out of the patent dance. On the other hand, when the Sponsor holds a large number of patents, the Applicant would be wise to fully engage in the patent dance to gain some control over the litigation, reduce the risk of a preliminary injunction, reserve the right to file declaratory judgement action, and exploit the Sponsor's contentions on legal issues.

However, such freedom and strategies are luxuries solely for the Applicant. The lack of choice for the Sponsor may slightly tip the intricate balance towards the Applicant. Thus, the burden to carefully tune and restore the balance rests on the district court. To reconcile the spirit of the BPCIA and the difficulties in obtaining sufficient facts to support an infringement claim in the absence of the patent dance, the district court should apply a more lenient pleading standard to protect the Sponsor's right. Furthermore, when the Sponsor has to heavily rely on discovery to dig for information withheld by the foreclosure of the patent dance,

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[240] Kulathila, *supra* note [233], at 1305.
[241] *See* Tanaka, *supra* note [8], at 680.
[242] *See* Sandoz Inc. v. Amgen Inc., 137 S. Ct. 1664.

the district court should facilitate the discovery process to place the parties back on track for efficiently resolving disputes. Doing this would realize the BPCIA's two goals: stimulating and rewarding innovations as well as providing the public with affordable therapeutic agents.

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TOWARDS ENHANCED OVERSIGHT OF "SELF-GOVERNING" DECENTRALIZED AUTONOMOUS ORGANIZATIONS: CASE STUDY OF THE DAO AND ITS SHORTCOMINGS

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INTRODUCTION

Blockchain, cryptocurrency, smart contracts—these obscure terms began flooding the news a few years ago and for good reason. These are technologies with the potential to fundamentally change the way in which society performs its business transactions.

The blockchain, in layman's terms, is a "ledger [that] is kept and updated communally by all the computers that are hooked into the [blockchain] network."[1] Because the ledger is kept communally, no single computer or institution is in charge of the financial data on the ledger.[2] "If any one computer keeping the records is hacked or knocked offline, the other computers can go on without it."[3] Because of this property, blockchain technology is of particular interest to companies that manage large amounts of data. It represents an opportunity to make databases resilient to tampering.[4] Apart from the security benefits, blockchains can potentially

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[1] Nathaniel Popper, *What Is the Blockchain? Explaining the Tech Behind Cryptocurrencies*, N.Y. TIMES (June 27, 2018), https://www.nytimes.com/2018/06/27/business/dealbook/blockchains-guide-information.html.
[2] *See id.*
[3] *Id.*
[4] *See id.*

provide a solution to keeping multiple copies of a database synchronized.[5] That is why Fortune 500 companies are investing billions of dollars into blockchain technology.[6] Samsung Electronics, AXA Group, and Bank of America are just a few of the myriad companies that are developing blockchain technologies for a variety of applications such as tracking global supply chains, automatically executing insurance payments, and creating letters of credit.[7]

Large corporations aren't the only ones that can benefit from blockchain technology. Average consumers can use smart contracts, programmable automated transactions that operate and store their records on the blockchain, as a secure way to buy goods and services from online markets.[8] Smart contracts can even be programmed as an investment vehicle, similar to a mutual fund, to receive capital from multiple investors and invest them in another enterprise. Unlike mutual funds, these smart contracts lack an ostensible fund manager. Decisions on how to manage the fund are made via a majority vote amongst the investors. Such smart contracts are called "Decentralized Autonomous Organizations" or "DAOs." In fact, investors have already shown explosive interest in such ventures. The first smart contract of such a kind, The DAO, raised $150 million over the course of four weeks in mid-2016, making it the most successful crowdfunded project in history at the time.[9]

Despite the eagerness of investors to dive into DAOs, DAO smart contracts, like any other contract, are imperfect and unable to completely escape the risk of governance problems and contractual disputes. DAO smart contracts are programmed to have their parties resolve such disputes through "self-governance." That is, parties to a DAO will resolve disputes through majority vote, without relying on a central legal authority. However, unguided and unchecked dispute resolution in

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[5] *See id.*

[6] *See* Andrew Ross Sorkin, *Demystifying the Blockchain*, N.Y. TIMES (June 27, 2018), https://www.nytimes.com/2018/06/27/business/dealbook/blockchain-technology.html.

[7] *See* Michael del Castillo, *Big Blockchain: The 50 Largest Public Companies Exploring Blockchain*, FORBES (July 3, 2013), https://www.forbes.com/sites/michaeldelcastillo/2018/07/03/big-blockchain-the-50-largest-public-companies-exploring-blockchain/#33bc337d2b5b.

[8] *See* Nathaniel Popper, *Ethereum, a Virtual Currency, Enables Transactions that Rival Bitcoin's*, N.Y. TIMES (Mar. 27, 2016), https://www.nytimes.com/2016/03/28/business/dealbook/ethereum-a-virtual-currency-enables-transactions-that-rival-bitcoins.html.

[9] *See* Nathaniel Popper, *A Venture Fund with Plenty of Virtual Capital, but No Capitalist*, N.Y. TIMES (May 21, 2016), https://www.nytimes.com/2016/05/22/business/dealbook/crypto-ether-bitcoin-currency.html.

such a nascent area of technology, still mostly beyond the reach of the law, will most certainly result in unfair outcomes and processes.

This Note proposes that fair, self-governed resolution of governance problems and disputes within a DAO is unrealistic. Further, this Note calls for the intervention of neutral third-parties in the blockchain ecosystem to adjudicate disputes fairly, enforce fiduciary duties, and promote public policy. This Note also proposes that among the variety of tribunals that could adjudicate such disputes, traditional courts are most appropriate for the role. Finally, this Note proposes that government regulatory agencies are best suited to prosecute such cases.

Part I of this Note presents an overview of distributed ledger technology, blockchains, smart contracts, and DAOs. This part provides a deep dive into the motivation behind the development of each technology. Part II is a case study of The DAO. Although The DAO did not last long enough for serious governance problems to emerge, an analysis of The DAO's voting system reveals a highly problematic governance system. Part III examines traditional economics literature and extracts lessons supporting this Note's thesis that self-governance of DAOs is futile. Part IV proposes a set of substantive rules that should be imposed on DAOs and also highlights the neutral third-parties that can adjudicate disputes arising from violations of those substantive rules. The final section concludes this Note.

I
THE HISTORY OF DISTRIBUTED LEDGER TECHNOLOGY, BLOCKCHAINS, AND SMART CONTRACTS

Computing technology has pervaded all aspects of the legal practice, and financial contracts represent a significant area of interest. Transferring a natural-language financial contract into a format that can be processed electronically presents opportunities for the automatic execution and enforcement of contracts without the need for courts, and consequently, the reduction of transaction costs. One such example is a "smart contract." The idea of digitizing and automating contracts was popularized in 1994 when Nick Szabo coined the term "smart contract" to describe "a computerized transaction protocol [, or a computer program,] that executes the terms of a contract."[10] Szabo envisioned that smart contracts would "satisfy common contractual conditions (such as payment terms, liens, confidentiality, and even enforcement), minimize exceptions both malicious

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[10] NICK SZABO, SMART CONTRACTS (1994), http://www.fon.hum.uva.nl/rob/Courses/InformationInSpeech/CDROM/Literature/LOTwinterschool2006/szabo.best.vwh.net/smart.contracts.html.

and accidental, and minimize the need for trusted intermediaries."[11] Szabo intended smart contracts to minimize fraud and reduce transaction costs including arbitration and enforcement costs.[12]

A smart contract can be analogized to a vending machine. As long as the machine has inventory and money is properly inserted into the machine, a contract for the sale of a bottled beverage will be automatically executed. Smart contracts can also govern more complicated financial transactions that may require inputs from the parties over the course of its execution. In a car insurance smart contract for example, the driver can enter an input detailing a car accident. Such inputs can trigger predetermined steps according to the terms of the car insurance smart contract—the determination of whether the driver previously defaulted on monthly premiums, the delivery of an insurance payout, and the adjustments to the insurance rate—which can then be automatically executed by a computer.

The models and technologies for automatically executing contractual provisions (e.g., the transfer of assets upon satisfaction of pre-defined conditions) have experienced continuous innovation with some implementable forms emerging in the early 2000s. Yet, smart contracts did not see widespread utilization until only recently. The main problem preventing implementation was both parties to a transaction each having to have two separate instances of a smart contract program run on two separate systems (unless a party concedes to running only one instance of the smart contract on their counterparty's system as in the car insurance smart contract example *supra*). Realizing a functional smart contract would be further complicated if the parties disagreed on the smart contract code and decided to program their own versions of the smart contract; the parties would then run the risk of the two versions producing different results in practice. However, the development of the distributed ledger in 2008 brought a platform on which a common smart contract could be hosted and executed.

A distributed ledger "is a digital record that is shared instantaneously across a network of participants."[13] It functions by storing identical copies of the digital record with each of the individual users (or nodes) on the network. In the smart contract context, whenever a new transaction occurs and the ledger must be updated, each copy of the ledger is simultaneously updated with new information. However, the update is only made possible when the majority of nodes agree on the new

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[11] *Id.*
[12] *See id.*
[13] INT'L SWAPS AND DERIVATIVES ASS'N & LINKLATERS, WHITEPAPER: SMART CONTRACTS AND DISTRIBUTED LEDGER - A LEGAL PERSPECTIVE 7 (2017).

changes by each individually verifying the new transaction against the preexisting ledger. This ensures that there is no deviation within the multiple copies of the data and only a single version of the record exists, albeit stored on multiple nodes. That single record represents a golden source of data that cannot be tampered with. A malicious hacker could alter the transactions kept on a centralized ledger with relative ease, but simultaneously infiltrating a majority of nodes in a large distributed ledger network would be a near impossible task.

The blockchain is the quintessential implementation of distributed ledger technology. Think of the blockchain as a database, maintained by all the nodes on the blockchain network, that is structured as a chronologically ordered, linear series of data "blocks." Each block serves as a record of transactions with the latest block on the blockchain aggregating the most recent transactions.[14] Before being added to the blockchain, the latest block must be broadcasted to and verified by a majority of the nodes on the entire blockchain network. Once the nodes reach consensus, the latest block is appended to the block that immediately precedes it in the blockchain by an encrypted reference.[15] This results in the entire transaction history of the network being recorded in a series of data blocks connected through chains of encrypted references, hence the name "blockchain." Once a new block is added, updated copies of the blockchain record are distributed to each individual user for future verification purposes. The append-only nature of the blockchain makes transactions on the blockchain irreversible. Today, the term "blockchain technology," technically a subset of its mother technology, has become synonymous with distributed ledger technology and this Note uses the two terms interchangeably. Some of the largest functioning blockchains today include the Bitcoin and Ethereum blockchains.

