Nicolas Chartier, coproducer of the Academy Award-winning film *The Hurt Locker*, successfully overcame the challenges of independent film financing.  

Page 8
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SAN DIEGO   ORANGE COUNTY   LOS ANGELES   SAN FRANCISCO
FEATURES

26 Hard Money
BY JOHN W. CONES
The financing of independent films through contingent promissory notes is likely subject to state and federal securities laws

33 Boxing Match
BY ROBERT G. BADAL, CAROLINE KANE, AND BETHANY STEVENS
The litigation over Redbox’s distribution of DVDs demonstrates that, even when intellectual property rights are involved, a concerted refusal to deal can draw antitrust scrutiny

Plus: Earn MCLE credit. MCLE Test No. 192 appears on page 35.

38 Copy Caveats
BY MILES FELDMAN AND DANIEL FIORE
Courts continue to struggle to define the limits of permitted copying of entertainment in light of new technologies

DEPARTMENTS

10 Barristers Tips
Preventing idea submissions from being stolen
BY PAUL MENES

14 Practice Tips
The future of the FCC’s new indecency policy
BY JOHN F. STEPHENS AND MATTHEW G. STEIN

19 Tax Tips
The taxation of deferred compensation in standard service agreements
BY BRADFORD S. COHEN AND ROBIN C. GILDEN

48 Closing Argument
How can a lawyer become a producer?
BY MICHAEL J. WEISS

46 Classifieds

46 Index to Advertisers

47 CLE Preview
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Mr. Gleitman has practiced sophisticated estate planning for 26 years, specializing for more than 14 years in offshore asset protection planning. He has had and continues to receive many referrals from major law firms and the Big Four. He has submitted 52 estate planning issues to the IRS for private letter ruling requests; the IRS has granted him favorable rulings on all 52 requests. Twenty-three of those rulings were on sophisticated asset protection planning strategies.

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This issue marks *Los Angeles Lawyer*’s 26th annual Entertainment Law Issue. Over the years we have published articles covering a wide range of legal issues affecting the entertainment industry. One area that has proven to be continually fertile for our writers and readers is independent film financing. The financing structures for independent films evolve with the same frequency as changes in financing sources. For a business in which profitability is the exception to the rule, stability is elusive.

In this issue, John W. Cones analyzes the use of contingent promissory notes as a form of financing for independent films. Contingent promissory notes typically are employed in an effort to avoid the obligations of security laws by recasting an equity investment as debt financing. But, as Cones warns, this is risky. Courts will likely treat contingent promissory notes as an equity investment subject to securities laws.

*The Hurt Locker*, which won this year’s Academy Award for Best Picture, is an interesting example of the success that can be achieved by independent films. The producers financed and produced the film through debt, mezzanine, and equity financing—despite the fact that the film did not meet traditional market criteria. In many ways, its producers—including Nicolas Chartier, who is featured on our cover—were forced to swim upstream. In doing so, they may have expanded the market for independent films.

Currently, most independent films are financed by a combination of debt, mezzanine, and equity financing as well as some form of territorial incentives, such as tax credits. Sometimes the equity investors are savvy about the film business, analyzing an investment meticulously prior to financing. Many times, however, the equity investors have little to no experience in the entertainment industry and provide financing without significant analysis and for reasons other than purely financial considerations. If a film fails, the parties from the latter group are most likely to complain and consider claims against the producer, including claims for securities violations.

Many independent films financed through current structures result from a compromise between commercial necessities and creative desires. Producers may select certain actors and directors because of their perceived value in specified territories. Moreover, producers often avoid entire genres of films because they are deemed as lacking enough value in the international market to garner sufficient international presales and estimates supporting the required debt and mezzanine financing.

*The Hurt Locker* was financed despite its nonconformity with traditional requirements for commercial independent films. Its cast was not seen as highly valuable in the international market. It was filmed in Jordan, a country not offering any production incentives. Its subject matter, the Iraq War, was viewed as having no economic value in the international marketplace. Despite these obstacles, the producers made their film. Maybe the success of *The Hurt Locker* will lead to new forms of financing for independent films. If that occurs, lawyers facilitating these projects will have to adapt once again to the ever-evolving market of independent film financing.
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Preventing Idea Submissions from Being Stolen

JUST ABOUT EVERYONE at one time or another has had an idea for a movie, TV show, product, or service. Many people decide to take a shot at making their dreams of fame or fortune a reality or a reality show. But there are great dangers facing an idea submitter unless he or she is properly protected. An attorney does not want clients to see their ideas appear on store shelves, television, or a movie screen without seeing any money, credit, or attribution. Knowing the basics of idea protection may help attorneys avoid being at the receiving end of an aggrieved client’s homicidal impulses. With good legal advice and effective planning, a lot can be done to protect a client’s idea before and during submission.

For many people, the first step in idea protection is a copyright. However, copyright law holds that copyright protection exists only for “original works of authorship fixed in any tangible medium of expression.” Examples include writings, sound recordings, pictures, movies, other audiovisual works, sculptures, drawings, content that is visible or audible on devices, architecture, and choreography. The law specifically distinguishes between a “fixed” and “tangible” work and an idea, stating, “In no case does copyright protection for an original work of authorship extend to any idea…regardless of the form in which it is described, explained, illustrated, or embodied in such work.” However, ideas and their submission are protected under the law of California and other states.

Proper Use of Copyright

If a client is an idea person, the first step to take before submitting anything is to commit a version of the idea to paper, videotape, film, or other tangible medium. This forces clients to be specific with an idea. Clients should be as detailed as possible regarding characters, story lines, plot points, locations, functionality, and look and feel, depending on the submission. This specificity can also qualify for the substantial similarity test, which, along with access, are the two major elements needed to establish copyright infringement under federal law and idea theft under California law.

Copyright attaches to an original work upon creation, not registration, but to protect an idea, step two is to register the client’s work with the Copyright Office. Registration establishes a date of creation. If two very similar works are created without the creator of one knowing about or copying elements of the other, the first in time usually wins. Registration is also a prerequisite to filing a copyright infringement suit and the noninfringing party’s right to claim certain statutory damages and attorney’s fees from the infringers.

The third step is for the client to place a conspicuous copyright notice on his or her submission materials before disseminating any copies. It should be “affixed in such manner and location as to give reasonable notice of the claim of copyright.”

California Law

In California and in other states, state law allows idea theft claims under several theories. One is that the submission constitutes an implied-in-fact contract if the conduct of the parties manifests its existence and terms. Another is misappropriation of the submitter’s confidential, proprietary information or trade secrets, per California’s Uniform Trade Secrets Act (Civil Code Sections 3426 et seq.), which provides for injunctive relief and monetary damages for the acquisition and use of a trade secret. Relief has also been granted when the recipient breaches a fiduciary duty to the submitter. A separate cause of action exists for violation of a recipient’s duty to maintain a confidential relationship.

The NDA

Although the elements needed to prove these theories are different, an ideal way of gaining protection for the submitter under federal and state law is to get the recipient to sign a nondisclosure or confidentiality agreement (often called an NDA) before submission. As with submission materials themselves, the more specificity in an NDA the better. Courts are loath to enforce broadly worded NDAs. Provisions to have in NDAs include:

- A clear statement or definition of the materials being submitted.
- The specific limited purpose for which they are being submitted.
- A provision limiting those people on the recipient side who are authorized to review the materials.
- A strict, detailed confidentiality provision including language that specifies which particular materials in the submission constitute the submitter’s confidential information and trade secrets.
- A specific, revocable time limit to evaluate the materials for the purpose.
- Upon termination for any reason, all submitted materials and any copies and derivatives are all returned to the submitter or the submitter’s attorney.
- An acknowledgement by the recipient that the submitter expects to receive money, other compensation, credit, or other attribution for any use of any of the materials by anyone.
- Any use of any of the materials except for evaluating them for the purpose for which they are being submitted is intentional copyright infringement and violations of applicable state law.

The NDA should be mutual if applicable. The submitter client may learn some of the receiver’s confidential information during discussions about the materials or the purpose. Making an NDA mutual may give the recipient more incentive to sign. Unfortunately, there are more people who want to submit ideas than there are people or companies to submit them to. Many recipients will not accept unsolicited materials. Or, the recipient may require a submitter to sign a very one-sided NDA that limits the submitter’s rights and remedies.

If the recipient will not agree to the submitter’s NDA and will only accept the materials without one, the next best thing to an NDA is

Paul Menes practices entertainment and IP law with Sedgwick, Detert, Moran & Arnold in Los Angeles. He thanks Ira M. Steinberg for assistance with legal research for this article, the full text of which is available on request from the author.
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to send letters or e-mail messages that “convey your anticipation” (CYA). E-mail is preferable because recipients can claim they never received letters. Letters should be sent via registered mail, FedEx, or other confirmed delivery method. However, these delivery methods may raise the suspicions of idea recipients and cause submissions to be rejected.

The basic purpose of CYA correspondence is to confirm as much as possible the facts of a submission. It is very important that the tone of CYA correspondence be friendly, conversational, and innocuous. A cover e-mail should note how happy the submitter is to have the opportunity to submit, include a list of what materials are being submitted, explain why the material is being submitted (the purpose), state what the recipient is expected to do with the materials, and ask the recipient to contact the submitter or submitter’s attorney should the recipient want to express opinions, ask questions, or discuss the materials. Finally, the CYA correspondence should indicate that the client expects compensation if the recipient wants to make any use of the materials.

If the recipient indicates a desire to have a meeting or telephone conference about the materials, either initially or after submission, the submitter’s attorney should confirm the meeting and its purpose in writing. An e-mail reply should also be sent after contact by telephone or in person. The message should thank the recipient for his or her time and interest and briefly summarize what was discussed and whether any further discussions or meetings are contemplated.

In the unfortunate event that a client decides to file a claim for copyright infringement or theft of an idea, a signed NDA or CYA correspondence can help establish the necessary elements. The more similarity between specific points, details, and characterizations between the submitted materials and the alleged infringing materials, the likelier it is to be able to prove substantial similarity.

The excitement of an innovative idea for a show, movie, product, or service is contagious, but eagerly sharing that idea can ruin a person’s chances for obtaining the deserved fruits of his or her creativity. Following the proper steps greatly increases the odds.

---

4 Golding v. RKO Pictures, Inc., 35 Cal. 2d 690, 695 (1950); Sid & Marty Krofft Television v. McDonald’s Corp., 562 F. 2d 1157 (9th Cir. 1977).
6 CIV. CODE §1621.
8 Davies, 14 Cal. 3d at 510.
SINCE APRIL 2009, A SLIP OF THE TONGUE in a celebrity’s speech or by a news reporter under deadly fire can result in a payment of a huge fine to the Federal Communications Commission. In FCC v. Fox Television Stations, the Supreme Court’s recent indecency-related decision, the Court upheld the FCC’s new policy banning the use of isolated utterances of four-letter words as indecent, finding the policy “entirely rational” under the law that governs federal administrative powers. The 5-4 decision effectively expands the sanctioning power of the FCC and has resulted in nervous huddles around delay equipment during live television and radio broadcasts, with hands ready to slam the delay button, lest a flippant expletive leak onto the airwaves.

This precedent-setting case arose from a lawsuit brought by Fox after the FCC reprimanded the network for two incidents that occurred in 2002 and 2003. Singer Cher and television personality Nicole Richie used variations of four-letter words during live award show broadcasts. The FCC based its decision on purported statutory authority to prohibit indecent broadcasts and declared for the first time that an isolated use of an expletive can be deemed actionably indecent when viewed in the context of the broadcast as a whole. This approach signaled a drastic change in policy, in that prior FCC decisions indicated that the FCC would not take action against the one-time utterance of single-word expletives. Pursuant to this new policy, the FCC issued a Notice of Apparent Liability to the Fox television network but declined to impose sanctions for either incident.

Under the Administrative Procedure Act, actions by federal administrative agencies may be challenged on the ground that they are arbitrary or capricious. Fox, joined by the other major broadcast networks, argued that the FCC acted arbitrarily or capriciously in changing its policy regarding fleeting expletives. The Second Circuit agreed, holding that the FCC's new policy was arbitrary and capricious because the FCC had “failed to articulate a reasoned basis for its change in policy.” Although the Second Circuit mentioned that it appeared that the FCC was regulating profane speech, it did not directly address the First Amendment issues in any detail.

The FCC did not accept the Court's offer to explain its new policy on fleeting expletives, believing any explanation would be futile in view of the Second Circuit's comments about the FCC's chance of surviving a First Amendment challenge. The FCC's petition for certiorari raised only a statutory question, not a constitutional argument. Specifically, the FCC asked the Supreme Court to decide whether the Second Circuit was wrong in striking down the single-usage ban under the indecency provision of communications law.

The Court subsequently granted certiorari for the purpose of reviewing the Second Circuit’s reversal of the two orders against Fox by the FCC. The grant of certiorari initially surprised broadcasters, because the appeal was based on a procedural issue rather than substantive First Amendment concerns related to a limit on free speech. Some commentators have speculated that the free speech question and its probable redress on remand may have been the driving force behind the Court's interest.

The Fox Case

Justice Antonin Scalia penned the majority opinion, holding that the FCC’s new policy and pursuit of action against broadcasters was neither arbitrary nor capricious. Concentrating less on the merits of the FCC’s argument, the majority instead focused on addressing the weak points raised by the broadcasters and undermining the reasoning of the Second Circuit in nullifying the new policy.

For example, the majority pointed to the broadcasters’ claim that the FCC’s repeated reliance on the context in which fleeting expletives are made is simply a smoke screen for imposing a regime of unbridled FCC discretion. The Court claimed that it previously approved of FCC regulation based on a nuisance rationale. Under

The Future of the FCC’s New Indecency Policy

John F. Stephens is a partner with Sedgwick, Detert, Moran & Arnold LLP who practices media and entertainment litigation. Matthew G. Stein is an associate with SDMA who practices products liability and media and entertainment litigation.
November 24, 2009

Jack Trimarco
Jack Trimarco & Assoc.
9454 Wilshire Blvd., 6th Floor
Beverly Hills, CA 90212

Dear Jack:

I am writing this letter to express my gratitude for your tremendous and outstanding expertise in assisting in a date rape by drug investigation which focused on my client (a former NBA player).

Your testing of my client and preparing him for the investigation and interview by the Huntington Beach Police Department led to the police department declining to even proceed to the District Attorney’s Office with the case. Your testing, procedures, and reputation led the Huntington Beach Police Department to conclude that the “victim” was lying and your conclusion that the “defendant” was telling the truth was correct. The cost of your test, literally saved my client thousands of dollars in attorney fees and months, if not, a year or so of aggravation.

On behalf of my client, and my office I want to thank you for your assistance in the matter.

Yours truly,

Andrew M. Stein
this rationale, the context in which statements are made is all-important. The Court found no basis in the Administrative Procedure Act for mandating anything different.9

Justice Scalia further criticized Fox’s advocacy of compartmentalizing expletives as literal or nonliteral and therefore offensive or not offensive.10 Championing the FCC’s position, the Court instead found that distinguishing the words in context does not render the words in a specific context indecent.11

In fact, the Court specifically agreed with the assertion that many words are indecent regardless of context.12

The majority also argued that, with the latest technological advances, broadcasters have more control over what they transmit, making it more inexcusable to allow indecent material to slip onto the airwaves.13 Combating the Second Circuit’s analysis, the majority noted that the FCC’s prior stance on expletives did not preclude it from reformatting its policy to comply with the standard of 18 U.S.C. Section 1446, which provides, “Whoever utters any obscene, indecent, or profane language... shall be fined under this title.”14 The Court further held that retaining some discretion and considering each isolated expletive on a case-by-case basis does not render the new policy arbitrary or capricious.15

The Pacifica Precedent

The majority addressed Fox’s argument that the FCC went beyond the scope of authority approved in FCC v. Pacifica.16 Pacifica arose from a father’s complaint to the FCC that his son had heard George Carlin’s “Filthy Words” routine one afternoon over the radio in New York City.17 Pacifica, the owner of the radio station that made the broadcast, was sanctioned by the FCC for violating FCC regulations that prohibited the broadcast of indecent material.18 The Supreme Court ruled that the routine was “indecent but not obscene.”19 Under the law, obscene broadcasts are prohibited at all times and are not protected by the First Amendment. Indecent broadcasts, however, have been held not to rise to the level of obscene broadcasts, and so may be made so long as they are restricted to avoid the chance that children may view or hear them. Indecency is defined as language or material that depicts or describes, in terms patently offensive as determined by the FCC for violating FCC regulations, that each case is scrutinized by the FCC on an individual basis. Accordingly, small broadcasters who cannot afford the delay technology often employed by large broadcasters may not be subject to the same standard as major corporate networks. Such considerations were held to be crucial and greatly contributed to the majority’s endorsement of the FCC’s new enforcement policy regarding fleeting expletives.

In dissent, Justice Stephen Breyer questioned the explanation offered by the FCC in changing its indecency rules from a policy permitting a single “fleeting use” of an expletive to a policy that made no such exception. Unsatisfied with the FCC’s unsupported assertion that the new policy is “a good one,” Justice Breyer would have required the FCC to answer the question of why the commission changed its rule.

Justice Breyer’s dissent criticized many of the FCC’s arguments and answers as being unsupported by any evidence, particularly the explanation that under the old policy, media syndicates were allowed to broadcast expletives at any hour of the day as long as they were aired one at a time. The lack of empirical evidence to support the commission’s explanations eviscerated the validity of the change and suggested to the dissent that the FCC’s answer to the question, “Why the change?” is, “We like the new policy better.” This response was severely condemned by broadcasters as insufficient for an agency whose policy affects constitutional rights.

Justice Ruth Bader Ginsburg, who also dissented, raised similar constitutional concerns. Justice Ginsburg said that, in a case that turns on government restriction of spoken words, “[T]here is no way to hide the long shadow the First Amendment casts over what the Commission has done.” Not to be overshadowed by the other dissenting justices, Justice John Paul Stevens, a golfer, argued that the FCC missed the mark in failing to distinguish the use of the offending words. “As any golfer who has watched his partner shank a short approach knows it would be absurd to accept the suggestion that the resultant four-letter word uttered on the golf course describes sex or excrement.”

The High Court’s opinion in Fox appears to have left many broadcasters in a state of discontent in that it left the door open to the question of whether the new policy violates the First Amendment. It appears, at first blush, that the Court ignored the issue of freedom of speech altogether, deciding instead to focus on the procedural issues in the case. But one cannot blame the Supreme Court for not addressing the First Amendment issue. The true blame lies with the Second Circuit, which originally declined to address the constitutional argument. As a result, the issue handed up to the Supreme Court was confined to the FCC’s reasoning for reversing its longstanding indecency enforcement policy with respect to isolated and fleeting expletives. While the major broadcasters attempted to bring the First Amendment issue to the forefront in their briefs to the Supreme Court, the majority responded by noting that the Supreme Court “is one of final review, ‘not of first view’... and there is no reason to abandon...usual procedures in a rush to judgment without a lower court opinion.”

The Court’s refusal to address any issues not ruled on by the lower court shifts the constitutional debate over the new FCC policy back to the Second Circuit. With the FCC’s powers to regulate fleeting expletives now defined and expanded, the issue in the Second Circuit on remand may very well be, “Is it an infringement on the freedom of speech to sanction broadcasters for unscripted, fleeting expletives?”

Constitutional Issues

If the Supreme Court ever takes up the First Amendment issue on certiorari, the FCC will need to strengthen its weaker constitutional arguments. More specifically, the FCC must confront the issue of whether its policy regarding fleeting expletives regulates speech by the “least restrictive means.” The commission will also likely need to argue that its new policy constitutionally furthers a compelling state interest, in spite of technology such as the V-chip, which blocks programs based on their ratings. The FCC will further need to address the fact that the V-chip may be ineffective in protecting children, because some broadcasts may be misrated.

In addition, the FCC will need to demonstrate that its policy is narrowly tailored to achieve its goal of protecting children from hearing indecent speech, because the policy only restricts programming between 6 A.M. and 10 P.M. This safe harbor policy has emerged from the Court’s settled content and context reasoning. With limited exceptions, government cannot restrict what is said (content), but government can impose reasonable restraints on when, where, and how it is said (context). This raises the issue of the implications of channeling indecent pro-
programing to the current safe harbor of 10 P.M. to 6 A.M.

Along these same lines, the FCC will also have to show that in light of the well-supported freedom of speech cases Cohen v. California and Rosenfield v. New Jersey, protecting children from hearing a single-word expletive is a viable state interest.

**Technology**

In the wake of Fox, broadcasters contesting FCC indecency rulings will likely raise the argument that the V-chip and other parental oversight devices render the FCC’s regulatory powers of indecent speech on broadcast television unconstitutional. As with other restrictions on protected behavior, it is widely recognized that regulations are constitutional only if they are narrowly tailored and exhibit the least restrictive means to further a relevant governmental interest. The justification for the FCC’s regulatory powers regarding broadcast material depends on the state’s interest in protecting children. The availability of technology to accomplish this goal undermines the necessity of the FCC’s sanctions, since the technology is arguably a less restrictive means of accomplishing that goal.

According to the broadcasters, major cultural shifts and the vast technological improvements of the last 30 years have rendered the Pacifica standard moot. Broadcast media do not have the captive audience they had before satellite television, cable, and the Internet. Stated differently, the FCC’s asserted interest in shielding children from indecent material is undermined by the fact that children can now access indecent material by means other than broadcast television and radio. For example, broadcasters will surely point to podcasts, live interactive video games, social networking sites, and other easily accessible media content that is not regulated by the FCC.

Even if the FCC is able to present convincing evidence to bolster its First Amendment arguments, the Court may turn toward broadcasters. The court’s recent holdings and ideological leanings have given legal scholars and practitioners some insight into the probable outcome of First Amendment cases. Justice Scalia’s majority opinion appears to give some leeway to the FCC with respect to the degree of First Amendment protection available to broadcasters. Therefore, it appears that Justices Alito, Scalia, and Roberts will likely find in favor of the FCC in a case similar to Fox.

Justice Clarence Thomas noted that the Pacifica decision was unconvincing when it was issued and that the passage of time has only increased doubt regarding its continued validity. His hesitation lies in the roots of the First Amendment. As Justice Thomas wrote in his concurring opinion, the text of the First Amendment makes no distinctions among print, broadcast, and cable media. Nevertheless, he sided with the majority in part in the Fox decision. Accordingly, Justice Thomas is somewhat of a wild card in the First Amendment debate.

Ginsburg’s dissent, however, may be read to signal that she and the other two dissenting justices (Justices Breyer and Stevens) may endorse a standard that would allow for fleeting expletives and find the new FCC policy an unconstitutional infringement on free speech. Justice Ginsburg made it a point in her dissent to note that the First Amendment casts a long shadow over the FCC’s new policy on fleeting expletives. In her view, the FCC failed to provide a sufficient explanation as to why it changed its indecency policy. These three may find in favor of the broadcasters on the free speech issue.

The newest member of the Supreme Court, Justice Sonia Sotomayor, has a record that does not show a rigid, ideological outlook on First Amendment issues. Although First Amendment advocates have praised her opinions in a gag order dispute and in protest cases, she also has been criticized for joining in rulings involving limits on the online expression of students and commercial speech. Overall, however, she may be considered in favor of free speech and broadcasters. This leaves the decisive vote in the hands of Justice Kennedy, who may be retiring soon.