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[14] *See* Bitcoin Wiki, *Block*, https://en.bitcoin.it/wiki/Block (as of Dec. 5, 2018).
[15] *See id.*

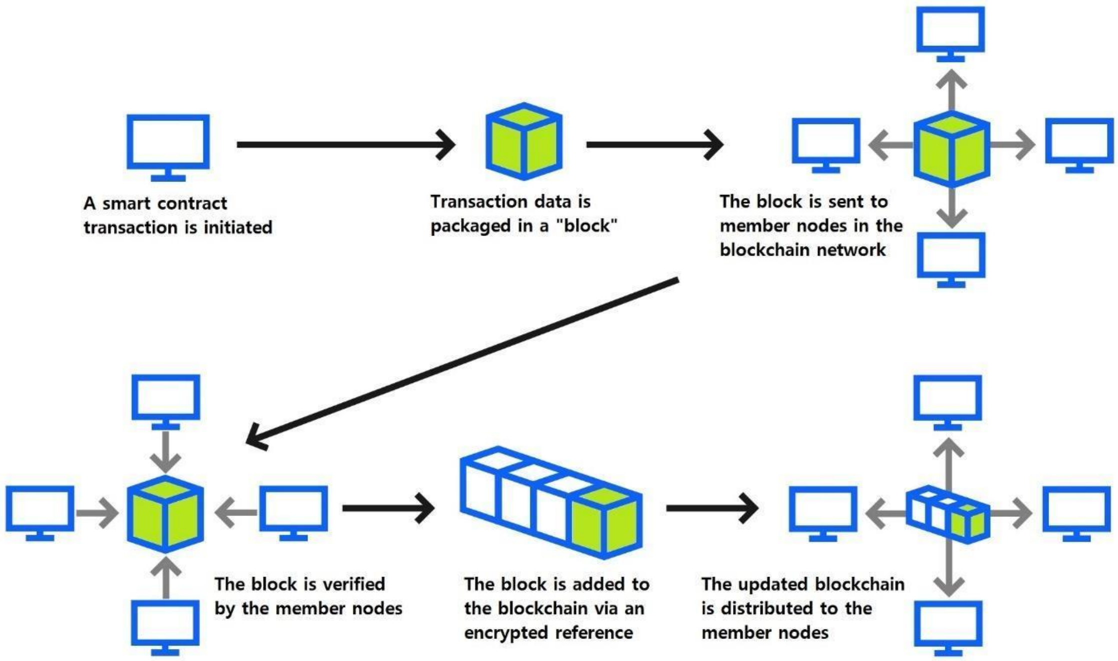

Figure 1. How a smart contract transaction is incorporated into a blockchain

Blockchains employ virtual currencies to act as mediums of exchange for their transactions. These currencies, dubbed "cryptocurrencies," are programmed specifically to function on decentralized networks that lack any kind of central authority. Werbach and Cornell's explanation on cryptocurrencies sheds light on the subject:

> The core attribute of [cryptocurrency] is that it allows unrelated individuals and organizations to have confidence in transactions without trusting intermediaries or a legal system. A currency requires trust because buyers and sellers must believe that the tokens they exchange for assets of value will themselves have value. A one hundred dollar bill without the "full faith and credit" of the United States of America is just a piece of paper featuring a green portrait of Benjamin Franklin. [A cryptocurrency] supplies a mechanism of trust that does not require the backing of any trusted institution or government. And that same mechanism can be employed for other kinds of transactions.[16]

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[16] Kevin Werbach & Nicolas Cornell, *Contracts Ex Machina*, 67 DUKE L.J. 313, 325 (2017) (citation omitted).

The aforementioned mechanism of trust is supplied when cryptocurrencies are secured by "cryptography rather than traditional means."[17]

What does it mean for a virtual currency to be secured by cryptography? On the blockchain, parties can set up an "account," comprised of a public address (a "public key") and a password (a "private key").[18] To transfer funds in the course of a transaction, a user of the blockchain finds another user's public key, transfers cryptocurrencies, and inputs their private key, sealing the transaction with a "digital signature."[19] This process ensures that all transactions are authenticated and non-repudiable. The party that authorized the transfer of funds in a disputed transaction will have a difficult time arguing that they did not engage in a transaction unless they can prove that their private key was compromised.[20]

The usage of blockchain and cryptocurrencies for transactions uniquely enables smart contracts. Storing the transactional data and running the code of a smart contract on a blockchain network would guarantee that "there is only one 'golden' version [of the code and transaction history], which effectively binds both parties."[21] Furthermore, once the smart contract begins to run, both parties can take comfort in that the transaction will self-execute with neither party able to tamper with it.[22] The transactions would be irreversible. Once a transferor securely sends cryptocurrencies to a transferee's public address, it is impossible to transfer them back out without the transferee's private key. The smart contract, in addition to its self-executing and irreversible properties, is also self-enforcing because withholding payment when the relevant condition is satisfied is not possible if the smart contract code does not allow for it.[23] Thus, when combined with blockchain technology and cryptocurrencies, the smart contract offers a self-executing, immutable, and self-enforcing alternative to the traditional methods of performing financial transactions.

Smart contracts on a blockchain are not limited to transactions between two parties; they can also govern transactions between multiple investors. Imagine a mutual fund—a smart contract can pool cryptocurrencies from investors and invest them in other ventures. But also imagine that mutual fund having voting rights

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[17] *Id.* at 315 n.3.

[18] *See* Cardozo Blockchain Project, Cardozo School of Law, *"Smart Contracts" & Legal Enforceability*, Research Report No. 2 (Oct. 16, 2018) (https://cardozo.yu.edu/sites/default/files/2020-01/smart_contracts_report_2_0.pdf).

[19] *See id.*

[20] *See id.*

[21] INT'L SWAPS AND DERIVATIVES ASS'N & LINKLATERS, *supra* note 13, at 9.

[22] *See id.*

[23] *See id.*

similar to a corporation—a smart contract can give its investors voting rights which can be used to influence how the cryptocurrencies are managed. It is possible for such a smart contract to also have an administrator responsible for coding the smart contract. Exactly how such a smart contract operates and manages its cryptocurrencies would depend on how the smart contract is coded and designed.

The smart contract discussed above can be seen as forming a for-profit organization encompassing numerous investors and potentially a code-developing administrator. The blockchain community has labeled such organizations, investors bound together by a smart contract, Decentralized Autonomous Organizations or DAOs.[24] Despite having some characteristics of a corporation, such as shareholders and voting rights, it is ambiguous whether a DAO can be classified as a corporation since it has not been formed under the corporate laws of any jurisdiction. As a result, it is unclear what body of law should apply to such an organization, and they are not currently recognized as legal entities.[25]

One of the primary aims behind the design of DAOs is to tackle the principal-agent problem.[26] Such a problem "arises whenever the welfare of one party, termed the 'principal', depends upon actions taken by another party, termed the 'agent'. . . . [A]lmost any contractual relationship, in which one party (the 'agent') promises performance to another (the 'principal'), is potentially subject to an agency problem."[27] Traditional corporations and investment funds are also subject to the principal-agent problem. One generic problem facing corporations and investment firms is the conflict between the firm or asset's owners and its hired managers.[28] "The problem lies in assuring that the managers are responsive to the owners'

[24] *See* ALLEN & OVERY LLP, DECENTRALIZED AUTONOMOUS ORGANIZATIONS (July 2016), http://www.allenovery.com/publications/en-gb/Pages/Decentralized-Autonomous-Organizations.aspx; Shermin Voshmgir, *Tokenized Networks: What is a DAO?*, BLOCKCHAINHUB (July 2019), https://blockchainhub.net/dao-decentralized-autonomous-organization. A DAO is not limited to being used as an investment vehicle, but this Note will limit its discussion to DAOs used for investment purposes.

[25] *See* Popper, *supra* note 9; ALLEN & OVERY LLP, *supra* note 24, at 5; CHRISTOPH JENTZSCH, DECENTRALIZED AUTONOMOUS ORGANIZATION TO AUTOMATE GOVERNANCE 1 (2016), https://ia800603.us.archive.org/11/items/DecentralizedAutonomousOrganizations/WhitePaper.pdf.

[26] *See* JENTZSCH, *supra* note 25, at 1

[27] John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems, Legal Strategies, and Enforcement* 2 (Harvard John M. Olin Center for Law, Economics, and Business, Discussion Paper No. 644 7/2009, 2009), http://www.law.harvard.edu/programs/olin_center/papers/pdf/Kraakman_644.pdf.

[28] *See id.*

interests rather than pursuing their own personal interests."[29] To address this problem, rules describing permitted and proscribed conduct are imposed on managers by private contracts (e.g., corporate bylaws) and corporate law.[30] But whatever the rules may require, "[t]he core of the difficulty is that, because the [manager] commonly has better information than does the principal about the relevant facts, the principal cannot easily assure himself that the [manager's] performance is precisely what was promised."[31] Consequently, "the [manager] has an incentive to act opportunistically, skimping on the quality of his performance, or even diverting to himself some of what was promised to the principal."[32] To assure that the manager does not shirk his responsibilities, the principal must engage in costly monitoring of the manager, which further reduces the value of the venture.[33] "While bad behavior may make a corporation or its management civilly or criminally liable, punishment can come as little comfort to an investor who has already lost their money."[34] And not all investors will have the resources to bring an enforcement action in the first place.

Aware of the principal-agent problem, the architects of an early version of a DAO smart contract sought to circumvent the problem by eliminating, or, at least, diminishing the powers of, the problem's cause, the manager. Created by Slock.it, a German corporation, and implemented on the Ethereum blockchain, "The DAO" operated according to a majority vote by its investors instead of entrusting the entirety of the investors' assets to a central manager who decides how to manage the assets.[35] In addition, by having "governance rules [that were] automated and enforced using software," The DAO did not even allow the choice of disobeying the governance rules that were hard-coded into the smart contract.[36]

Despite its advantages and lofty ideals, The DAO still could not fully resolve its problems of governance and dispute resolution. Smart contracts are only as perfect as the humans that write their code, and The DAO was no exception. Bugs in smart contract software are as inevitable as misunderstandings or misrepresentations in traditional contracts. The DAO, through majority vote, resolved a crippling contractual dispute that led to its downfall. However, a deeper

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[29] *Id.*
[30] *See* JENTZSCH, *supra* note 25, at 1.
[31] Armour, *supra* note 27, at 2.
[32] *Id* (footnote omitted).
[33] *Id.*
[34] JENTZSCH, *supra* note 25, at 1.
[35] *See id.* at 2.
[36] *Id.* at 1.

look into The DAO incident reveals that, without judicial oversight, self-directed dispute resolution has the potential to lead to the suppression of minority "shareholders" in the smart contract, engender self-dealing, and allow for fraud.

II
THE DAO AND ITS DOWNFALL

Central to the story of The DAO is Ether, one of the two leading cryptocurrencies used in the blockchain ecosystem today. Ether is the cryptocurrency used on the Ethereum blockchain and is the second most popular cryptocurrency behind Bitcoin. Ether can be exchanged for traditional fiat currency on online exchanges such as Coinbase.[37] The price of Ether has fluctuated between $102 and $335 in 2019.[38] At the time this Note was written on September 14, 2019, 1 unit of Ether was traded for $190 on Coinbase.[39]

Ether and the Ethereum blockchain have been continuously developed since 2013 by the Russian-Canadian programmer Vitalik Buterin. While the Bitcoin blockchain can also support smart contracts, the Ethereum blockchain has been widely regarded as the better platform for programming and publishing smart contracts. This is because "[E]thereum replaces [B]itcoin's more restrictive language . . . with a language that allows developers to write their own programs. . . . The [Ethereum] language . . . supports a broader set of computational instructions."[40] The focus of the Ethereum blockchain is to integrate real-world transactions into the blockchain ecosystem through the development of smart contracts.