Fortunately for the broadcasters, Justice Kennedy has been heralded as a strong supporter of the First Amendment and is unlikely to dismiss the constitutional objections to the FCC’s new policy. In International Society for Krishna Consciousness v. Lee, he wrote, “[T]he First Amendment is often inconvenient. But that is beside the point. Inconvenience does not absolve the government of its obligation to tolerate speech.”

Taking the foregoing into consideration, the prospects do not favor the FCC if broadcasters manage to present a First Amendment challenge to the Supreme Court. This context has captured the attention of the legal community and has legal scholars and practitioners calling Fox—with its avoidance of the constitutional issue—the overture to a future main event. Blog postings, newsletters, and commentaries have been addressing government powers regarding the First Amendment. Many believe the issue will reach the Court during its next two terms.

**The Lambert Fallout**

Within a matter of months, for example, the Supreme Court may take another step toward clarifying the government’s power to control indecency on radio and television. The issue in this possible next case may not involve four-letter words but rather crotch-grabbing performers. The issue of broadcast indecency was most recently raised after American Idol runner-up Adam Lambert performed live during the 2009 American Music Awards. A conservative group, the Liberty Counsel, filed a complaint with the FCC against ABC for airing what the group claimed was an outrageously lewd performance, during which Lambert kissed a male keyboardist, ground a dancer’s head against his pelvis, and grabbed the crotch of another male performer.

Lambert told Rolling Stone magazine, “Female performers have been doing this for years—pushing the envelope about sexuality—and the minute a man does it, everybody freaks out. We’re in 2009—it’s time to take risks, be a little more brave, time to open people’s eyes and if it offends them, then maybe I’m not for them. My goal was not to piss people off, it was to promote freedom of expression and artistic freedom.” In response to his performance, ABC received more than 1,500 complaints from television viewers. ABC subsequently canceled Lambert’s appearances on Jimmy Kimmel Live and Good Morning America. In further backlash, the production company for the American Music Awards canceled Lambert’s appearance on the 2009 New Year’s Rockin’ Eve program held in Times Square.

Although Lambert’s performance was edited for the West Coast audience, the end of the act was viewable in the Central Time Zone at 9:55 P.M. The basis for the complaints that were filed was that ABC broadcast indecent material before the 10:00 P.M. curfew. It appears likely that the FCC will fine ABC. The question remains whether ABC will object to the fine and incur the cost of litigating the issue.

The question remains whether Lambert’s performance violated the FCC’s new regulations. Fox and Pacifica dealt with fleeting expletives, but Lambert’s physical performance—not his lyrics—is at issue. Should the case reach the Supreme Court, it will still need to determine whether ABC violated contemporary community standards and whether a fine by the FCC runs contrary to freedom of speech. Numerous media outlets have asked that the Supreme Court use the Lambert performance to lay down the law on the FCC’s ambiguous regulatory policy regarding indecency.

The FCC’s recent clampdown on the use of fleeting expletives has led to a number of other indecency-related cases that may pique the interest of the Supreme Court. For example, the FCC fined CBS $550,000 for the half-second of nudity that occurred during Janet Jackson’s 2004 Super Bowl half-time performance. A federal appeals court, however, overturned the fine after concluding
that the commission had acted arbitrarily. The FCC has yet to request certiorari.28

For now, broadcasters are left with the ruling in Fox. To stay within Fox’s safe harbor, those radio and television broadcasters that can afford it will have to employ delayed transmissions and have a finger on the button ready to censor. Protocol is not so easily defined for broadcasters that cannot afford the delay equipment. The FCC policy allows for individualized consideration and noncompliance if the delay technology is overly burdensome, but there are no guaranteed requirements and results. Projected outcomes probably include limitations of potential guests and discussion topics.

With the First Amendment question still unresolved, broadcasters will have to be on guard for the occasional expletive that tends to surface during live broadcasts. The FCC’s policy leaves broadcasters to censor any conceivably offensive material, which may be preventing a full and fair presentation of broadcast material. The FCC’s powers will likely be challenged in the federal appellate courts either by Fox on remand or by another case in the near future. In the meantime, television directors huddle in their booths with sweaty palms and brows, nervously waiting to press the delay button.

2 Fox Television Stations, Inc. v. FCC, 489 F. 3d 444 (2d Cir. 2007).
3 Id. at 451.
5 Fox Television Stations, 489 F. 3d at 452.
6 Id. at 458.
7 Id. at 461, 462.
9 Id. at 1815.
10 Id. at 1812.
11 Id. at 1808, 1809.
12 Id. at 1812.
13 Id. at 1803.
17 Id. at 729.
18 Id. at 730.
19 Id. at 730.
20 FCC, 129 S. Ct. at 1815.
22 FCC, 129 S. Ct. at 1820.
23 Id.
24 Id.
25 Id.
The Taxation of Deferred Compensation in Standard Service Agreements

AT THE END OF 2004, CONGRESS ENACTED LEGISLATION that was intended to curb perceived abuses in nonqualified executive compensation plans. A prime example of these abuses involved top executives at Enron who were participants in traditional nonqualified deferred compensation plans. Under the tax rules applicable at the time, the executives were able to receive substantial payouts from those plans just prior to the collapse of Enron. After the collapse, rank and file employees who participated in Enron’s qualified pension plans received no distributions from those plans. Congress enacted I.R.C. Section 409A to regulate nonqualified deferred compensation plans in order to prevent this type of abuse in the future. However these rules, as interpreted by treasury regulations that became effective on January 1, 2009, have had a profound, complex, and likely unintended effect on many standard service contracts in the entertainment industry.

Violation of these rules can result in the imposition of severe penalties, including the acceleration of the recognition of all deferred income that is payable under the nonqualified deferred compensation plan, interest on the taxes owed on the accelerated income, and the imposition of a 20 percent penalty tax on this income.1 Notably, the California Franchise Tax Board has taken the position that it will also impose a 20 percent penalty tax on the income if the taxpayer is subject to California income or franchise taxes, even though the maximum California personal income tax rate is currently 9.55 percent.2 These tax consequences and penalties are imposed on the person who provides service (the service provider) and not on the person for whom the services are rendered (the service recipient).

Under Section 409A, a nonqualified deferred compensation plan is defined to include any arrangement that is not a qualified pension or profit sharing plan pursuant to which a service provider may receive compensation in a taxable year later than the taxable year in which the service provider performs the services.3 Therefore, in an entertainment industry context, any standard service agreement that provides for profit participations, box office bonuses, residuals, and other similar payments to be paid in a taxable year later than the year in which services are performed constitutes a nonqualified deferred compensation plan under Section 409A. When services are provided through a loan-out corporation, Section 409A rules will apply to both the agreement between the loan-out corporation and the service recipient and the agreement between the loan-out corporation and the service provider.

Certain short-term deferrals are not subject to Section 409A. A payment qualifies as a short-term deferral when, in the absence of an election by the service provider to otherwise defer the compensation, the payment is actually or constructively received by the service provider by no later than the latter of 1) the 15th day of the third month beginning after the end of the service provider’s taxable year in which a substantial risk of forfeiture lapses or 2) the 15th day of the third month beginning after the end of the service recipient’s taxable year in which a substantial risk of forfeiture lapses.4 A right to a payment that is never subject to a substantial risk of forfeiture is considered to be no longer subject to a substantial risk of forfeiture on the first date the service provider has a legally binding right to the payment.5

For example, if the service provider and the service recipient both have the calendar year as their respective tax years and the payment is not subject to a substantial risk of forfeiture, then a payment is deemed to be a short term deferral if the payment is required to be paid to the service recipient no later than March 15 of the year that begins immediately after the year in which the service provider performs the services.

Exceptions to the Rules

A “substantial risk of forfeiture” is a standard included in the IRC Section 409A rules that is used to determine whether deferred compensation should be included in the taxable income of the service provider on receipt or at same later date. A substantial risk of forfeiture exists if 1) entitlement to the amount is conditioned upon the performance of substantial future services by the service provider or 2) the occurrence of a condition related to a purpose of the compensation, and 3) the possibility of forfeiture is substantial.6

A substantial risk of forfeiture that relates to a purpose of the compensation includes a condition that relates either to the service provider’s performance for the service recipient or the service recipient’s business activities or organizational goals.7 For example, the requirement that a service provider make certain personal appearances after the release of a motion picture in order to receive profit participations is a substantial risk of forfeiture related to the service provider’s performance of substantial future services.

An example of a substantial risk of forfeiture due to a service recipient’s business activities or organizational goals is a requirement that the earnings of the service recipient exceed a certain level,8 such as a requirement that the service recipient recover its expenses in producing and advertising a motion picture from box office receipts prior to the service provider receiving a profits participation.

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Some commentators have taken the view that profit participations cannot be deemed to be subject to a substantial risk of forfeiture. They support this argument based on a comment contained in the preamble to the treasury regulations issued under Section 409A:

One commentator suggested that any right to a payment be treated as subject to a substantial risk of forfeiture until the amount of the payment is readily determinable, at least where the payment could be zero. The Treasury Department and the IRS do not believe that this standard is appropriate. However, this statement in the preamble to the treasury regulations appears to be diametrically opposed to treasury regulations that provide that a substantial risk of forfeiture can be a condition that the service recipient’s earnings exceed a certain level.

Another argument that profit participations are not subject to a substantial risk of forfeiture is that such payments are similar to stock appreciation rights, and stock appreciation rights are not treated as being subject to a substantial risk of forfeiture under the treasury regulations. However, the treasury regulations contain rules that provide when a stock right will no longer be subject to a substantial risk of forfeiture, thereby implying that stock rights can be subject to a substantial risk of forfeiture.

Another exception to the application of Section 409A to deferred compensation is the independent contractor exception. Under this rule, a deferred compensation payment is not subject to Section 409A if in the year in which the service provider first has a legal right to a payment 1) the service provider provides service to two or more service recipients other than as an employee or a director, 2) the service provider is not related to either service recipient and the service recipients are not related to each other, and 3) the service recipient receives no more than 70 percent of his or her income from any one service recipient for services performed by the service provider in that year. The independent contractor exception is difficult to apply and generally will not be met if the service provider performs service primarily for one motion picture studio, one record label, or one television network.

There are other exceptions to the Section 409A rules that apply to certain stock options and stock appreciation rights. However, these exceptions generally do not apply to standard entertainment industry service contracts.

The motion picture industry is apparently lobbying the Treasury Department on the application of the substantial risk of forfeiture rules to profit participations, box office bonuses, residuals, and other categories of income that may be deemed to be deferred compensation under Section 409A. The Treasury Department has not yet issued any written notices with respect to the issue.

The Section 409A Rules

If none of the exceptions to the Section 409A deferred compensation rules apply, an compensation arrangement must comply with the Section 409A rules or the income acceleration, interest, and penalty provisions will kick in. There are three sets of requirements under Section 409A. The first provides when an election to defer income must be made. The general rule is that the election to defer income must be made no later than the last day of the taxable year ending before the year in which the service provider will perform the services.

If a taxpayer does not have the right to elect to defer income (which is the case with most standard entertainment industry service contracts) the election rules will be satisfied if the designation of the time and form of payment occurs no later than 1) the time the service provider first has a legally binding right to the compensation or, if later, 2) the time the service provider would be required to make such an election if the service provider were provided with an election.

Since the service provider under a standard entertainment industry service contract first receives a right to receive profit participations, box office bonuses, or residuals when the service provider enters into a contract agreeing to perform the services, the election requirement will generally be met.