A. The Mechanics and History of The DAO

The DAO is perhaps the most infamous case of a self-governed resolution of a smart contract dispute. The DAO was one of the first implementations of a virtual organization existing on a blockchain seeking to use smart contracts to formalize, automate, and enforce governance rules similar to those in traditional corporations.[41] Created by Slock.it, a German software company, and implemented on the Ethereum blockchain, The DAO was designed as a for-profit entity, similar to a mutual fund.

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[37] *See How to Buy Ethereum*, COINBASE, https://www.coinbase.com/buy-ethereum (last visited Sept. 14, 2019).

[38] *See Ethereum Price Chart (ETH)*, COINBASE, https://www.coinbase.com/price/ethereum (last visited Sept. 14, 2019).

[39] *See id.*

[40] Alyssa Hertig, *How Do Ethereum Smart Contracts Work?*, COINDESK, https://www.coindesk.com/information/ethereum-smart-contracts-work.

[41] *See* JENTZSCH, *supra* note 25, at 1.

The DAO would operate in a "decentralized" manner in that it would make decisions based on votes by investors.[42] The DAO was to be "autonomous," and would have a project proposal and voting process that would be automatically executed by the code of The DAO smart contract.[43]

The lifecycle of The DAO began in 2016 by amassing Ether from investors. In exchange for the investors' Ether, The DAO distributed DAO Tokens which were analogous to stock in a corporation; DAO Tokens represent both units of voting power and rights to The DAO's profits.[44] After an offering period of approximately four weeks, The DAO solicited "proposals" for how its funds might be used.[45,46] Any DAO Token Holder could submit a proposal on how to use The DAO's Ether.[47] One example of the proposals submitted to The DAO is Slock.it's own: a project "to design and manufacture a 'smart' lock system that would enable 'sharing economy' members (such as AirBnB homeowners) to programmatically grant access to their homes to approved renters."[48] Investors would earn rent on each transaction that used the smart lock system and voted by allocating their DAO Tokens for specific proposals (since DAO Tokens could be converted into Ether, this was conceptually similar to crowdfunding a project).[49] Proposals had to be approved by a "Curator" before investors could vote on them.[50] Initially chosen by Slock.it, curators were individuals who screened proposals to determine whether they originated from an identifiable party[51] and whether they had any fraudulent intent.[52] After a screening process, curators would present the proposals to investors by adding them to a

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[42] *See* SEC. & EXCH. COMM'N, RELEASE NO. 81207, REPORT OF INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934: THE DAO 4 (2017) [hereinafter SEC. & EXCH. COMM'N].

[43] *See id.*

[44] *See id.*

[45] *See* Quinn DuPont, *Experiments in Algorithmic Governance: A History and Ethnography of "The DAO," a Failed Decentralized Autonomous Organization, in* BITCOIN AND BEYOND: CRYPTOCURRENCIES, BLOCKCHAINS, AND GLOBAL GOVERNANCE 157, 160 (Malcolm Campbell-Verduyn ed., 2017).

[46] *See* JENTZSCH, *supra* note 25, at 2.

[47] *See id.*

[48] DuPont, *supra* note 45, at 161.

[49] *See id*. at 160.

[50] *See* SEC. & EXCH. COMM'N, *supra* note 42, at 7.

[51] *See id.*

[52] *See* JENTZSCH, *supra* note 25, at 2 ("For example, an attacker with 51% of the tokens, acquired either during the fueling period or created afterwards, could make a proposal to send all the funds to themselves. Since they would hold the majority of the tokens, they would always be able to pass their proposals.").

"whitelist." [53] The investors' voting rights weren't limited to voting on business proposals. Investors could propose and vote on a wide array of issues within The DAO, such as the election of a new curator and splitting The DAO into two.[54] Investors could even vote for specific decisions within approved projects such as the hiring of a new employee.[55] "The level of management granularity would be set by the [smart] contract . . . that runs on the blockchain, and projects could choose to have the minutia of decisions voted on by members, or decide to have only major decisions go to vote."[56]

After its launch on April 30, 2016, The DAO enjoyed widespread popularity within the blockchain community as it raised $150 million-worth of Ether.[57] However, this success was short lived. In late May, "concerns about the safety and security of The DAO's funds began to surface due to vulnerabilities in The DAO's code."[58] Finally on June 17, 2016, the codified implementation of The DAO smart contract diverged from its original intention. Several errors in the smart contract code written by the Slock.it team allowed a single "attacker" to drain approximately $50 million-worth of Ether from The DAO.[59] The DAO smart contract code had a built-in security measure preventing the attacker from immediately exchanging the siphoned Ether off of the Ethereum blockchain and into traditional currency, but the fate of the stolen funds and that of The DAO were in limbo. The stolen funds could not be retrieved, even by the Slock.it programmers who wrote and administered the smart contract, because the only point of access would be through the attacker's private key.

To secure the diverted Ether, Slock.it's founders, the Ethereum Foundation, and The DAO's biggest investors, with all their political clout in the blockchain community, pushed for a "Hard Fork" to the Ethereum blockchain.[60] A Hard Fork is an update to the blockchain's protocol which would result in a completely new blockchain.[61] Proponents of the Hard Fork, which included the Slock.it team, planned to revert the new blockchain to one that resembled the Ethereum blockchain

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[53] *See* SEC. & EXCH. COMM'N, *supra* note 42, at 8.
[54] *See* JENTZSCH, *supra* note 25, at 2-3.
[55] *See* DuPont, *supra* note 45, at 160.
[56] *Id.*
[57] *See* SEC. & EXCH. COMM'N, *supra* note 42, at 2-3.
[58] *See id.* at 9.
[59] *See id.*
[60] *See id*; *see also* DuPont, *supra* note 45, at 165.
[61] *See* ALLEN & OVERY LLP, *supra* note 24, at 4.

before the launch of The DAO.[62] This would also have the effect of returning all of the funds raised by The DAO, including those taken by the attacker, to The DAO investors.[63] In contrast to Slock.it's stance on the issue, a minority of investors argued that "code is law" and that a Hard Fork would go against the very spirit of decentralized autonomous organizations.[64] These dissidents thought that "[t]he hard fork would amount to an intervention—a bail-out of The DAO—seemingly at the behest of The DAO's biggest investors."[65] The purpose of the Ethereum blockchain and The DAO, after all, was to provide an immutable transactional record and host smart contracts that would solve the principal-agent problem. Yet all those ideals seemed to take a back seat when the financial and reputational interests of blockchain authorities were on the line. This conflict between Slock.it and their dissenting investors was a quintessential smart contract dispute, with one party looking to respect the original intent of the smart contract and the other seeking to strictly uphold its language (or code). After a majority vote among all participants of The DAO, they executed the Hard Fork, and the new Ethereum blockchain went live on July 20, 2016.[66]

B. The SEC Investigation of The DAO

On July 25, 2017, the Securities and Exchange Commission ("SEC") issued a report on The DAO incident. Although the focus of the SEC investigation was to determine whether DAO Tokens were securities, the report still identified significant shortcomings in The DAO's system of self-governance.

1. The Curators Designated by Slock.it Had Unfettered Power Within The DAO

The designers of The DAO smart contract created the curator position to protect investors from fraudulent proposals.[67] But, in doing so, The DAO inadvertently revived the managerial authority that it was meant to eliminate. The curators had "ultimate discretion as to whether or not to submit a [project] proposal for voting" by the investors.[68] The only guidelines that the curators had were to: (1) confirm that any project proposal for funding originated from an identifiable person or organization; and (2) confirm that the smart contracts associated with the project

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[62] *See* SEC. & EXCH. COMM'N, *supra* note 42, at 9.
[63] *See* ALLEN & OVERY LLP, *supra* note 24, at 4.
[64] *See* DuPont, *supra* note 45, at 165.
[65] ALLEN & OVERY LLP, *supra* note 24, at 4.
[66] *See* SEC. & EXCH. COMM'N, *supra* note 42, at 9.
[67] *See* JENTZSCH, *supra* note 25, at 2.
[68] SEC. & EXCH. COMM'N, *supra* note 42, at 8.

properly reflected its proposed intent.[69] If a curator determined that a proposal met these criteria, "[she] could add the proposal to the 'whitelist,' which was a list of Ethereum Blockchain addresses that could receive [funds] from The DAO if the majority of DAO Token holders voted for the proposal."[70] Curators also held control over "the order and frequency of proposals, and could impose subjective criteria for whether the proposal should be whitelisted."[71] The curators themselves admit to wielding such immense power. One of the curators designated by Slock.it stated that "the curator had 'complete control over the whitelist . . . the order in which things get whitelisted, the duration for which [proposals] get whitelisted, when things get unwhitelisted . . . [and] clear ability to control the order and frequency of proposals,' noting that 'curators have tremendous power.'"[72] Another curator "publicly announced his subjective criteria for determining whether to whitelist a proposal, which included his personal ethics."[73] The curators "also had the power to reduce the voting quorum requirement by 50% every other week" where the same effect would take place only if no proposal reached the minimum quorum requirement for 52 weeks.[74]

It is evident that the curators, as the gatekeepers of $150 million of digital funds, had great power and responsibility. However, Slock.it chose the curators unilaterally without soliciting any feedback from The DAO investors.[75] Instead of revealing any kind of selection process, Slock.it merely touted that the curators were well qualified and trustworthy.[76] The curators all appeared to live outside the United States and many of them were associated with the Ethereum Foundation, the developers of the Ethereum blockchain.[77] Slock.it, when programming The DAO's smart contract code, contemplated no check on the curators' power other than allowing investors to submit proposals for the replacement of a curator. It was the "curators [who] had the power to determine whether a proposal to remove curator was put to a vote."[78]

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[69] *See id.* at 7.
[70] *Id.* at 8.
[71] *Id.*
[72] *Id.* (quoting Epicenter, *EB134—Emin Gün Sirer And Vlad Zamfir: On A Rocky DAO*, YOUTUBE (June 6, 2016), https://www.youtube.com/watch?v=ON5GhIQdFU8).
[73] *Id.*
[74] *Id.*
[75] *See id.* at 7.
[76] *See id.* n.25.
[77] *See id.*
[78] *Id.* at 13.

The DAO incident was too short-lived to have developed any problems warranting an enforcement action from the SEC, but the highly suspect power structure of The DAO was a recipe for serious governance problems. The DAO's curators were the gatekeepers to proposals and thus have a strong say in how The DAO should use its funds. When considering that the curators had tremendous power, were difficult to remove, and had reason to endorse proposals favorable to Slock.it or the Ethereum Foundation, the notion that Slock.it had orchestrated a ripe opportunity to engage in self-dealing becomes quite plausible.