The second set of requirements under Section 409A covers when payments of deferred compensation can be made. Under these rules, a payment of deferred compensation can only be made at one of the following times:

1. The service provider’s separation from the service.
2. The service provider becoming disabled.
3. The service provider’s death.
4. A time or a fixed schedule specified under the plan.
5. A change in the ownership or effective control of the service recipient or in the ownership of a substantial portion of the assets of the service recipient.
6. The time of an unforeseeable emergency.

“Separation from service,” “disabled,” “change in ownership or effective control,” “change in ownership of a substantial portion of the asset” and “unforeseeable emergency” are all defined terms under the treasury regulations. If a service provider is a “specified employee,” the specified employee can receive deferred compensation that is payable on a separation from service, no earlier than six months after the effective date of the separation.

In standard entertainment industry service contracts, the deferred compensation will be payable at a time or a fixed schedule specified under the agreement. This can be a specific date (such as March 15, 2014), or at a specified time, or pursuant to a fixed schedule if objectively determinable amounts are payable at a date or dates that are nondiscretionary and objectively determinable at the time the amount is deferred.

In addition, a plan may provide that a payment, including a payment that is part of a schedule, is to be made during a designated taxable year of the service provider that is objectively determinable and nondiscretionary at the time the payment event occurs. For example, a schedule of three substantially equal payments payable during the first three taxable years following the taxable year in which a master recording is delivered to a record label is such a payment plan.

A plan may also provide that a payment, including a payment that is part of a schedule, is to be made during a designated period objectively determinable and nondiscretionary at the time the payment event occurs. But the designated period must begin and end within a single taxable year of the service provider, or the designated period must not be more than 90 days and the service provider does not have a right to designate the taxable year of the payment.

Most standard entertainment industry service contracts that include profit participations, box office bonuses, or residuals provide that a service provider will receive an accounting no later than a certain date and the service provider will receive a payment within a certain number of days after the accounting is delivered to the service provider. If the contract provides that the service provider will receive the payment no later than 90 days after the accounting is delivered, the 90-day period spans two years, and the service provider cannot elect the year within which he or she will receive the payment, this payment arrangement should satisfy the payment date requirements of Section 409A.

The third set of requirements under Section 409A state that once an election has been made specifying the amounts and payment dates of the deferred compensation, the amounts and payment dates generally cannot be changed, except as provided in the treasury regulations. The regulations state that, except as otherwise provided in the treasury regulations, a nonqualified deferred compensation plan may not permit the acceleration of the time or schedule of any payment or amount scheduled to be paid pursuant to the terms of the plan. However, a payment that is made no more than 30 days prior to its due date is not deemed to be an accelerated payment for these purposes.

Additionally, if a payment is subject to a
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substantial risk of forfeiture and the service recipient (as opposed to the service provider) waives or accelerates the satisfaction of the condition constituting the substantial risk of forfeiture, the waiver or acceleration by the service recipient is not deemed to be a prohibited acceleration, provided that all the other rules under Section 409A applicable to such deferral of compensation (including the requirement that the payment be made upon a permissible payment event) are otherwise satisfied with respect to the deferral of compensation.25 This exception can result in an accelerated payment of profit participations that does not violate the rules of Section 409A if the service recipient is given the option to waive or accelerate the condition constituting a substantial risk of forfeiture in the initial agreement with the service provider. The treasury regulations provide a list of other exceptions to the rule against acceleration of payments of deferred compensation.26

The payment of deferred compensation also cannot be deferred from the initially designated payment date, except in accordance with the rules contained in treasury regulations. Under these rules a subsequent deferral election complies with the requirements of Section 409A only if all three of the following conditions are met:

1) The subsequent deferral election cannot take effect until at least 12 months after the date on which the election is made.
2) In the case of an election related to a payment, other than a payment made on account of the disability, death, or unforeseen emergency of the service provider, the payment with respect to which such election applies must be deferred for a period of not less than five years from the date such payment would otherwise have been paid.
3) If the original payment was to be made at a fixed time or schedule set forth in the plan, the election must be made not less than 12 months before the date the payment is scheduled to be paid.27

Opportunity to Correct Defective Plans

In IRS Notice 2010-6,28 the IRS provides methods under which taxpayers can voluntarily correct certain failures of a nonqualified deferred compensation plan to comply with the requirements of Section 409A, and, in certain cases, limit the amount includible in income as well as additional taxes under Section 409A. The relief provisions contained in Notice 2010-6 apply only to inadvertent and unintentional failures to comply with the requirements of Section 409A(a). The relief is not available if the failure is either intentional or directly or indirectly related to participation in a listed transaction under Treasury Regulations Section 1.6011-4(b)(2). The correction program announced in Notice 2010-6 is intended to
encourage taxpayers to review nonqualified deferred compensation plans to identify and correct any provisions that fail to comply with the requirements of Section 409A.

Section III.C of Notice 2010-6 provides that the relief provided in Sections V through XI of the notice is not available for a service provider participating in a nonqualified deferred compensation plan if a federal income tax return of the service provider or a federal tax return of the service recipient is under examination with respect to nonqualified deferred compensation for any taxable year in which the document failure existed. However, Section XI.D of Notice 2010-6 provides that, when applying Section III.C of Notice 2010-6 for corrections made on or before December 31, 2011, the IRS will treat as “under examination” only a specific document failure that has been identified as an issue in the examination of a nonindividual service recipient on or before December 31, 2011. Therefore, for any document failure that has not yet been specifically identified, the requirements that the nonindividual service recipient not be under examination with respect to the plan will be treated as satisfied and the document failure may be eligible for correction under the applicable section of Notice 2010-6, provided that all other eligibility requirements are met.

The rules contained in Section 409A and the treasury regulations issued under it are broad and complex and contain many traps for the unwary. An attorney representing a service provider who may receive payment for services in a taxable year later than the year in which the services are performed should carefully review Section 409A and the treasury regulations. To the extent that an issue is not addressed in the Internal Revenue Code or the treasury regulations, a tax professional should be consulted.

1 I.R.C. §409A(a).
2 Rev. & Tax Code §17501.
3 I.R.C. §409A(d); Treas. Reg. §1.409A-1(b)(1).
7 Id.
8 Id.
10 Treas. Reg. §1.409A-1(d)(1)
12 For this purpose a person is related to another person if the persons bear a relationship to each other that is specified in I.R.C. §267(b) or §707(b)(1), subject to the modifications that the language “20%” is used instead of “50%” each place it appears in I.R.C. §§267(b) and 707(b)(1), and I.R.C. §267(c)(4) is applied as if the family of an individual includes the spouse of any member of the family or the persons engaged in trades or businesses under common control (within the meaning of I.R.C. §52(a) and (b)). In addition, an individual is related to an entity if the individual is an officer of an entity that is a corporation or holds a position substantially similar to an officer of a corporation with an entity that is not a corporation.
14 To determine if a payment that would otherwise be considered to be deferred compensation is exempt under this rule, the adviser must determine when the service provider first obtained a legal right to the payment. This will generally be stated in the written agreement that grants the service provider the right to receive the payment. Then in applying the 70% test, only amounts received by the service provider for services performed in the year in which the service provider first had a legal right to the payment are counted. In informal discussion with the IRS, it has indicated that some leniency may apply to this rule, so that if a service provider is on the cash receipts and disbursements method of accounting, payments received shortly after the year in question for service provided in that year will be counted. However, there is no specific guidance regarding what is meant by “shortly.”
17 Treas. Reg. §1.409A-3(a).
18 Treas. Reg. §1.409A-3(b).
19 As defined in Treas. Reg. §1.409A-1(i).
20 Treas. Reg. §1.409A-3(i)(1).
21 Treas. Reg. §1.409A-3(i)(1).
22 Id.
23 Treas. Reg. §1.409A-3(i)(1).
24 Treas. Reg. §1.409A-3(i).
25 Treas. Reg. §1.409A-3(i).
26 Treas. Reg. §1.409A-3(i).
27 Treas. Reg. §1.409A-3(i).
29 I.R.S. Notice 2010-6, 2010-3 I.R.B.
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Legal liabilities may arise for independent film producers who rely on contingent promissory notes

by John W. Cones

WHEN ADVISING independent producers who seek financing for production of a film, some entertainment counsel recommend that their clients raise the money via contingent promissory notes. Typically, the promissory notes are not collateralized or not adequately collateralized. Moreover, the notes are not guaranteed, insured, or otherwise secured. Repayment of the notes depends upon the financed film earning sufficient revenues.

These attorneys suggest that contingent promissory notes constitute debt rather than securities and, consequently, the clients’ compliance with federal and state securities laws is not required. This advice appears to be motivated in part by the desire of counsel or the clients to avoid what they consider to be the burdensome and potentially costly task of compliance.

Unfortunately, this advice is extremely risky. It overlooks a significant body of federal and state statutory and case law addressing whether promissory notes are securities. Moreover, courts vary in the standard they use for determining whether the contingent promissory notes constitute securities. Indeed, courts have applied at least three distinctive tests, commonly referred to as the family resemblance test, the Howey test, and the risk capital test. The problem becomes even more complicated because the issue can be raised in federal or state court and in civil or criminal proceedings. If the promissory notes being offered by an independent film producer are securities, the producer needs to comply with federal and state securities laws, including the antifraud rule, to avoid potential criminal or civil liability.

Entertainment counsel can try to predict in advance which of the three separate standards for determining whether a financial transaction involves the sale of a security will apply to

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a particular client's situation years into the future. The better practice for counsel, however, is to ensure that clients avoid running afoul of any of the three tests.

Currently, federal courts uniformly apply the family resemblance test. The family resemblance test is also the primary test in state civil and administrative cases. California courts purportedly use the risk capital test for civil and criminal proceedings, but these courts sometimes mix elements of the risk capital test with the Howey test in their decisions.

The definition of a “security” in the federal Securities Act of 1933 includes “notes,” “bonds,” “debentures” and “evidences of indebtedness.” Thus at first blush it seems that all notes are securities, although the 1933 Act also excludes from the securities registration requirement some notes with maturities no longer than nine months. Nevertheless, a promissory note with a maturity date of less than nine months is of little use in the production financing of a feature film, although short-term notes may be helpful for the bridge financing associated with the development and packaging of a film project.

**Federal Factors and List of Exceptions**

For many years, various federal appellate courts produced confusing and inconsistent standards regarding what kind of notes constituted securities and which were exempt from the securities registration requirement. In 1990, the U.S. Supreme Court resolved much of the conflict by excluding debt instruments that resemble standard commercial (as opposed to investment) transactions from securities coverage.

The Court reached this conclusion in *Reves v. Ernst & Young*, which involved uncollateralized, uninsured demand notes. However, while the Court held that the 1933 Act creates a presumption that any note in excess of nine months is a security, it did not suggest that notes less than nine months were not securities. Indeed, earlier case law almost uniformly held that short-term notes are securities if the notes possess investment characteristics. For example, in *Briggs v. Sterner*, a federal appellate court held that short-term demand notes offered to obtain risk capital were securities. Thus, it appears that even short-term promissory notes that are used to raise funds for the development and packaging of a feature film may have to be viewed as securities.

The *Reves* Court adopted the family resemblance test, which allows for the rebuttal of the presumption that a note is a security if the issuer of the note—such as an independent producer—can show that the note bears a “strong family resemblance” to items on a list of court-created exceptions. The list includes:

1. Notes delivered in consumer financing.
2. Notes secured by a home mortgage.
3. Short-term notes secured by a lien on a small business or some of its assets.
4. A character loan to a bank customer.
5. Short-term notes secured by an assignment of accounts receivable.
6. Open-account debt occurred in the ordinary course of business.
7. A loan by a commercial bank for current operations.

The contingent promissory notes that are typically used by independent film producers to finance the production costs of their films are not on the list. Therefore, practitioners should proceed carefully because, under this test, the notes are considered to be securities—and compliance with federal and state securities laws is required for their issuance.

Still, *Reves* offers a narrow possibility to producers by holding that the list of exceptions can be expanded. According to the Court, four factors may be considered in determining whether another form of note is a security or an exception that should be added to the list:

1. Motivations of the buyer and seller. If the purpose of the seller of the note—that is, the film producer—is to raise money for the general use of a business enterprise or to finance substantial investments—for example, the production costs of a feature film—and the buyer of the note is interested primarily in the profit the note is expected to generate, the instrument is very likely to be considered a security. On the other hand, if the money is used to acquire a minor asset or consumer goods to correct the seller's cash-flow difficulties or to advance some other commercial or consumer purpose, the note is less likely to be a security.
2. Plan of distribution. If there is general, widespread distribution of the instrument, it is more likely to constitute a security.
3. Reasonable expectations of the investing public. These expectations will constitute the basis of whether an instrument will be deemed a security.
4. Risk-reducing factors. The instrument will not be a security if the application of the Securities Act is rendered unnecessary due to the existence of risk-reducing factors. For example, bank certificates of deposit are not considered securities because they allow for the elimination of risk through federal insurance.

A *Pepperdine Law Review* article criticized this four-factor federal addition to the family resemblance test for being ambiguous and for not stating specifically whether the test requires the presence of all four factors. Stuart Cohn, a professor at the University of Florida College of Law, opines that it does not. With regard to the third factor, Cohn states that the perceptions of unsophisticated investors, who may be unaware of whether an instrument is a security, would not be controlling if other factors indicated that a security was being issued.

Without the presence of significant risk-reducing factors, a contingent promissory note used to provide financing for the substantial costs associated with the production of a feature or documentary film most likely will be considered a security. This finding will occur no matter what the investors' expectations were or whether the instrument was widely distributed. Under the family resemblance test, contingent promissory notes will probably not be added to the list of exceptions.

Many decisions on this issue by courts in various states are consistent with *Reves* based on definitions of “securities” that mirror the federal definition. California state court decisions, however, are not. To bring about more uniformity among the states regarding the regulation of securities, Congress passed the National Securities Markets Improvement Act in 1996. The NSMIA, however, allowed states to continue to rely on their own definitions of what notes should be considered securities. Thus, state courts still look to state law as the final authority, although they often seek guidance from federal case law.

**California's Tests**

Instead of following the *Reves* family resemblance test, California courts use the risk capital test, which was first established (although not explained very clearly) in *Silver Hills Country Club v. Sobieski* in 1961. California (among other states) also has recognized that not every note is a security. As early as 1939, the California Supreme Court observed that “it plainly was not the legislature's intent that ‘every’ note or evidence of indebtedness, regardless of its nature and of the circumstances surrounding its execution, should be considered as included within the meaning and purpose of the [securities] act.” The state supreme court also has consistently held, as it did in *Silver Hills*, that “the courts look through form to substance.” More recently, in its 1986 *People v. Figueroa* decision, the court stated that “it is not the label affixed to a particular instrument which determines whether it constitutes a ‘security’. [In] searching for the meaning and scope of the word ‘security’ in the Act, form should be disregarded for substance and the emphasis should be on economic reality.” Further, the *Figueroa* court noted that it would look to federal decisions for guidance on the issue of what constitutes a security.
the U.S. Supreme Court reaffirmed its commitment to the principle that substance governs form.\textsuperscript{22}

*Silver Hills* involved the sale of country club memberships. The California Supreme Court stated that Corporations Code Section 25008 “defines a security broadly to protect the public against spurious schemes, however ingeniously devised, to attract risk capital.”\textsuperscript{23} According to the court, “[T]he objective [of the corporate securities laws] is to afford those who risk their capital at least a fair chance of realizing their objectives.”\textsuperscript{24} The country club in *Silver Hills*, according to the court, was “soliciting the risk capital with which to develop a business for profit. The purchaser's risk is not lessened merely because the interest he purchases is labeled a membership. Only because he risks his capital along with other purchasers can there be any chance that the benefits of club membership will materialize.”\textsuperscript{25} The court held that the state’s Corporate Securities Law of 1968 was “clearly applicable” to the sale of the promotional memberships, adding that “[w]hether the investment contract ... is not lessened merely because the investment was not a security.\textsuperscript{42} If the same or similar circumstances were considered now, the outcome is likely to be different. In *Syde*, the transaction was between a purported film producer and a purported film producer, and the film industry in which the court determined that the transaction was not a security.\textsuperscript{42} If the same or similar circumstances were considered now, the outcome is likely to be different. In *Syde*, the transaction was between a purported film producer and a purported film producer, and the film industry in which the court determined that the transaction was not a security.\textsuperscript{42} If the same or similar circumstances were considered now, the outcome is likely to be different. In *Syde*, the transaction was between a purported film producer and a purported film producer, and the film industry in which the court determined that the transaction was not a security.\textsuperscript{42} If the same or similar circumstances were considered now, the outcome is likely to be different. In *Syde*, the transaction was between a purported film producer and a purported film producer, and the film industry in which the court determined that the transaction was not a security.\textsuperscript{42} If the same or similar circumstances were considered now, the outcome is likely to be different. In *Syde*, the transaction was between a purported film producer and a purported film producer, and the film industry in which the court determined that the transaction was not a security.\textsuperscript{42} If the same or similar circumstances were considered now, the outcome is likely to be different. In *Syde*, the transaction was between a purported film producer and a purported film producer, and the film industry in which the court determined that the transaction was not a security.
parents of children who were to be given acting training and featured in the film along with other children. The cast members were to be paid for their services and receive a percentage participation in the company’s gross receipts upon the sale or distribution of the completed movie. The court stated:

“It is settled that the Corporate Securities Law was not intended to afford supervision and regulation of instruments which constitute agreements with persons who expect to reap a profit from their own services or other active participation in a business venture. Such contracts are clearly distinguished from instruments issued to persons who, for a consideration paid, stipulate for a right to share in the profits or proceeds of a business enterprise to be conducted by others; and the court will look through form to substance to discover whether in fact the transaction contemplates the conduct of a business enterprise by others than the purchasers, in the profits or proceeds of which the purchasers are to share.”

The court did not distinguish between the parents (the actual investors) and the children who cannot, by any stretch of the imagination, be considered active in the sense that they are involved in management in any meaningful way. Also, even though the parents accompanied the children to their rehearsals, they were not permitted in the rehearsal studio, much less given any say with regard to management of the project.

When profits are expected to come from the joint efforts of partners—whether in a general partnership, joint venture, or a member-managed LLC—the courts are not likely to consider that arrangement a security. The leading federal case on when a general partnership interest can be designated as a security is Williamson v. Tucker, a 1981 case. The leading federal case on when a joint venture interest can be designated as a security is Williamson v. Tucker, a 1981 case. The Fifth Circuit Court of Appeals held that a general partnership or joint venture interest can be designated as a security if the investor establishes one of three scenarios:

1) An agreement among the parties leaves little power in the hands of the partner or venturer that the arrangement in fact distributes power akin to a limited partnership. Units in a limited partnership are always considered to be securities.
2) The partner or venturer is so inexperienced and unknowledgeable in business affairs that he or she is incapable of intelligently exercising his or her partnership or venture powers.
3) The partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that the partner or venturer cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

Further, California courts have supported the view of securities regulators that an active investor must have some level of knowledge and understanding of the field in which he or she is investing. In Consolidated Management Group, LLC v. California Department of Corporations, a California appellate court ruled that “the investor’s inexperience and dependence on a managing venturer served to establish that the joint venture interests were in fact securities.” The court stated that these business promoters—who were selling investments in oil well drilling equipment and using a joint venture as the investment vehicle—“were soliciting investments from people who would, as a practical matter, lack the knowledge to effectively exercise the managerial powers conferred by the joint venture agreements.” The court noted that “the success of the particular projects marketed was uniquely dependent on the efforts of the...managing venturer, and that investors would be relying on those efforts in making their investments.” Ultimately, the court observed that the “investments were solicited from persons with no experience in the oil and gas industry.”

Consolidated Management went beyond the requirement that an investor must be experienced and knowledgeable in business affairs generally. Further, the Consolidated Management court cited with approval a line of federal cases from the Fifth, Ninth, and Eleventh Circuits acknowledging that general business sophistication does not necessarily equip an investor to manage a specialized enterprise. These cases found that “[r]egardless of investors’ general business experience, where they are inexperienced in the particular business they are likely to be relying solely on the efforts of the promoters to obtain their profits.”

Thus, if the circumstances of the 1951 Syde case were revisited today, it is very unlikely that the decision would be the same. Because of the subsequent refinements by courts regarding who may be considered an active investor in an investment transaction, it is clear that neither the parents nor the children in Syde would qualify pursuant to the standards established in Williamson or Consolidated Management.

Consequently, a film producer issuing one or more promissory notes to finance the production of a motion picture, when the maturities for the notes exceed nine months, would have to presume that the notes are securities. Even in situations in which the notes are short-term demand notes, if they are offered...
to obtain risk capital—which is typically the case in independent film finance—those notes would also be securities.

If the transaction is questioned and the federal family resemblance test applies, the producer may seek to rebut the presumption by arguing that the note he or she is issuing bears a strong family resemblance to one or more of the notes listed by the courts as not being securities. But the success of that rebuttal effort does not appear to be likely. Further, the producer may seek to convince a court of the need for a new category of note not constituting a security. Once again, the contingent promissory note most likely could not meet the burden of persuasion to be added to the list of excluded instruments. For contingent promissory note transactions with the purpose of raising money to finance substantial investments—for example, the production of a feature film with no risk-reducing factors such as collateral or insurance—the reasonable expectation of the investing public is that the notes constitute securities. Even if the transactions are limited in their distribution, for all practical purposes, the contingent promissory notes would very likely still be recognized as securities.

If California state law applies and either the risk capital test or elements of the federal Howey test are used, the producer will need to make sure the promissory notes are adequately collateralized, insured, or otherwise secured, or that the investor is not only actively involved in management of the project but capable of being involved in management in a meaningful way because of his or her knowledge and experience in the film industry. Of course, for most independent filmmakers, putting their own assets at risk with the hope that their return on an independently produced film will adequately cover that risk is usually not a good idea.

In most instances, independent film producers would be better advised to spread the risk of their creative ventures among a large group of passive investors who are prohibited from interfering with the producers’ creative control. Moreover, practitioners should advise producers to recognize when a security is being offered and to comply with federal and state securities laws.48

1 Kenneth L. MacRitchie, Is a Note a “Security”? Current Tests under State Law, 46 S.D. L. Rev. 369, 409 (Summer 2001).
2 Id. at 409.
3 Id.
4 Id. at 396, 409.
7 Stuart R. Cohn, Securities Counseling for New and Developing Companies ch. 3, at 6 (2000).
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10 See Exchange Nat. Bank of Chi. v. Touche Ross & Co., 544 F. 2d 1126, 1138 (2d Cir. 1976) (adding items 1-6 to the list); see also Chemical Bank v. Arthur Andersen & Co., 726 F. 2d 930 (2d Cir. 1984), cert. denied, 469 U.S. 884 (1984) (adding item 7 to the list).


13 COHN, supra note 7, ch. 3, at 9.


15 Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938).


17 People v. Davenport, 13 Cal. 2d 681, 686 (1939).

18 See Domestic & Foreign Petroleum Co., Ltd. v. Long, 4 Cal. 2d 547, 555 (1935).


20 Id. at 735; see also Tcherepnin v. Knight, 389 U.S. 332, 336 (1967); United Housing Found., Inc. v. Forman, 421 U.S. 837, 848-52 (1975).