Imagine the following hypothetical: Slock.it submits a fraudulent proposal—disguised as legitimate—to the curators with the intent of funneling The DAO's funds into its venture. The curators, who are supposed to act as a check against such sham proposals, list the venture on The DAO's whitelist anyway because of their ties with Slock.it. At the voting stage, Slock.it, in league with The DAO's biggest investors, manages to gather more than 51% of The DAO's voting power and bulldozes the proposal through. Even if the minority investors figure out the scheme, any effort to protect their own funds, such as a proposal to split off their own funds into a new DAO, must go through the Slock.it-dominated curators and is unlikely to survive. The DAO's system of self-governance left open the possibility of Slock.it and majority investors misappropriating the minority investors' funds with no valid way for the minority investors to counteract Slock.it's devices.

2. The Voting Rights of The DAO Investors Did Not Afford Them Meaningful Control Over the Enterprise

The voting rights of DAO Token holders were limited "because DAO Token holders' ability to vote for contracts was a largely perfunctory one; and . . . DAO Token holders were widely dispersed and limited in their ability to communicate with one another."[79] The DAO's voting process was also designed to disincentivize voting against proposals.

First, DAO Token holders could only vote on proposals vetted by the curators. But that "clearance process did not include any mechanism to provide DAO Token holders with sufficient information to permit them to make informed voting decisions."[80] With no formal report on the projects from the curators, investors were substantially reliant on any information fed to them by Slock.it management.

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[79] *Id.* at 14.
[80] *Id.*

Second, the pseudonymity and dispersion of investors made it difficult for them to exchange information or join efforts to effect change within The DAO. "Investments in The DAO were made pseudonymously (such that the real-world identities of investors are not apparent), and there was great dispersion among those individuals and/or entities who were invested in The DAO and thousands of individuals and/or entities that traded DAO Tokens in . . . secondary market[s]."[81] Slock.it did create and maintain online forums on which investors could discuss project proposals, but the forums were hopelessly inadequate to serve as a gathering place for investors to form voting blocs to assert actual control over The DAO.[82] This was due to the Slock.it forums being open to pseudonymous non-investors as well as there being too many DAO token holders for them to effectively coordinate movements amongst themselves.[83] The inadequacy of the forums was "later demonstrated through the fact that DAO Token holders were unable to effectively address the Attack without the assistance of Slock.it."[84] The pseudonymity and dispersion of investors diluted their control over The DAO.

Third, investors' voting rights were further attenuated by The DAO's biased voting process. "[A]s noted in a May 27, 2016 blog post by a group of computer security researchers, The DAO's structure included a 'strong positive bias to vote YES on proposals and to suppress NO votes as a side effect of the way in which it restricts users' range of options following the casting of a vote.'"[85] The DAO's smart contract would tie up the DAO Tokens used in a vote of a proposal until that proposal was resolved. DAO Token holders could avoid such restrictions by abstaining from voting; any DAO Tokens not used in a vote could be freely withdrawn or transferred.[86] "As a result, DAO Token holders were incentivized either to vote yes or to abstain from voting."[87] Such a voting process would distort voting behavior, especially amongst smaller investors with fewer DAO Tokens to spare, and "would not accurately reflect the consensus of the majority of DAO Token holders."[88]

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[81] *Id.*
[82] *Id.* at 15.
[83] *Id.*
[84] *Id.*
[85] *Id.* at 7. *(quoting* Dino Mark et al., *A Call for a Temporary Moratorium on The DAO*, HACKING, DISTRIBUTED (May 27, 2016 1:35 PM), http://hackingdistributed.com/2016/05/27/dao-call-for-moratorium/).
[86] *Id.*
[87] *Id.*
[88] *Id.*

The limited voting rights of The DAO investors further increased their susceptibility to self-dealing. A lack of meaningful information on the proposals, no effective way to share the little information that the investors did have, and a strong bias to abstain or vote affirmatively meant that investors were more likely to inadvertently vote for fraudulent, self-dealing proposals.

III
THE MYTH OF SELF-GOVERNANCE OF TRADITIONAL CONTRACTS AND CORPORATIONS

The problems revealed in the SEC investigation are not specific to The DAO nor are they unique to entities on the blockchain. Traditional economics literature suggests that successful self-governance of a contractual dispute or of a corporation is a myth.

A. The Theory of Incomplete Contracts

The theory of incomplete contracts anticipates situations where the resolution of contractual disputes without a neutral third-party would lead to inefficient and inequitable outcomes. Consider two risk-neutral parties, a seller and a buyer of chicken, that can each profit by engaging in a transaction. The two parties initially meet on date zero, the seller agrees to invest in a shipment of chicken on date one, and the exchange of the chicken is scheduled to occur on date two. If it were possible for the parties, at date zero, to enter a contract that covers the entire transaction period and accounts for all possible contingencies, the seller would have enough confidence to fully invest in the chicken at an early stage of the transaction, and both parties would benefit. However, because contracts are incomplete by nature (i.e., it is impossible to *ex ante* bargain over all aspects of the contract),[89] the risk of *ex post* contractual disputes is inevitable. Suppose the buyer and seller agree on a contract specifying the price, quantity, and grade of chicken. However, the contract is silent on the type of chicken (i.e., does not distinguish between stewing chickens and broiling chickens). The interpretation of such missing or ambiguous contractual terms is typically left to a court, which may look to sources such as custom or trade usage to fill in the gaps of the contract. Interpreting the contract without a neutral third-party, however, will leave the party with greater bargaining power free to demand deference to its own interpretation of the contract. A neutral third-party is necessary to fairly construe ambiguous clauses.

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[89] *See* Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691, 699 (1986).

Even if the contract were free of ambiguities and clearly defined each party's obligations, its enforcement would be difficult without a neutral third-party. One kind of *ex post* dispute occurs on date one when the seller underinvests in the chicken out of fear of giving the buyer too much bargaining power on date two. This leads to an inefficient situation where the seller doesn't fully commit to a mutually beneficial transaction due to the seller's mistrust of the buyer, and the initial contract failed to account for that mistrust.[90] In such a dispute, the seller is apprehensive that the buyer will abuse his increased bargaining power at a later stage of the transaction when the seller has already invested heavily in the chicken. As a result, the seller refuses to invest in the full amount of chicken as specified in the contract made at date zero. Because the buyer's profitability is reliant on the seller fully performing his end of the bargain, the buyer has less bargaining power and may have to make some concessions if the two parties decide to renegotiate prior to date one.

Another kind of *ex post* dispute occurs when the seller does commit to an expensive investment in the chicken, but the buyer decides to abuse his bargaining position by opening renegotiations prior to the exchange of the chicken on date two. In this second kind of dispute, the seller has already sunk a great deal of capital into the chicken and is pressured to sell it off quickly. The seller is also likely to be incurring costs such as interest payments and storage fees that will continue to cut into his profit margins the longer the transaction is delayed. Knowing this, the buyer refuses to buy the full amount of chicken according to the terms decided on date zero. Because the seller's profitability depends on the buyer purchasing the entirety of the chicken without significant delay, the seller has less bargaining power and may have to yield to the buyer on some points if the two parties decide to renegotiate prior to date two.

Self-governance of such disputes is unlikely to be fair due to imbalances in bargaining power (favoring the seller on date one and the buyer on date two). In the absence of a neutral third-party, the party with greater bargaining power is likely to command more discretion with regards to the interpretation of the original contractual provisions and use it to produce an advantageous, but not necessarily accurate, reading of the contract. To control the exercise of discretion and prevent such inequitable and inefficient outcomes, a neutral third-party such as a court must intervene.

It is possible to draw parallels between hypothetical buyer-seller disputes and contractual disputes in the smart contract world. In a financial smart contract such

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[90] *See* Patrick W. Schmitz, *The Hold-Up Problem and Incomplete Contracts: A Survey of Recent Topics in Contract Theory*, 53 BULL. ECON. RES. 1, 4-6 (2001).

as The DAO, when the smart contract deviates from its original intent due to bugs in the code or unforeseen circumstances, renegotiations are likely to favor the party holding the cryptocurrencies rather than the investors who gave up those assets. An entity like Slock.it would have the bargaining power in this situation—it has technical expertise in the smart contract code, insider information about the proposals, and most importantly, possession of the assets. This is especially true on the blockchain since an investor who has already fully committed to a smart contract venture by transferring his cryptocurrencies cannot freely withdraw his investment. Cryptocurrency assets that have been transferred to another blockchain user's address, or wallet, can't be taken back without the address-holder's private key. Applying the theory of incomplete contracts to DAOs, it becomes clear that a neutral third-party is necessary to prevent potential abuses of superior bargaining power in smart contract disputes.

B. The Failure of "Self-Enforcing" Corporate Law in Post-Soviet Russia

Traditional economics literature also warns that the self-governance of corporations, resolving conflicts and policing conduct within a corporation without relying on courts, is also likely to fail. During the mass privatization of state-owned enterprises in the formerly centrally planned Russian economy, American law professors Bernard Black and Reinier Kraakman helped design "self-enforcing" corporate laws that would govern Russian joint stock companies.[91] The scholars were cognizant that "the corporate laws of developed economies . . . depend upon highly evolved market, legal, and governmental institutions and cultural norms that often do not exist in emerging economies"[92] and that Russia was infested with "insider-controlled companies, malfunctioning courts, weak and sometimes corrupt regulators, and poorly developed capital markets."[93] Thus, Black and Kraakman sought to devise a set of laws that would vest substantial decision-making power in large outside shareholders with incentives to make beneficial decisions for a company.[94] Their model self-enforcing law would achieve enforcement "through actions by direct participants in the corporate enterprise (shareholders, directors, and managers), rather than indirect participants (judges, regulators, legal and accounting professionals, and the financial press)."[95] Black and Kraakman envisioned that such a law would minimize the need for formal enforcement by courts, incentivize

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[91] *See* Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1912 (1996).

[92] *Id.* at 1913.

[93] *Id.* at 1915.

[94] *See id.*

[95] *Id.* at 1916.

managers and controlling shareholders to obey the rules, and reduce self-dealing by corporate insiders.[96]

Alas, the self-enforcing corporate law did not perform as expected, and privatization efforts in Russia were a massive failure.[97] Notwithstanding the law's effects, managers and controlling shareholders of major Russian companies engaged in extensive self-dealing which the government neglected to control.[98] In 1999, Black and Kraakman observed that "the Russian ruble has plunged; the Russian government has defaulted on both its dollar- and ruble-denominated debt, most banks are bankrupt; corruption is rampant, tax collection is abysmal, capital flight is pervasive, and new investment is scarce."[99] To say the least, the self-enforcing corporate law didn't work out too well.

The architects of the self-enforcing law identified several problems that contributed to the ineffectiveness of the self-enforcing corporate law, one of which is analogous to a problem faced by the blockchain world. "[M]ass privatization of large enterprises is likely to lead to massive insider self-dealing unless . . . a country has a good infrastructure for controlling self-dealing."[100] Black and Kraakman admit that "[t]he privatizers, ourselves included, underestimated the extent to which functioning law requires honest courts and prosecutors that can redress gross violations."[101] Good laws take years to write and good institutions take years to build, but privatization in Russia happened much too rapidly for good laws and institutions to take root.[102] Decent laws on securities, companies, and bankruptcy were adopted by 1998, but by that time corrupt company managers established their positions and opposed efforts to strengthen or enforce the laws.[103] The aftermath was a disaster: most company managers stole whatever assets their private enterprises had, killing otherwise viable companies.[104] Black and Kraakman observed that "Russia's core problem [in 2000 was] less lack of decent laws than lack of the infrastructure and political will to enforce them."[105] The self-enforcing corporate

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[96] *See id.* at 1915-16.

[97] *See* Bernard Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 STAN. L. REV. 1731, 1733 (2000).

[98] *See id.*

[99] *Id.*

[100] *Id.* at 1734.

[101] *Id.* at 1756.

[102] *See id.* at 1753.

[103] *See id.*

[104] *See id.* at 1734.

[105] *Id.* at 1755.

laws, which the American scholars themselves created, already prohibited much of the rampant self-dealing by managers and large shareholders, but they were hopelessly ineffective when entrusted to apathetic courts and prosecutors.[106] Black and Kraakman concluded by warning that "a decent legal and enforcement infrastructure must precede or at least accompany privatization of large firms" to prevent widespread self-dealing.[107]

Similar to Russia in the 1990s, there is no government or judicial oversight in the world of smart contracts to prevent insider self-dealing. In the United States, only Arizona and Tennessee have enacted legislation related to smart contracts, and even those bills merely acknowledge smart contracts as binding contracts.[108] Even regulatory bodies such as the SEC, despite retroactively ruling that The DAO should have registered the offer and sale of its DAO Tokens,[109] do not affirmatively seek to police the governance structures of similar entities on the blockchain. Lastly, there is no case law to provide guidance on smart contract disputes.[110] Smart contracts are currently in a blind spot of the law and if Black and Kraakman teach us anything, it is that self-governance of corporation-like entities will fail in the absence of well-established legal institutions. If left to their own devices without legal intervention, a self-governing DAO will most likely engage in self-dealing at the expense of its investors.

IV
THE NEED FOR DISPUTE RESOLUTION BY NEUTRAL THIRD-PARTIES IN DAOS

Traditional economics literature predicts that The DAO's self-governance would have broken down even if not for The DAO's exploitation by the attacker. Future iterations of DAOs, even those that are equipped with superior code and are free of Slock.it's curators, are unlikely to escape The DAO's fate. This is because

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[106] *See id.* at 1755-56 ("The reported price to stall a criminal investigation into, say, a business-related Mafia hit: $50,000 in Moscow; less elsewhere.").

[107] *Id.* at 1735.

[108] *See* Scott H. Kimpel & Chris Adcock, *The State of Smart Contract Legislation*, HUNTON ANDREWS KURTH LLP (Sept. 5, 2018), https://www.blockchainlegalresource.com/2018/09/state-smart-contract-legislation/#page=1; ARIZ. REV. STAT. ANN. § 44-7061 (2017); TENN. CODE ANN. § 47-10-202 (West 2018).

[109] *See* SEC. & EXCH. COMM'N, *supra* note 42, at 16.

[110] *See* Scott A. McKinney et al., *Smart Contracts, Blockchain, and the Next Frontier of Transactional Law*, 13 WASH. J.L. TECH. & ARTS 313, 325 (2018).

there is "no such thing as a fully decentralized and autonomous organization"[111] as Voshmgir argues:

> Depending on the governance rules, there are different levels of decentralization. While the network might be geographically decentralized, and have many independent but equal network actors, the governance rules written in the smart contract or blockchain protocol will always be a point of centralization and loss of direct autonomy. DAOs can be architecturally decentralized (independent actors run different nodes), and are geographically decentralized (subject to different jurisdictions), but they are logically centralized (the protocol). The question of how to upgrade the code—when and if necessary—is very often delegated to a set of experts who understand the techno-legal intricacies of the code, and therefore represent a point of centralization.[112]

Even the most impeccably designed DAOs will have a focal point, even if it is the slightest concentration of power. And whenever there is a disparity in power, no matter how minor, parties will seek to abuse it in the absence of a legal watchdog.

In a legal vacuum, DAOs cannot be expected to robustly handle disputes and governance problems on their own. It is clear that transactions on the blockchain network involving a sizable group of investors need a disinterested third-party to fairly resolve their disputes. This note explores three threshold questions that must be addressed before we jump to adjudication. The questions being: (1) What substantive rules should the neutral third-party use to adjudicate disputes from DAOs? (2) Which neutral third-party is best suited for this task? (3) And which parties ought to bring DAO smart contract disputes in front of a neutral third-party tribunal? This Note proposes that (1) the fiduciary duties of loyalty and due care from the law of corporations and the doctrine of public policy from the law of contracts should be applied (2) in the court system (3) by government regulatory bodies. To achieve this goal, a combination of efforts from the legislature and regulatory agencies would be needed.

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[111] Voshmgir, *supra* note 24.
[112] *See id.*

A. What to Enforce: Fiduciary Duties from Corporate Law and The Doctrine of Public Policy from Contract Law

On the issue of what substantive rules should be applied to DAOs, this Note borrows rules and doctrines from two areas of substantive law: corporate law and contract law. This is because of the dual nature of DAOs; a DAO is a programmable contract that vests voting rights and rights to profits to its "shareholders." This Note adopts the fiduciary duties of loyalty and due care as defined by state corporate law (e.g., Delaware General Corporate Law). This Note also supports the application of the well-established doctrine of public policy from contract law.

1. The Fiduciary Duties of Loyalty and Due Care

In a traditional corporation, "[d]irectors owe a duty of loyalty to the corporation . . . [that] both forbids directors to 'stand on both sides' of a transaction and prohibits them from deriving 'any personal benefit through self-dealing.'"[113] This has an effect of "mandat[ing] that a director not consider or represent interests other than the best interests of the corporation and its stockholders in making a business decision."[114] Directors also owe a duty of care in that they must exercise a "requisite degree of care in the process of decisionmaking and act on an informed basis."[115] Scholarship[116] and the current practice of state courts[117] also espouse the application of both fiduciary duties of loyalty and due care to non-corporate business entities such as limited liability companies.

The purported goal of DAOs is to successfully manage the assets under their control and to maximize their net economic returns. The manner in which DAOs achieve this may vary depending on their specific smart contract code, but they essentially follow the same script: investors entrust their cryptocurrency assets to a central administrator who manages the investments. Even in a DAO that has drastically attenuated the powers of the central administrator, some kind of

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[113] R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, BALOTTI AND FINKELSTEIN'S DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.16 (3d ed. Supp. II 2019) ("The duty of loyalty also 'encompasses cases where the fiduciary fails to act in good faith.'").

[114] *Id.*

[115] *Id.* at § 4.15.

[116] *See* Lyman Johnson, *Delaware's Non-Waivable Duties*, 91 B.U. L. REV. 701, 702 n.6 (2011).

[117] *See id.* at 2-3 n.8 ("In the absence of clear contractual language modifying or eliminating fiduciary duties, Delaware courts impose traditional fiduciary duties on managers and controlling members of LLCs. *See, e.g.*, Kelly v. Blum, C.A. No. 4516-VCP, 2010 WL 629850, at *10 nn.69-70 (Del. Ch. Feb. 24, 2010).").

centralization of power is unavoidable.[118] Insofar as the central administrator possesses some kind of authority over the investors' assets, it can be said that the investor and the central authority have formed a fiduciary relationship.

i. The Duty of Loyalty

When parties form such a fiduciary relationship, it is difficult to contract *ex ante* for specific behavior of the fiduciary due to the inherent uncertainty of asset management.[119] In addition, the cost of constantly monitoring the fiduciary is too high to be feasible.[120] Thus, in such a relationship, the beneficiary is exposed to a risk that the fiduciary may misappropriate the asset for his own benefit, but may not have sufficient information to determine whether the fiduciary has been acting in bad faith or not.[121] Due to the beneficiary's imperfect information, the probability of the fiduciary receiving a sanction for his wrongdoing is less than 100%. However, if the sanction for the fiduciary's misappropriation were mere disgorgement of the asset, misappropriation would be profitable on average, and a fiduciary cannot be deterred from stealing.[122] "Just as a thief cannot be deterred simply by requiring her to return the stolen goods whenever she is caught, [a fiduciary] cannot be deterred from appropriating the [beneficiary's] asset if the sanction is perfect disgorgement."[123] The fiduciary duty of loyalty is a bundle of rules designed to solve such a deterrence problem by raising the enforcement probability and increasing sanctions.[124] The duty of loyalty accomplishes this by imposing evidentiary rules (e.g., presumption of misappropriation, burden of proving a transaction's fairness on the fiduciary) — which raise the probability of enforcement—and punitive damages—which disincentivizes misappropriation because it requires more than mere disgorgement of the misappropriated asset.[125]

Such legal burdens (in the form of penalties and harsh evidentiary burdens), however, may cause fiduciaries to "respond defensively by avoiding questionable conduct, ensuring that compliance with fiduciary rules is apparent and incontestable,

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[118] *See* Voshmgir, *supra* note 24.

[119] *See* Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1046-47 (1991).

[120] *See id.* at 1047.

[121] When the only information revealed to the beneficiary is his poor returns, he cannot distinguish the fiduciary's misappropriation of the asset from the poor performance of the investment. *See id.* at 1051.

[122] *See id.* at 1052-53.

[123] *Id.* at 1053.

[124] *See id.* at 1054.

[125] *See id.* at 1054-56.

and obtaining the consent of [the beneficiary] . . . for potentially suspect transactions."[126] This will most likely "increase the fiduciary's costs, reduce her productivity, and cause her to forego advantageous opportunities."[127] To be economically justified, it is important for the specific rules in the fiduciary duty of loyalty to set a cost on fiduciaries that is less than the gain to beneficiaries from the decrease in wrongdoing by fiduciaries.[128] Neutral third-parties, tasked with adjudicating a DAO-related dispute, can rely on state corporate law to provide a rich background from which they can find laws on the duty of loyalty finely tuned to the economics of fiduciaries.