21 Figueroa, 41 Cal. 3d 714, 735.


24 Id. at 815.

25 Id.

26 Id. at 816.


28 Leach, 106 Cal. App at 450.


30 Id. at 291.

31 Corporate Securities Law of 1968, CORP. CODE §25000 et seq.


33 Id.


39 Id. at 386 (citing People v. Leach, 106 Cal. App. 442 (1930)).


41 Tom Dahlquist, Regulation and Civil Liability under the California Securities Act, 33 CAL. L. REV. 343, 360 (1945).

42 People v. Syde, 37 Cal. 2d 675, 768 (1951).

43 Id. at 768.


45 Williamson v. Tucker, 645 F. 2d 404 (5th Cir. 1981).


47 See Securities & Exch. Comm’n v. Merchant Capital, LLC, 483 F. 3d 747 (11th Cir. 2007); Holden v. Hagopian, 978 F. 2d 1115 (9th Cir. 1992); Williamson, 645 F. 2d 404.

48 For a discussion of various film financing methods, see JOHN W. CONES, FORTY-THREE WAYS TO FINANCE YOUR FEATURE FILM (3d ed. 2007).
entertainment LAW

by Robert G. Badal, Caroline Kane, and Bethany Stevens

FEDERAL CIRCUITS are split on whether the exercise of intellectual property rights may constitute an unreasonable restraint of trade in violation of antitrust laws. Some hold that intellectual property owners pursuing their rights are nearly immune from antitrust challenges. In contrast, others find that claims or defenses based on intellectual property rights only create a rebuttable presumption that the restraint is lawful.

A recent decision, Redbox Automated Retail LLC v. Universal City Studios LLP, raises a number of questions about balancing the rights of intellectual property owners with the requirements of the antitrust laws. In Redbox, a district court allowed a downstream retailer to pursue a Sherman Act Section 1 claim despite the copyright holder’s claim of exclusive rights. While the case is still being litigated, the district court’s ruling nevertheless serves as a warning for owners of intellectual property regarding future claims deeming their conduct a restraint of trade.

Redbox rents and sells DVDs through a network of over 22,000 interactive, self-service kiosks at locations nationwide. The kiosks typically hold a maximum 700 DVDs (with as many as 200 different titles) and are updated weekly with new releases. A single Redbox kiosk might carry up to 45 DVDs of each of the most popular new releases. A DVD from a Redbox kiosk rents for $1 per night, which is roughly one-third what Redbox’s competitors charge. Redbox is not a producer of DVDs and, therefore, is reliant on others to provide the DVDs that populate its kiosks.

Since its founding in 2002, Redbox has been successful in implementing its kiosk model for distributing DVDs to the viewing public. In the third quarter of 2009, Redbox’s revenues were reported to be over $198 million—nearly double its revenue for the same quarter of the previous year. Additionally, Redbox substantially expanded its network of self-service kiosks from 12,000 at the end of 2008 to over 21,000 at the end of 2009.

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From its inception, Redbox acquired DVDs from distributors—such as Ingram Entertainment, Inc., and Video Product Distributors—that have agreements with studios, including Universal, to distribute studio-produced DVDs. In 2008, Universal allegedly told Redbox that it would prohibit its distributors from doing business with Redbox unless Redbox entered into a revenue sharing agreement that, among other provisions, would prohibit Redbox from renting or selling Universal DVDs until 45 days after they became available to the public through Universal's traditional means of distribution. Notably, Redbox gains 30 percent of its revenues on new DVDs in the first two weeks of their release and 60 percent of its revenues in the first 45 days. The revenue sharing agreement also would limit the number of copies of Universal DVDs that each Redbox kiosk could stock.

Although the terms of the revenue sharing agreement would limit Redbox's distribution, Redbox alleges that its competitors, who charge approximately three times more than Redbox, would not be so limited. According to Redbox, when Redbox refused to enter into this revenue sharing agreement, Universal asked Ingram and VPD to stop selling DVDs to Redbox. Since then, Redbox has attempted to stock its kiosks with Universal DVDs purchased from retailers. However, that temporary solution was apparently short lived. Redbox alleges that Universal demanded that Best Buy and Walmart refuse to sell or limit sales of Universal DVDs to Redbox.

On October 10, 2008, Redbox sued Universal in federal court in Delaware for copyright misuse, antitrust violations, and tortious interference with contractual relationships. Universal moved to dismiss Redbox’s complaint, and Redbox filed an amended complaint. Redbox alleges that Universal seeks to “eliminate the channel of low-cost, highly-convenient kiosk rental and resale; or…unlawfully eliminate competition from Redbox (and other kiosk outlets)....” Universal filed a supplemental motion to dismiss arguing, among other things, that as the holder of the copyrights for the movies embedded in the DVDs it has an absolute right to control distribution of its copyrighted content. In its supplemental motion to dismiss, Universal stated that “the law permits the conduct about which Redbox complains specifically because suppliers, not distributors, are best positioned to decide how to compete and how to distribute their products.”

On August 17, 2009, the court granted in part and denied in part Universal’s motion to dismiss. First, the court dismissed Redbox’s claim of copyright misuse because the Third Circuit recognizes that claim solely as an affirmative defense and not as an independent claim. Second, the court dismissed Redbox’s tortious interference with contractual relationships claim because Redbox’s contracts with Ingram and VPD did not guarantee that Universal DVDs would be provided to Redbox. A breach of contract is a required element for a tortious interference claim, and the contracts with Ingram and VPD were not breached. Third, the court addressed the plaintiff’s antitrust claim by concluding that it alleges “a vertical nonprice restraint or vertical boycott.” The court held that the plaintiff sufficiently pled a Section 1 claim by alleging “that Universal has induced or otherwise convinced others to boycott Redbox in distribution of Universal DVDs, producing anticompetitive effects, specifically Redbox’s inability to compete in the DVD rental and sales markets of Universal DVDs.”

At the end of September 2009, Universal filed a motion to certify the court’s August 17, 2009, order for 28 U.S.C. Section 1292(b) interlocutory appeal. The court has not yet ruled upon the motion.

In its present posture, the Redbox/Universal litigation brings to the surface a conflict between the principles that animate the antitrust laws and those that drive the intellectual property laws. While both bodies of law are intended to promote innovation and creativity, they employ contrasting means. The antitrust laws encourage innovation through increased competition by removing barriers to entry and attacking monopolistic and market-foreclosing conduct. The intellectual property laws accomplish the same goal with restricted competition by granting exclusive rights to property owners for a specified period and thus preventing others from using the property.

The Redbox/Universal litigation raises a perplexing dilemma: an intellectual property owner can exclude others from using its property but still risks potential antitrust liability for doing so. How can intellectual property owners ensure that they are not crossing the line into behavior prohibited by antitrust laws as they exercise the broad rights given to them by patent, copyright, or trademark laws? The answer to this question requires an understanding of what exclusionary rights intellectual property laws may—and may not—confer as well as an examination of when a refusal to deal is prohibited by antitrust laws.

Refusal to Deal

Although the Redbox/Universal litigation implicates only the rights of copyright holders, some of the relevant antitrust principles also apply to other forms of intellectual property. While the laws governing each type of intellectual property—patent, trademark, or copyright—are distinct and “confer[.] somewhat different property rights and provide[.] a different type of protection,” each regime provides rights that allow property owners to control the use and distribution of their works. For example, the copyright owners of DVD content in the Redbox/Universal litigation relied in part on their “exclusive right,” granted by 17 U.S.C. Section 106(3), to sell, license, or otherwise distribute copies of a copyrighted work.

Litigants and their counsel as well as judges and other commentators have likened the exclusive rights conferred by the intellectual property laws to “legal monopolies.” Court decisions are replete with broad statements regarding the freedom of copyright holders to withhold their protected content
1. The antitrust laws generally permit companies to freely choose with whom they will deal.
   True. False.

2. According to rulings of the First and Ninth Circuits, a refusal to deal based on the exercise of intellectual property rights is presumptively unjustified. 
   True. False.

3. A group boycott may constitute a violation of Section 1 of the Sherman Act. 
   True. False.

4. The antitrust laws and intellectual property laws are both intended to encourage innovation—the former by increasing competition and the latter by restricting it. 
   True. False.

5. A breach of contract is a required element of a claim for tortious interference with contractual relationships. 
   True. False.

6. Redbox owns the copyrights to the DVDs it rents through its kiosks. 
   True. False.

7. Unilateral refusals to license content protected by an intellectual property right are generally lawful. 
   True. False.

8. A supplier and its distributor have a vertical relationship. 
   True. False.

9. Redbox rents DVDs to consumers not only at its kiosks but also through the mail and at brick-and-mortar stores. 
   True. False.

10. All concerted refusals to deal are presumptively anti-competitive. 
    True. False.

11. 17 U.S.C. Section 106(3) grants exclusive rights to sell, license, or otherwise distribute copies of a copyrighted work. 
    True. False.

12. The Third Circuit recognizes copyright misuse as an independent claim and an affirmative defense. 
    True. False.

13. The determination of whether a refusal to deal is a justifiable business practice involves a question of fact. 
    True. False.

14. The U.S. Supreme Court has recognized a group boycott as a cognizable Section 1 claim for over 60 years. 
    True. False.

15. Although patents, trademarks, and copyrights are governed by distinct statutory schemes, the protections provided for each type of intellectual property right are identical. 
    True. False.

16. One goal of the antitrust laws is to preserve the choices available to market participants. 
    True. False.

17. If an intellectual property right is lawfully obtained, its subsequent exercise cannot be the basis for an antitrust claim. 
    True. False.

18. Redbox’s antitrust allegations appear to be based on a vertical boycott theory. 
    True. False.

19. Some have described the exclusive rights conferred by the intellectual property laws as “legal monopolies.” 
    True. False.

20. While antitrust immunity may exist for the exercise of intellectual property rights, it is not without limits. 
    True. False.

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19. □ True □ False
20. □ True □ False
from any and all others as they see fit. As the Supreme Court has stated, “The owner of the copyright, if he pleases, may refrain from vending or licensing and content himself with simply exercising the right to exclude others from using his property.”4 However, despite these statements, case law also recognizes limits to the exclusionary rights under the intellectual property laws—including those imposed by the antitrust laws.

A number of courts have considered whether and to what extent a defendant copyright or patent holder’s refusal to sell, license, or supply its property rights can avoid antitrust liability based on a claimed right under the intellectual property laws. In cases involving unilateral refusals to license an intellectual property, or to sell or supply protected works or technology, courts generally decline to impose antitrust liability. Even here, however, caveats abound. Courts have recognized that in certain circumstances an intellectual property right does not confer an unfettered right to refuse to deal, and this potentially exclusionary conduct is not immune from antitrust liability.