The fiduciary duty of loyalty should have its place in governing DAOs, even when the fiduciary's powers and functions over a beneficiary's assets are largely automated (and thus attenuated). As long as there exists some degree of centralization of power, which is inevitable,[129] a fiduciary can exert some degree of discretion over the beneficiary's asset, and that leaves room for misappropriation. The stakes are high, especially when countless DAO-like entities are already raising monumental sums of money through initial coin offerings ("ICOs"), the sale of "coins" (similar to the sale of DAO Tokens) to investors to raise cryptocurrencies to be used in various projects on the blockchain. In 2017, "there were a total of 552 ICOs with a volume of just over $7.0 billion."[130] By mid-2018, "537 ICOs with a total volume of more than $13.7 billion [had] been registered since the beginning of the year."[131] However, more than 80% of ICOs in 2017 were identified as scams.[132] Formalizing and enforcing the fiduciary duty of loyalty in the blockchain world could begin to stem the prevalence of such deceitful schemes.

ii. The Duty of Due Care

Misappropriation of assets is not the only way in which a fiduciary can breach his duty; a fiduciary may manage the beneficiary's assets carelessly. A fiduciary must make sound decisions on how to manage an asset by obtaining and relying on

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[126] *Id.* at 1064.
[127] *Id.* at 1064-65.
[128] *Id.* at 1065.
[129] *See* Voshmgir, *supra* note 24.
[130] Markus Kasanmascheff, *PwC Report Finds That 2018 ICO Volume is Already Double That of Previous Year*, COINTELEGRAPH (June 30, 2018), https://cointelegraph.com/news/pwc-report-finds-that-2018-ico-volume-is-already-double-that-of-previous-year.
[131] *Id.*
[132] *See* Ana Alexandre, *New Study Says 80 Percent of ICOs Conducted in 2017 Were Scams*, COINTELEGRAPH (July 13, 2018), https://cointelegraph.com/news/new-study-says-80-percent-of-icos-conducted-in-2017-were-scams.

relevant information.[133] The fiduciary duty of due care can also be seen as a bundle of rules, similar to the duty of loyalty, designed to incentivize a fiduciary to exercise diligence and care instead of shirking his responsibilities.[134]

Unlike the duty of loyalty, which requires the fiduciary to give no weight to his own interests, the duty of care should not require unwavering diligence to the beneficiary at the excessive expense of the fiduciary.[135] This makes economic sense because the more effort the fiduciary expends in managing an asset, the marginal cost for the fiduciary goes up while the marginal value for the beneficiary goes down.[136] In this context, if a fiduciary operates at a level of effort where his marginal cost remains lower than the marginal benefit for the beneficiary, he can be said to be shirking his duties.[137] Thus, for optimal deterrence, the duty of due care should charge a grossly negligent fiduciary with compensatory damages greater than the cost that he is saving by shirking.[138]

One may think that enforcing the duty of due care does not belong in DAOs. After all, many traditional processes requiring the diligence of the fiduciary can be either automated or delegated to investor vote in a DAO. However, no matter how trivial the effort, as long as there is some central authority exercising its diligent management over a DAO's assets, the duty of care is needed. Slock.it's curators could have been negligent in screening The DAO's proposals. A smart contract developer can be careless in programming a DAO's code. Enforcing the duty of due care will motivate fiduciaries in DAOs to exercise greater care and reduce human error in a field where even a small coding error can have dire consequences.

2. The Doctrine of Public Policy

Even with the fiduciary duties of loyalty and due care, it is still possible for DAOs to engage in illicit activity. Imagine a DAO that raises funds from investors to acquire drugs and sell them via the blockchain. Suppose that the smart contract code doesn't screen for age, making it possible for minors to purchase drugs. Imposing fiduciary duties will do nothing to prevent such criminal activity. The duties are designed to protect only the pecuniary interests of beneficiaries. After all, it could be said that the DAO was loyal to the profits of its investors and exercised due care in its transactions. The enforcement of the contract law doctrine of public

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[133] *See* Cooter & Freedman, *supra* note 119, at 1056.
[134] *See id*. at 1056-61.
[135] *See id*. at 1059.
[136] *See id*. at 1058.
[137] *See id*. at 1059.
[138] *See id.* at 1059-60.

policy, stating that an agreement is unenforceable if it goes against legislation or it is clearly outweighed by public policy,[139] is necessary to deter DAOs from being used for unlawful purposes.

An online platform that goes against the law and public policy, albeit not a smart contract on blockchain, was shut down by the Department of Justice in 2013. "Silk Road was a massive, anonymous criminal marketplace that operated using the Tor Network, which renders Internet traffic through the Tor browser extremely difficult to trace."[140] Originally founded on libertarian ideals, the marketplace quickly took a turn for the worse as its customers "principally bought and sold drugs, false identification documents, and computer hacking software."[141] Between 2011 and 2013, "thousands of vendors used Silk Road to sell approximately $183 million worth of illegal drugs, as well as other goods and services."[142] The founder of Silk Road, Ross Ulbricht, was found guilty for narcotics trafficking, money laundering, computer hacking, and operating a criminal enterprise.[143]

Another online enterprise, this time a blockchain smart contract, has recently caught the attention of the Commodities Futures Trading Commission ("CFTC").[144] Augur is a blockchain-based prediction market platform which launched in July 2018.[145] Running on the Ethereum blockchain, "Augur allows anyone to create contracts to predict future events such as the outcome of basketball games, elections, the price of Bitcoin or the closing value of the Dow Jones Industrial Average."[146] Bets and payouts are made using cryptocurrencies, and about $1.5 million was wagered within the first two weeks of Augur's launch. In many ways the distinction

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[139] *See* RESTATEMENT (SECOND) OF CONTRACTS § 178 (AM. LAW INST. 1981); *see also* 17A C.J.S. *Contracts* § 278 (2019) ("Contracts contrary to public policy, that is, those which tend to be injurious to the public or against the public good, are illegal and void, even though actual injury does not result therefrom.").

[140] United States v. Ulbricht, 858 F.3d 71, 82 (2d Cir. 2017).

[141] *Id.*

[142] *Id.*

[143] *See* United States v. Ulbricht, 31 F. Supp. 3d 540, 546 (S.D.N.Y. 2014).

[144] *See* Matthew Leising, *As Crypto Meets Prediction Markets, Regulators Take Notice*, BLOOMBERG (July 26, 2018), https://www.bloomberg.com/news/articles/2018-07-26/as-crypto-meets-prediction-markets-u-s-regulators-take-notice.

[145] *See* Mike Orcutt, *This New Blockchain-Based Betting Platform Could Cause Napster-Size Legal Headaches*, MIT TECH. REV. (Aug. 2, 2018), https://www.technologyreview.com/s/611757/this-new-ethereum-based-assassination-market-platform-could-cause-napster-size-legal/.

[146] Leising, *supra* note 144.

between prediction markets and gambling is not clear,[147] and one problem with Augur is that it could be seen as an online gambling site, which is illegal under federal laws.[148] Even if the bets occurring on Augur were not interpreted to be gambling, they at least constitute either event contracts or binary options, which are both unlawful to list without approval from the CFTC.[149] CFTC Commissioner Brian Quintenz has recently remarked that the CFTC has generally prohibited prediction markets, where individuals use binary options or event contracts to bet on the outcome of future events, as against public policy.[150] Event contracts present an even more alarming problem than gambling. "[E]vent contracts based upon war, terrorism, assassination, or other similar incidents may be contrary to the public interest"[151] because they present a financial incentive for event contract participants to actively engage in such activities. The CFTC has noted the resemblance of the Augur contracts to binary options and event contracts but has yet to pursue any action against Augur.[152]

Smart contracts were conceived to facilitate transactions. But because the blockchain space operates on a pseudonym-basis and is less regulated than traditional markets, it is prone to spawn illegal transactions and markets that go against the public welfare. Enforcing the contract law doctrine of public policy can help DAOs stay true to their purpose, facilitating transactions without producing negative externalities.

B. Which Neutral Third-Party Will Adjudicate: Courts, Arbitrators, or Blockchain Dispute Resolution Services[153]

The smart contract of The DAO appointed curators to oversee which project proposals would be selected and to act as caretakers of inactive token holders' funds.[154] Despite creating a managerial position that had the potential to be heavily abused and create disputes, The DAO smart contract didn't include any clause (or code) requiring the selection of a neutral third-party as a dispute resolution

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[147] *See* Orcutt, *supra* note 145.

[148] *See* 31 U.S.C. § 5363 (2006).

[149] *See* Orcutt, *supra* note 145.

[150] *See* Brian Quintenz, Comm'r, U.S. Commodity Futures Trading Comm'n, Remarks at the 38th Annual GITEX Technology Week Conference (Oct. 16, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz16.

[151] *Id.*

[152] *See* Leising, *supra* note 144.

[153] This section will assume that jurisdictional issues have already been resolved.

[154] *See* JENTZSCH, *supra* note 25, at 2.

mechanism.[155] This Note has already established that self-driven governance and dispute resolution, especially in a legal void such as the blockchain space, will always be fruitless. There are three viable options for dispute resolution: courts, arbitration, and dispute resolution services, and this Note will determine which neutral third-party is best situated to resolve disputes of DAOs by applying the aforementioned corporate law and contract law doctrines.

1. The Court System

Perhaps the most defining characteristic of DAO-related disputes is their novelty. Although blockchain technology made its public debut in 2008 when the Bitcoin whitepaper was released, it didn't gather mainstream attention until around 2014 when users began to realize that the underlying technology could be utilized for applications other than cryptocurrencies.[156] With blockchain technology and smart contracts only being exposed to the public eye for about five years, the law didn't have much time to catch up with their technological developments. This Note proposes that the court system is best suited to adjudicate smart contract disputes, especially when there is a dearth of positive law and judicial opinions on the topic of smart contracts.

The greatest advantage the court system has over other neutral third-parties is its ability to generate precedent. "American courts follow the doctrine of *stare decisis* and defer to earlier cases on similar issues."[157] *Stare decisis* confers many benefits on the American legal system such as predictability, efficiency, and legitimacy.[158] The court system's ability to set precedent is particularly valuable in an emergent area of law where there is no precedent to grant the above benefits. Even a single successful case of smart contract dispute resolution can provide a precious point of reference on which future courts and other tribunals can then rely.

When it comes to the first precedent-setting smart contract disputes, the adjudicating tribunal's primary concern should be the accuracy of the opinion. Accurate judgments require correctly applying the substantive law to the facts and

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[155] *See id.*

[156] *See* Bernard Marr, *A Very Brief History of Blockchain Technology Everyone Should Read*, FORBES (Feb. 18, 2018), https://www.forbes.com/sites/bernardmarr/2018/02/16/a-very-brief-history-of-blockchain-technology-everyone-should-read/.

[157] John M. Walker Jr., *The Role of Precedent in the United States: How Do Precedents Lose Their Binding Effect?*, STANFORD LAW SCH.: CHINESE GUIDING CASES PROJECT 2 (Feb. 29, 2016), https://cgc.law.stanford.edu/wp-content/uploads/sites/2/2016/02/CGCP-English-Commentary-15-Judge-Walker.pdf.

[158] *See id* at 3.

technology of the case. There is no reason to doubt the court system's legal expertise. Judges are more than capable of not only navigating the rules making up the fiduciary duties of loyalty and due care, but also discerning what is in the public's interest for the purpose of the contract law doctrine of public policy. While there may be valid concerns about the court's subject matter expertise in a smart contract dispute, courts have ample resources to develop adequate insight into blockchain technology. Judges have access to expert witnesses brought into court by the litigants, and courts are flexible enough to arrange for technology tutorials prepared by said experts.[159] Furthermore, there already exists a degree of specialization in the modern court system, both at the state and federal levels.[160] If smart contract disputes become more prevalent, state and federal legislatures may foster subject matter expertise in smart contracts and blockchain technology by creating specialized courts. The appeals process also increases the likelihood of the court system delivering an accurate judgment.

Finally, the court system has finely calibrated rules of evidence and procedure to ensure fair process. A self-governed contractual dispute is prone to abuses of bargaining power. This can be seen in the example of The DAO where investors weren't given meaningful control in a vote to resolve a smart-contract dispute. The smaller investors in The DAO were disadvantaged by a lack of voting information and a voting system that disproportionately favors voters with more votes to spare. The court system's rules of evidence and procedure, on the other hand, are established and upheld by neutral judges with no stake in the smart contract dispute. Unless the parties contract around them, the rules do not bend to fit the purposes of one party over the other. This guarantees that a party with greater bargaining power is not unduly favored in the court system.

This is not to say that the court system is without flaws. Litigation in courts can be lengthy and expensive. The parties may not want to reveal the details of their dispute to the public. Such drawbacks, however, are secondary to the goal of establishing accurate precedent through a fair process, especially when no such precedential authority yet exists.

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[159] *Markman* hearings in a patent infringement suit give federal district courts the discretion to entertain technology tutorials prepared by an expert. *See* J. Michael Jakes, *Using an Expert at a* Markman *Hearing: Practical and Tactical Considerations*, IP LITIGATOR (Aug. 2002, https://www.finnegan.com/en/insights/using-an-expert-at-a-markman-hearing-practical-and-tactical.html).

[160] *See* Chad M. Oldfather, *Judging, Expertise, and the Rule of Law*, 89 WASH. U. L. REV. 847, 847-48 (2012).

2. Arbitration

The number of federal civil cases resolved by trial between 1962 and 2002 has decreased by 84%.[161] "This dramatic decrease in the trial rate may be attributed, at least in part, to business and public concerns about the high costs and delays associated with full-blown litigation, its attendant risks and uncertainties, and its impact on business and personal relationships."[162] Conventional wisdom suggests that arbitration addresses these concerns by offering lower costs, shorter resolution times, confidentiality, and a more flexible process.[163]

Nevertheless, arbitration has a critical drawback as a dispute resolution mechanism that makes it incompatible with resolving smart contract disputes on DAOs. To the extent that arbitrators create precedent, it is unclear whether such precedent plays a meaningful role in guiding future disputes.[164] The Financial Industry Regulatory Authority ("FINRA"), which operates the largest securities dispute resolution forum in the United States, typically does not issue any explanations for their arbitration awards.[165] In a survey of National Association of Security Dealers ("NASD") arbitration awards from the years 2003 and 2004,[166] "fewer than 5% of awards provided even a brief explanation for the result, and fewer than half of these included anything 'that would be deemed an opinion by any stretch of the definition.'"[167] Surely securities arbitration awards, with such terse reasoning, would have very little, if any, precedential value. Other areas of arbitration, such as employment or class arbitration, do write reasoned awards, but they rely heavily judicial precedent and hardly consider arbitral precedent.[168] The literature has also suggested that even the parties to arbitration may not see arbitration awards as legitimate sources of legal authority.[169] As previously explained in Section IV.B.1,

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[161] *See* Thomas J. Stipanowich, *Arbitration: The "New Litigation,"* 2010 U. ILL. L. REV. 4 (2010).

[162] *Id.*

[163] *See id.*

[164] *See* W.C. Mark Weidenmaier, *Judging-Lite: How Arbitrators Use and Create Precedent*, 90 N.C. L. REV. 1091, 1124-31 (2012).

[165] *See id.* at 1104.

[166] NASD combined with the member regulation, enforcement, and arbitration operations of the New York Stock Exchange to form FINRA.

[167] Weidenmaier, *supra* note 164, at 1104 (citing Jennifer J. Johnson, *Wall Street Meets the Wild West: Bringing Law and Order to Securities Arbitration*, 84 N.C. L. REV. 123, 144 (2005)).

[168] Only 1.3% of employment arbitration awards and 15.5% of class arbitration awards cite arbitral precedent. Labor arbitration is a curious outlier with 76.2% of its awards citing arbitral precedent. *See* Weidenmaier, *supra* note 164, at 1125.

[169] *See id.* at 1130-31.

respect for precedent is what gives the American judicial system its predictability, efficiency, and legitimacy.[170] The importance of precedent is accentuated in a field that has no established body of formal legislative or judicial guidance. Without the ability to create persuasive precedent, it is unlikely that arbitration will function well in adjudicating disputes arising from smart contracts.

3. *Blockchain Dispute Resolution Services*

By "blockchain dispute resolution service," this Note refers to private dispute resolution services, which take the form of smart contracts that purport to manage disputes arising specifically from blockchain technology and smart contracts. Such services have been growing in number since cryptocurrencies gained mainstream popularity as an investment vehicle.[171] The essential function of these services is to elect an online jury that will determine the outcome of the dispute by majority vote. The procedures through which these services select jurors varies wildly, from randomly choosing from those who have invested cryptocurrencies in the service[172] to selecting from juror applicants pre-screened for legal experience.[173] Most blockchain dispute resolution services contemplate an incentive system where jurors not only receive an arbitration fee for their services, but also rack up a reputation score within the dispute resolution platform depending on the quality of their adjudications.[174] A higher reputation score will make the juror eligible for higher-stakes disputes and greater fees. One service proposes that all parties to a smart contract *ex ante* agree to deposit payments to an escrow account rather than make payments directly to the counterparty.[175] That service proposes guidelines for the timings of the deliveries of these payments to the escrow account and to the respective parties to the smart contract.[176]

Blockchain dispute resolution services are still in development and some have obvious flaws in their inner workings. But, it is conceivable that a well-functioning product could result if one were to take the well-thought-out and redeeming qualities

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[170] *See* Walker Jr., *supra* note 157.

[171] JUR, WHITEPAPER: DECENTRALIZED DISPUTE RESOLUTION INFRASTRUCTURE (2019), https://jur.io/wp-content/uploads/2019/05/jur-whitepaper-v.2.0.2.pdf; JURIS PROJECT, WHITEPAPER: JUSTICIA USQUAM EX NUSQUAM (Sept. 18, 2018), https://getjuris.com/publications; CLEMENT LESEAGE & FEDERICO AST, KLEROS (Sept. 2019), https://kleros.io/assets/whitepaper.pdf.

[172] *See* KLEROS, *supra* note 171, at 3.

[173] JURIS PROJECT, *supra* note 171, at 18-19.

[174] *See id.* at 40-46.

[175] JUR, *supra* note 171.

[176] *See id.* at 12.

from a variety of these services and combined them into a single service. This Note discusses blockchain dispute resolution services generally without limiting its analysis to any single service.

As articulated in Section IV.B.1 of this Note, a correct judgment requires both legal and subject matter expertise. The jurors for blockchain dispute resolution systems, compared to judges and arbitrators, would have unparalleled subject matter expertise on smart contracts. It can be presumed that the jurors, who are selected from users who have invested cryptocurrencies into the dispute resolution platform, possess at least a baseline understanding of how blockchains, cryptocurrencies, and smart contracts work. The same cannot be presumed for the jurors' legal expertise; they cannot be expected to have even an iota of familiarity with fiduciary duties or public policy exceptions in contracts. Clever design of a blockchain dispute resolution service's procedures can counteract the general lack of legal acumen amongst jurors to a certain extent, but these are imperfect solutions to a more fundamental problem. One particular service controls for its jurors' lack of legal knowledge by pre-screening jurors for legal experience, but still permits laypeople to join in on the adjudication.[177] Another service has a procedure for appeals, but without any guarantee that the next panel of jurors will be any more qualified.[178] The court system spends extensive resources toward building up its judges' subject matter expertise. Judges will have access to technology experts in the course of litigation. The court system is able to supply the time and expenses needed for judges to learn the requisite technical knowledge. Jurors of blockchain dispute resolution services, on the other hand, do not enjoy such support. A panel of jurors is not guaranteed to have a judge or other impartial legal professional to guide them. It is notably dubious whether blockchain dispute resolution services can adequately prepare their jurors to accurately adjudicate disputes, when they claim to issue decisions substantially faster and at a much lower cost than arbitration and litigation.[179]

The three blockchain dispute resolution services studied by this Note do not contemplate the generation of precedent.[180] They do not identify what substantive body of law they will rely on as their guiding principle. Instead, two of the platforms, Jur and Kleros, envision the blockchain community coming up with substantive

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[177] JURIS PROJECT, *supra* note 171, at 40-46.

[178] LESEAGE & AST, *supra* note 171, at 8.

[179] Jur claims that jurors will typically decide the most complex cases within 60 days. The simplest disputes are resolved for free within 24 hours. *See* JUR, *supra* note 171, at 31.

[180] *See* JURIS PROJECT, *supra* note 171; JUR, *supra* note 171; LESEAGE & AST, *supra* note 171.

guidelines about how to resolve disputes.[181] The blockchain dispute resolution services have not yet specified the details of this suggested mock legislation. Even if we were to assume that such guidelines could eventually transform blockchain dispute resolution services into an efficient and predictable system, blockchain dispute resolution services are far from achieving that goal. In their current state, different blockchain dispute resolution services with different jurors would most likely diverge in their rulings for an identical dispute; the different services are akin to black boxes that spit out arbitrarily decided verdicts.

4. The Unique Problem of Enforcement

There is one attribute of the different neutral third parties that we haven't yet discussed—enforcement ability. How effectively can the different neutral third parties enforce their award of damages? Courts typically enforce civil damages awards by issuing a writ of execution.[182] The writ empowers an enforcement officer to garnish the debtor's wages, bank account, or other assets.[183] Awards from arbitration and blockchain dispute resolution services can also be collected in the above manner by having a court confirm the award.[184]

Smart contract disputes are unique because the disputes involve cryptocurrencies, which can be very difficult to retrieve. If a party is holding its assets on a widely used cryptocurrency exchange, a writ of execution could be sufficient to compel the exchange to surrender the relevant assets. Even if the assets were not retrievable from the cryptocurrency exchange, an enforcement officer could collect money by seizing other properties owned by the debtor. However, things become much more complicated if the debtor owns all of his assets as cryptocurrencies in an address that is privately held. In other words, only the debtor has the private key to his cryptocurrency "wallet" and consequently, only the debtor is able to withdraw his cryptocurrencies. This creates a difficult situation because the standard ways in which enforcement officers go about collecting payments aren't going to get them any closer to the cryptocurrencies. In such situations, courts can

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[181] *See* JUR, *supra* note 171, at 20; LESEAGE & AST, *supra* note 171, at 10.

[182] *See* Fed. R. Civ. P. 69(a).

[183] *See* NEW YORK STATE UNIFIED COURT SYSTEM, COLLECTING THE JUDGMENT, (Apr. 1, 2013), https://www.nycourts.gov/courts/nyc/civil/collectingjudg.shtml; *see also* COLLECTION BASICS, NEW YORK STATE UNIFIED COURT SYSTEM (Mar. 14, 2018), https://www.nycourts.gov/courthelp/AfterCourt/collectionBasics.shtml.