For example, in United States v. Microsoft, a case brought by the United States and individual states accusing Microsoft of exclusive dealing and other exclusionary conduct, Microsoft argued that “if intellectual property rights have been lawfully acquired,” then “their subsequent exercise cannot give rise to antitrust liability.”5 In rejecting Microsoft’s contention that the exercise of intellectual property rights enjoyed antitrust immunity, the D.C. Circuit characterized the argument as a “bold and incorrect position as a baseball bat, cannot give rise to tort liability.”6

The Federal Circuit has also recognized the limits of the exclusionary rights granted by the intellectual property laws. It did so in Atari Games Corporation v. Nintendo of America, Inc.,7 which involved an antitrust challenge to Nintendo’s use of its patents to prevent retailers from selling unauthorized Nintendo-compatible game cartridges. In assessing whether to grant a preliminary injunction against Nintendo, the court noted, “When a patent owner uses his patent rights not only as a shield to protect his invention, but as a sword to evicercise competition unfairly, that owner may be found to have abused the grant and may become liable for antitrust violations when sufficient power in the relevant market is present.”8

Several circuits have taken a further step to clarify when the exercise of exclusionary intellectual property rights may constitute an antitrust violation. They have adopted what amounts to a “rebuttable presumption” standard. For example, the First Circuit considered a copyright holder’s refusal to deal in certain copyrighted software. The court held that “while exclusionary conduct can include a monopolist’s unilateral refusal to license a copyright, an author’s desire to exclude others from use of its copyrighted work is a presumptively valid business justification for any immediate harm to consumers.”9 After examining the historical relationship between intellectual property rights and antitrust liability, the court explained that rebutting the presumption—though not impossible—would only in rare cases be “unlikely to frustrate the objectives of the Copyright Act.”10

The Ninth Circuit also adopted a form of rebuttable presumption in Image Technical Services, Inc. v. Eastman Kodak Company.11 The plaintiff, a group of independent service organizations, challenged Kodak’s practice of refusing to sell replacement parts to its product customers who purchased service contracts from the ISOs rather than from Kodak. The ISOs alleged that Kodak unlawfully monopolized or attempted to monopolize the market for servicing Kodak copiers. At trial, Kodak argued that it held numerous patents and copyrights for its photocopers, diagnostic software, and service software and manuals, and that these intellectual property rights provided a legitimate business justification for its alleged refusal to deal with the ISOs. The jury rejected this argument and instead returned a verdict in favor of the ISOs. Kodak appealed.

Although the Ninth Circuit noted that it could “find no reported case in which a court has imposed antitrust liability for a unilateral refusal to sell or license a patent or copyright,” and that “courts do not generally view a monopolist’s unilateral refusal to license a patent as ‘exclusionary conduct,’” it held that the exercise of intellectual property rights creates only a rebuttable presumption that anticompetitive conduct is justified.12 The court upheld the jury’s verdict, finding it “more probable than not that the jury would have found Kodak’s presumptively valid business justification rebutted” as pretextual.13

In a different factual context, the Second Circuit recently overturned the dismissal of an antitrust claim brought against major music publishers in Starr v. Sony BMG Music Entertainment.14 The publishers—which each produce, license, and distribute music—established jointly owned Internet sites for the sale of digital music. According to the allegations in Starr, the publishers refused to provide music to independent Internet distributors. The Second Circuit held that this refusal to deal with independent Internet distributors was, at the very least, a factor that could be used to prove an unlawful restraint of trade.15

Group Boycott

The district court in the Redbox/Universal litigation indicated that the limits articulated in these refusal-to-deal cases may also apply to cases involving concerted refusals to deal undertaken by or involving a group of intellectual property rights holders. Although the court stated that the classic “group boycott” label does not reflect “the whole of [Redbox’s] claim,” the fact pattern relied on in the court’s ruling is close to the group boycott line of antitrust cases.

These cases hold that although the antitrust laws generally grant an entity broad autonomy in deciding with whom it will deal, a dominant entity’s use of its vertical relationships to coerce a customer or a distributor to refuse to deal with a competitor may give rise to a finding of a group boycott—a violation of Section 1. Supreme Court authority for more than 60 years holds that group boycotts limiting or restricting the choices available to market participants are unlawful. For example, the Court held in 1941 in Fashion Originators’ Guild of America, Inc. v. Federal Trade Commission that a boycott designed to destroy a rival method of competition violated the antitrust laws.16 The boycott was organized by a group of dress and textile manufacturers who sold original clothing. The manufacturers used their vertical relationships with retailers to coerce the retailers to refrain from doing business with a group of manufacturers selling “copied” designs. The defendants argued that they had legitimate business reasons to protect their designs from the copiers, but the Court rejected this argument. The purpose of the boycott, according to the Court, was “the intentional destruction of one type of manufacture and sale which competed with [the manufacturers],” so the manufacturers’ conduct was well within the ambit of the antitrust laws.

Nearly two decades later, in Klor’s, Inc. v. Broadway-Hale Stores, Inc.,17 the Court again confronted and found a group boycott that was harmful to competition. In the case, the defendant, a large department store, demanded that manufacturers and distributors of household appliances stop selling their goods to the plaintiff, a low-cost department store, if they wanted to continue to do business with the defendant. The Supreme Court reversed the Ninth Circuit’s grant of summary judgment to the defendant, observing that group boycotts “cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment.” The Court further noted that such a restraint “clearly has, by its nature and character, a
monopolistic tendency” and thus constitutes the type of harm the antitrust laws were designed to prevent.

The concern about preserving free market choice also arose in Blue Shield of Virginia v. McCready,18 which involved a health plan subscriber’s antitrust claim that an insurer had conspired with a society of psychiatrists to boycott clinical psychologists. The Supreme Court found that the boycott’s restriction of the subscribers’ ability to seek the psychological treatment of their choice resulted in antitrust injury.

The Court summarized and reinforced the concerns and principles reflected in Fashion Originators’, Klor’s, and McCready in Northwest Wholesalers Stationers, Inc. v. Pacific Stationery and Printing Company. While observing that not all refusals to deal are predominately anticompetitive, the Court stated that boycotts involving “joint efforts by a firm or firms to disadvantage competitors by ‘either directly denying or persuading or coercing suppliers or customers to deny relationships the competitors need in the competitive struggle’” have typically been presumed to have anticompetitive effects.19

Although these cases do not directly involve the exercise of copyright, trademark, or patent rights, the common themes that emerge—including concern for preserving the unrestricted market choices of buyers—appear to have influenced the court in the Redbox/Universal litigation. More generally, the themes thread through and illuminate other cases, including Kodak and Starr, in which the exercise of intellectual property not only protects patented technology or copyrighted works but also allegedly eliminates a competitor and diminishes the selections available to consumers.

Crucial Lesson
What seems clear from these cases in which antitrust law and intellectual property law are intertwined is that a concerted refusal to deal—even when intellectual property rights are involved—can draw antitrust scrutiny in a number of different factual circumstances.

Despite broad statements in some cases about the prerogative of intellectual property holders to control how they license—or, indeed, refuse to license—their content, it is likewise the case that the antitrust laws can constrain their ability to do so. Antitrust immunity may exist for the exercise of intellectual property rights, but it is not without limits.

It remains unclear which theory of antitrust liability Redbox is pursuing or which antitrust doctrine persuaded the Delaware judge to deny Universal’s motion to dismiss. Nor is it possible at this point to determine what actual facts will be adduced. As the prior cases show, factual circumstances are central to the ultimate analysis. The allegations in the amended complaint and Redbox’s opposition to Universal’s motion to dismiss suggest that Redbox is pursuing a theory that Universal is using its vertical relationships with its distributors and retailers to keep Redbox from distributing DVDs. The district court’s opinion stated that the classic group boycott label does not reflect “the whole of [Redbox’] claim,” but it permitted the complaint to survive the pleading stage without a full explanation of any other label that might apply.

Only further development of the facts will reveal whether the concerns that animate the case law addressing the issues of refusal to deal and group boycott will apply to the Redbox/Universal litigation. Whether Redbox will be able to prove the elements of its claims, and whether Universal’s conduct toward Redbox constitutes justifiable business practices and is procompetitive, must still be adjudicated. The crucial lesson for intellectual property owners is that a copyright holder was not able to escape Redbox’s antitrust allegations at the pleading stage, notwithstanding its uncontested status as a copyright holder. The facts may end up undercutting Redbox’s theory of liability. But for now, the court has determined that whatever antitrust protection the copyright laws might afford Universal, that protection is not absolute.

4 Fox Film Corp. v. Doyal, 286 U.S. 123, 127 (1932).
5 United States v. Microsoft, 253 F. 3d 34, 63 (D.C. Cir. 2001).
6 Id.
8 Id. at 1576. Compare In re Serv. Orgs. Antitrust Litig., 203 F. 3d 1322 (Fed. Cir. 2000) (With a few narrow exceptions, a unilateral refusal to deal is largely immune from antitrust liability).)
10 Id. at 1187 n.64.
11 Image Tech. Servs., Inc. v. Eastman Kodak Co., 125 F. 3d 1193 (9th Cir. 1997).
12 Id. at 1218.
13 Id. at 1219-20.
14 Starr v. Sony BMG Music Entm’t, 592 F. 3d 314 (2d Cir. 2010).
15 Id. at 323.
In 2009, two major court decisions addressed this continuing arms race. One, *RealNetworks, Inc. v. DVD Copy Control Association, Inc.*, involved a challenge by studios and others to the manufacture and distribution of devices for the copying, storage, and disk-free playback of DVD content. The second, *Cartoon Network LP, LLLP v. CSC Holdings, Inc.*, involved a copyright challenge to a cable company’s implementation of new remote storage digital video recorder (RS-DVR) technology. In the former, the U.S. District Court for the Northern District of California concluded that the challenged devices violated the Digital Millennium Copyright Act and the defendant’s license to use encryption technology designed to prevent the unauthorized copying of DVD content. In the latter, the U.S. Supreme Court let stand the Second Circuit’s ruling that a cable company’s providing of RS-DVR service to its customers did not constitute direct infringement of any copyrighted works actually recorded and played by customers using that service.

Although these two cases involved different technologies, the same tug-of-war between an entertainment industry determined to maintain control over its copyrighted content and watching a television program meant tuning in to the program while it was being broadcast, and viewing a motion picture meant taking a trip to the local theater. In those days, the unauthorized copying or performance of a program or film by a subscriber or customer was of relatively little concern because the technology to accomplish this infringing act was not available to the average consumer. Now, however, home entertainment’s technological marvels have brought new ways to infringe the exclusive intellectual property rights of copyright owners and licensees—or so they say. As new technical milestones are reached, the entertainment industry has responded with counter-technology, litigation, or both.

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**COPY CAVEATS**

Two recent cases show the extent and limitations of time shifting as a defense to copyright infringement.
a technology sector determined to keep pace with the public demand for content was at the heart of both. From these two most recent skirmishes, it is apparent that courts remain hostile to “traditional” unauthorized copying (e.g., the duplication of an encrypted DVD), but have tolerance for what might be dubbed “technical” copying (i.e., the caching of non-viewable copies that exist solely for the purpose of allowing some device to process the distribution of content that would otherwise be permissible in the absence of that copying).

The Start of Home Copying

The current tension between studios and the purveyors of consumer electronics began before the rise of the home computer. In 1976, in *Sony Corporation v. Universal City Studios, Inc.*, television studios alleged that the manufacturers and sellers of home videotape recorders (VTRs) were liable for contributory copyright infringement. The Supreme Court held, however, that “time-shifting,” or copying for purposes of later viewing, was a fair use of the studios’ copyrighted programming.

The issue changed in 2006, however, when the RS-DVR was developed. Use of this device requires the participation of cable providers, which also developed the technology. By virtue of that participation, the studios saw an opportunity to avoid the barriers to contributory infringement identified in the *Sony* case and sued instead for direct infringement. Ultimately, however, the studios fared no better and, in 2009, the Supreme Court declined to disturb a Second Circuit ruling that the cable provider committed no copyright infringement by its operation of the RS-DVR system.

The studios were more successful in challenging another new duplication device introduced in 2007 that allowed users to circumvent certain industry-standard copy-prevention technology and copy the contents of DVDs to hard drives for playback without the physical DVD. The studios attacked the new device as violative of the DMCA and a license agreement for the very copy-prevention technology that the device was designed to circumvent. The district court enjoined the manufacture and sale of the device under both theories. In so doing, the court resurrected the studios’ hope that at least some technological advances would be deemed as having gone too far.