[184] The language of the Federal Arbitration Act allows the appointment of blockchain dispute resolution services as arbitrators, provided that the parties agree by written contract. Parties to the arbitration may apply to a court to confirm arbitration awards. *See* 9 U.S.C. §§ 2, 9 (West 2018).

only incarcerate the disobeying party under a civil contempt charge until they comply with the court's order.[185]

Where courts and arbitrators would struggle to enforce a judgment involving cryptocurrencies, blockchain dispute resolution services provide a potential work-around for the problem. The blockchain dispute resolution services Kleros and Jur also provide escrow accounts in their smart contracts.[186] The Kleros and Jur escrow accounts can be opted into during contractual negotiations. Rather than making direct cryptocurrency payments to the other party at each contractual step, holding the payments in escrow and delaying delivery until the parties demonstrate further performance of the smart contract could circumvent difficult enforcement problems and hold-up problems. Protocols on smart contract design developed by blockchain dispute resolution services can serve as guidelines on how exactly to structure these transactions.[187]

C. Who Will Enforce: Private Investors or Government Regulatory Agencies

The final question posed by this Note is which agent is in the best position to enforce the law on otherwise unregulated disputes in DAOs. This Note has identified two categories of litigants that can potentially meet the challenge: private investors to the smart contracts and government regulatory agencies.

1. Private Investors

Before we inquire into the legal options that private actors can pursue against self-governed DAOs, it is important to identify who the average private investor is. Although there is some variance between survey results, they all seem to agree that the average cryptocurrency holder is male, millennial (between 18 and 39 years of age), and middle class (income of $50,000 to $100,000 a year).[188]

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185 Philip Moustakis, Lecture at New York University Stern School of Business (Mar. 27, 2019).

186 *See* JUR, *supra* note 171, at 12; Stuart James, *Kleros Escrow Explainer—Secure Your Blockchain Transactions Today*, KLEROS (Apr. 30, 2019), https://blog.kleros.io/kleros-escrow-secure-your-blockchain-transactions-today.

187 *See* JUR, *supra* note 171, at 12-14.

188 *See* Paul R. La Monica, *The Average Bitcoin Investor Really Is Young, Rich and Male*, CNN BUS. (Oct. 5, 2018), https://www.cnn.com/2018/10/05/tech/bitcoin-investors-survey/index.html; Kari Stray, *Bitcoin Users: Who They Are and What They Do?*, COINTELEGRAPH (Aug. 1, 2017), https://cointelegraph.com/news/bitcoin-users-who-they-are-and-what-they-do; Bloomberg, *This Is What the Average Bitcoin Owner Looks Like*, FORTUNE (Jan. 24, 2018), https://fortune.com/2018/01/24/young-men-buying-bitcoin.

With their relatively modest means, it is improbable that individual private investors will be able to bring large-scale smart contract disputes to court. Burbank, Farhang, and Kritzer have made the following observations while assessing private enforcement regimes:

> In the absence of public legal aid or a private interest group champion, the poor and those of modest means who wish to initiate civil litigation require other forms of assistance in order to gain access to the market for legal services. Since the turn of the twentieth century, clients and lawyers have been free to contract for a no-win, no-fee representation. . . . Such arrangements are most common in, but not restricted to, tort litigation and they most commonly call for the lawyer to receive one-third of any monetary judgment. It is also typical of such arrangements that the lawyer will pay the costs of litigation, subject to full or partial reimbursement in the event of success. . . . [However,] [t]he opportunity to earn a contingent fee is unlikely to attract lawyers unless there is a reasonable prospect for a substantial monetary recovery. . . . As the cost of litigation has increased, two phenomena may have enhanced the importance of litigation-funding mechanisms that permit clients and their attorneys to look elsewhere than the clients' personal assets to fund legal representation. First, some of what was affordable litigation for fee-paying clients 40 or 50 years ago may no longer be, at least in federal court, with the result that those at risk of being denied access to the market for legal services are not just the poor and those of modest means but a larger segment of the middle class.[189]

There are no public or private interest groups offering to fund litigation over smart contract disputes. Smart contract disputes have no precedent in the court system, and prospects for monetary recovery would be highly speculative at best. Even if investors sought to lower costs by consolidating their legal efforts, this is unlikely to be feasible since the investors will most likely be too dispersed and limited in their ability to communicate with each other.

There is another roadblock discouraging private investors from bringing smart contract disputes to court: it is unclear whether there are any private rights of action, express or implied, through which the private investors can claim relief. Unlike shareholder derivative suits in the corporate context, where the shareholders' claims and procedures are well defined, there is no legislation or case law that outlines what

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[189] Stephen B. Burbank et al., *Private Enforcement*, 17 LEWIS & CLARK L. REV. 637, 653-54 (2013).

claims a plaintiff can bring in a dispute with a DAO. Considering that the Arizona and Tennessee legislatures enacted legislation acknowledging the legality of smart contracts, private investors may be able to bring contract law claims in those jurisdictions.[190] Even in those jurisdictions, however, private investors would have difficulty enforcing fiduciary duties onto DAOs.

2. Government Regulatory Agencies

Government agencies such as the SEC and the Commodity Futures Trading Commission ("CFTC") have been fairly active in exercising oversight in the blockchain space. "[I]n early February 2018, the Chairman of the SEC and the Chairman of the CFTC both testified at a [Senate] hearing . . . entitled 'Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission.'"[191] The testimony demonstrated the continued collaboration and commitment of the two agencies to enforce the law on the blockchain.[192] This Note presents enforcement actions by the SEC and CFTC addressing problems most analogous to those articulated by this Note.

On September 11, 2018, the SEC issued the Crypto Asset Management Order, "finding that the manager of a hedge fund formed for the purpose of investing in digital assets had improperly failed to register the fund as an investment company."[193] The SEC also classified the fund's manager as an investment adviser, and found that he violated the antifraud provisions of the Investment Advisers Act of 1940 by making misleading statements to investors in the fund.[194]

On January 24, 2018, the CFTC announced an enforcement action against the operators of My Big Coin ("MBC"), a cryptocurrency, alleging commodity fraud

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[190] *See* ARIZ. REV. STAT. ANN. § 44-7061 (2017); TENN. CODE ANN. § 47-10-202 (West 2018).

[191] J. Dax Hansen et al., *More Legal Aspects of Smart Contract Applications*, PERKINS COIE 13 (Mar. 2018), https://www.perkinscoie.com/images/content/1/9/v3/199672/2018-More-Legal-Aspects-of-Smart-Contract-Applications-White-Pa.pdf.

[192] *See id.*

[193] *Statement on Digital Asset Securities Issuance and Trading*, U.S. SEC. AND EXCH. COMM'N (Nov. 16, 2018), https://www.sec.gov/news/public-statement/digital-asset-securites-issuuance-and-trading.

[194] The misleading statements, however, were that the fund was regulated by the SEC and that the fund had filed a registration statement with the agency. *See SEC Charges Digital Asset Hedge Fund Manager With Misrepresentations and Registration Failures*, U.S. SEC. AND EXCH. COMM'N (Sept. 11, 2018), https://www.sec.gov/news/press-release/2018-186.

and misappropriation.[195] The defendants allegedly misappropriated over $6 million from investors "by, among other things, transferring customer funds into personal bank accounts, and using those funds for personal expenses and the purchase of luxury goods."[196]

The SEC's and CFTC's enforcement actions are certainly steps in the right direction. They were, however, focused on prosecuting failures to register a venture with an agency (e.g., failures to register a security, an exchange, or a commodity) or blatant misrepresentations and frauds. The governance issues of DAOs that this Note seeks to address are more subtle and harder to detect but can have equally disastrous consequences. The real problem highlighted by The DAO incident isn't the hacking attack that led to The DAO's downfall; it's the allegedly self-governing power structure within The DAO that, in reality, gave its investors no meaningful control over the entire enterprise and left them open to manipulation and exploitation. Government regulatory agencies, with their greater resources and expertise, should affirmatively investigate the suspect governance structures of DAOs and similar entities.

CONCLUSION

In the February 26, 1995 issue of Newsweek, American astronomer and author Clifford Stoll illustrated his skepticism of the Internet:

> After two decades online, I'm perplexed. It's not that I haven't had a gas of a good time on the Internet. I've met great people and even caught a hacker or two. But today, I'm uneasy about this most trendy and oversold community. Visionaries see a future of telecommuting workers, interactive libraries and multimedia classrooms. They speak of electronic town meetings and virtual communities. Commerce and business will shift from offices and malls to networks and modems. And the freedom of digital networks will make government more democratic.
>
> Baloney. Do our computer pundits lack all common sense? The truth in no online database will replace your daily newspaper, no CD-ROM can

[195] *See CFTC Charges Randall Crater, Mark Gillespie, and My Big Coin Pay, Inc. with Fraud and Misappropriation in Ongoing Virtual Currency Scam*, U.S. COMMODITY FUTURES TRADING COMM'N (Jan. 24, 2018), https://www.cftc.gov/PressRoom/PressReleases/pr7678-18.

[196] *Id*.

> take the place of a competent teacher and no computer network will change the way government works.[197]

Like the Internet back in the 1990s, blockchain technology is poised to change the world. Smart contracts have great potential to reduce costs for financial transactions. DAOs have the capacity to engender business entities that greatly simplify and automate traditional institutional governance regimes. Like any revolutionary invention, however, these nascent technologies will have to endure suspicions and growing pains before adoption by the greater society.

One such growing pain is the prevalence of fraud in the blockchain community. Despite the booming interest in blockchain technologies—the total market capitalization for cryptocurrencies peaked at $795 billion in January 2018—shady dealings abound.[198] While studies disagree on the extent to which ICOs fail to deliver, the consensus seems to be that the typical ICO investment performs extremely poorly.[199] In addition, 78% of ICOs have been identified as scams.[200]

There is a lack of legislative and judicial oversight in the blockchain space. In such a legal vacuum, organization-like smart contracts, or DAOs, have resorted to resolving governance disputes on their own. This Note, through a case study of The DAO and review of economics literature, posits that self-governance of DAOs will ultimately result in misgovernance. Legislative, judicial, and regulatory bodies should work in tandem to affirmatively police the questionable governance practices of DAOs and enable an otherwise revolutionary technology.

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[197] Clifford Stoll, *Why the Web Won't Be Nirvana*, NEWSWEEK (Feb. 26, 1995), https://www.newsweek.com/clifford-stoll-why-web-wont-be-nirvana-185306.

[198] *Global Charts*, COINMARKETCAP, https://coinmarketcap.com/charts (last visited Sept. 22, 2019).

[199] *See* Ana Alexandre, *Research: ICO Market Down Almost 100% From a Year Ago, Raised $40 Million in Q1 2019*, COINTELEGRAPH (May 13, 2019), https://cointelegraph.com/news/research-ico-market-down-almost-100-from-a-year-ago-raised-40-million-in-q1-2019; U.S. COMMODITY FUTURES TRADING COMM'N, *supra* note 195; Sabrina T. Howell et al., *Initial Coin Offerings: Financing Growth with Cryptocurrency Token Sales*, EUROPEAN CORP. GOVERNANCE INST. 1, 27 (2018), https://ecgi.global/sites/default/files/working_papers/documents/finalhowellniessneryermack.pdf.

[200] *See* Alexandre, *supra* note 199 (citing SHERWIN DOLAT, CRYPTOASSET MARKET COVERAGE INITIATION: NETWORK CREATION, 24 (July 11, 2018)).