Cartoon Network

The Second Circuit’s ruling in *Cartoon Network* was rendered in August 2008, but it did not become final until almost a year later, when certiorari was denied by the U.S. Supreme Court. At issue in *Cartoon Network* was the RS-DVR. In contrast to a set-top or stand-alone DVR device (e.g., a TiVo) that stores recorded programming, the RS-DVR allows users to record programming on a local drive, an RS-DVR device (e.g., a TiVo) that stores recorded programming on a local drive, an RS-DVR allows users to record programming on “central hard drives housed and maintained by [a provider] at a ‘remote’ location.” When the user wishes to watch a recorded program, he or she sends a signal through the cable to the provider, after which the recorded program is transmitted to the user.6

Cablevision announced the RS-DVR system in March 2006. Before launch, however, a collection of television and movie studios sought to enjoin the new technology, arguing that operation of the system would directly infringe their copyrights to reproduce and publicly perform their copyrighted works. The studios “alleged theories only of direct infringement, not contributory infringement, and [the] defendants waived any defense based on fair use.” It is likely that the studios were influenced by the Supreme Court’s *Sony* decision when they opted to forgo a contributory infringement cause of action, perhaps reasoning that time shifting was just as much a noninfringing use of RS-DVR technology as of VTR technology. Given the myriad ways in which first-run television episodes are now made available to the public after the initial airing—including often on the studios’ own Web sites—it arguably would have been difficult to establish that the studios were harmed by use of the RS-DVR for time-shifting purposes.

From the perspective of the user, there is virtually no difference between a set-top and remote storage DVR; the functionality, operation, and playback all are essentially the same. From the perspective of the cable provider, however, the remote storage version of the DVR generates a copy of the copyrighted content, at least in a technical sense, that is not created under a set-top DVR system. With a set-top system, the content of the various television channels is gathered by the cable provider and transmitted to customers in a single stream of data, which concludes the involvement of the cable provider. With the RS-DVR system, on the other hand, the data stream is split into two: one is routed to the customer, and the other is directed to a buffer and then a server (or servers) housed at the
The studios alleged that the RS-DVR violated their exclusive rights of reproduction and public performance by 1) briefly storing the copyrighted content in the various buffers, 2) storing the copyrighted content on the hard disks, and 3) transmitting the copyrighted content from the hard disks to customers in response to playback requests. The district court agreed on all counts, holding that 1) the “aggregate effect of the buffering” was to reproduce an entire program, even if pieces of the program were stored in the buffer for only a short time, 2) it was the cable provider that made the copies on the hard disks, even if it was done at the customer’s request, and 3) given the commercial nature of the relationship between the cable provider and its customers, the transmission of a program from the hard disks was “to the public.”

The Second Circuit reversed on all three points. First, citing to Section 101 of the Copyright Act, the appellate court concluded that the copyrighted works were not “embodied” in the buffers “for a period of more than transitory duration” and, consequently, could not be said to be “fixed” in the buffers. Although the works indubitably were embodied in the buffers, the data resided there for no more than 1.2 seconds before being automatically overwritten. To find that this minuscule time was more than “transitory duration” would “read the duration language out of the statute.” The Second Circuit held that the acts of buffering did not create “copies” of the works as that term was defined in the Copyright Act.

Second, the appellate court concluded that the playback copies stored on the hard disks were made by the customers who transmitted the signal to record the programs, not by the cable provider. Under Religious Technology Center v. Netcom On-Line Communications Services, when there is a dispute as to the author of an allegedly infringing instance of reproduction, the court is to look to the “volitional conduct that causes the copy to be made.” In this case, the only volitional act by the cable provider was to design and maintain the RS-DVR system—conduct that, if wrongful, was subject to the doctrine of contributory infringement, which “stands ready to provide adequate protection to copyrighted works.” The customer, by contrast, actually orders the system to produce a copy of a specific program, just as a VCR user presses a button to make a recording. Therefore, only the customer could be held liable for direct infringement.

Finally, the Second Circuit held that the cable provider’s transmission of a recorded program upon receipt of a playback request did not involve the transmission of a performance to the public. Whereas the district court had focused on the potential audience for the copyrighted work, the appellate court examined the actual audience for the transmission and concluded that “the universe of people capable of receiving an RS-DVR transmission is the single subscriber whose self-made copy is used to create that transmission.” A transmission to a single subscriber is not a performance to the public.

RealNetworks

Somewhat less controversial is the district court’s conclusion in RealNetworks that it was a violation of copyright law and a license to use DVD encryption technology to manufacture a device that circumvented that technology and permitted a user to copy DVD content to a hard drive for later viewing without the need for the physical DVD.

In the mid-1990s, representatives of the motion picture, consumer electronics, and computer industries came together to form the Copy Protection Technical Working Group with the common goal of developing a standardized technology to prevent the unauthorized duplication of DVD content. Ultimately, the group endorsed the Content Scramble System (CSS), which encrypts the contents of a DVD, rendering it unplayable until it is “unlocked” by CSS “keys” on an authorized DVD drive. The CSS requires the presence of the DVD in the drive in order to function. The DVD Copy Control Association, Inc. (DVD CCA) was established in 1999 to license CSS technology to providers of DVD content and manufacturers of DVD drives using a standard form license agreement.

In 2007, RealNetworks, Inc., and RealNetworks Home Entertainment, Inc., entered into a CSS license agreement and soon after began to manufacture and distribute their RealDVD product. Upon insertion of a DVD into the drive of a device running RealDVD software, the user was prompted to either play the DVD, save the contents to the device’s hard drive, or do both simultaneously. The save function enabled the user to play the contents of the DVD at a later time, without the DVD. There was no limit to the number of times a DVD could be copied using RealDVD, so a single DVD—even a rented one—“could be passed around a dormitory, office or neighborhood” and copied on any computer. The End User License Agreement provided that the saving functionality of the RealDVD software was to be used only with DVDs that the end user owned, but there was no way to monitor or enforce compliance with this restriction.

A number of studios, along with the DVD CCA, commenced an action against Real, alleging that the manufacture and distribution of the RealDVD product violated the DMCA and Real’s CSS license agreement. As to the former, the DMCA injected anticircumvention and antitrafficking provisions into the Copyright Act, creating “new causes of action both for circumvention of access controls in ways that facilitate copyright infringement and for trafficking in circumvention devices that facilitate copyright infringement.” Thus, Section 1201(a) of the DMCA, the so-called access-control provision, provides that no person shall manufacture or provide any product that is “primarily designed or produced for the purpose of circumventing a technological measure that effectively controls access to a work protected under” the Copyright Act. Section 1201(b), the “copy-control” provision, similarly provides that no person shall manufacture or provide any product that is “primarily designed or produced for the purpose of circumventing protection afforded by a technological measure that effectively protects a right of a copyright owner under” the Copyright Act.

As a threshold matter, the district court first concluded that the CSS is a “technological measure” that “controls access to” protected works—namely, copyrighted DVD content—and “prevent[s] copying of copyrighted DVD content by the average consumer.” Under the DMCA, the relevant question, therefore, was whether the RealDVD product was “primarily designed” to circumvent either or both of these functions. The court found that the studios were likely to prevail on their claims under both Sections 1201(a) and 1201(b) of the DMCA.

With respect to Section 1201(a), the district court held that the RealDVD product was designed primarily for circumvention of the CSS and other protective measures to permit a user to access DVD content without the authority of the copyright owner. Indeed, Real admitted that “its intent upon initial development was to create a software product that copies DVDs to computer hard drives so that the user does not need the physical DVD to watch the content.” The court rejected Real’s argument that a DMCA claim was unavailable against a licensee of the CSS.
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technology on the grounds that Real was acting outside the scope of its license. Thus the studios were not limited to breach of contract claims.17

Similarly, the court held that Real had violated Section 1201(b) because the RealDVD product “removes or deactivates multiple layers of CSS protections,” enabling copyrighted DVD content to be copied to a hard drive and played without further CSS decryption or authentication. The fact that Real was a CSS licensee was irrelevant, since that license did not give Real the right to permanently copy DVD content to a hard drive. As stated by the district court: “The DMCA was intended for products like RealDVD; products that are expressly designed to circumvent technological measures for purposes of thwarting the rights of copyright owners to decide who may gain access to their copyrighted works in digital format.”18

Faced with these largely self-evident conclusions, Real invoked the Sony case for the proposition that making a personal copy of a DVD is a fair use, akin to the making of a copy of a televised program for time-shifting purposes. The district court observed, however, that Sony predated the enactment of the DMCA and was, to the extent it was incompatible, superseded by the DMCA, in particular by Sections 1201(a) and 1201(b). Even though the DMCA “provides for a limited ‘fair use’ exception for certain end users of copyrighted works, the exception does not apply to manufacturers or traffickers of the devices prohibited by 17 U.S.C. § 1201(a)(2).” In other words, “[W]hile it may well be fair use for an individual consumer to store a backup copy of a personally-owned DVD on that individual’s computer, a federal law has nonetheless made it illegal to manufacture or traffic in a device or tool that permits a consumer to make such copies.”19

Finally, the district court concluded that Real’s manufacture of the RealDVD product was a breach of the CSS license agreement. In the first place, it was irrelevant that the RealDVD product supposedly utilized its own protections (such that a copy produced by the RealDVD product could only be played on a device with that software), since the license was for CSS technology. It would be a “tortured reading indeed” to conclude that the CSS license permitted a licensee to dispose of the CSS technology once it had been used for unlocking the DVD content. Notwithstanding that the CSS license was a contract of adhesion, the court held that Real was bound by DVD CCA’s “reasonable expectations” at the time the contract was executed, which included a “copy prevention objective” embodied in the contract recitals. Moreover, the technical specifications set

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Los Angeles Lawyer - May 2010

43

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forth in the license required the use of particular forms of CSS encryption, such that the application of Real’s own form of encryption was noncompliant. For these reasons, the RealDVD product was deemed a violation of the CSS license agreement, and the district court enjoined its manufacture and sale, citing both the presumption of irreparable injury in copyright cases generally and a provision of the license agreement authorizing injunctive relief.

Future Considerations

If there is any bright-line rule that emerges from the convergence of the Sony, Cartoon Network, and RealNetworks decisions, it is that an unauthorized copy that is a mere means to a permissible end is not likely to be deemed what the Copyright Act was intended to prohibit, but the act does prohibit unauthorized copies that result from a process created for the purpose of making unauthorized copies. Stated differently, if the copying that occurs does not meaningfully alter what the consumer perceives—as in the case of playback via a remote storage versus set-top DVR system—the copying will be upheld. If the consumer makes direct use of the unauthorized copy, on the other hand—for example, by accessing a motion picture from a hard drive rather than a DVD—the copying will be disallowed.

Practically speaking, this dividing line, which admittedly runs through an ocean of gray, appears to be both appropriate and necessary. Most new technologies for the enjoyment of entertainment content involve some form of caching, buffering, or other digital processing that technically results in the creation of a copy of that content, even if short-lived. In most cases, that copying is required for the efficient operation of the technology and to enhance the quality of the viewing experience. It is not intended to result in a permanent copy of the content or serve as a substitute for viewing the program or movie through a licensed distribution channel. If all such copying constituted infringement, it is clear that most current and in-development technologies would be subject to litigation and possible injunctive relief.

For example, Internet protocol television with video-on-demand capability—or IPTV/VOD for short—is touted as the newest breakthrough in home television viewing. Rather than sending signals to all television channels simultaneously, as in cable and satellite broadcasting, IPTV allows the consumer to select which signal to watch and then transmits only that signal to a set-top box. This more streamlined approach frees scarce bandwidth for higher image and sound quality, as well as “more content choices to feed DVRs and multiple televisions in the home.”
For some providers, the content is actually downloaded to a device in the home; other providers merely stream the content into the home, where it passes through a buffer to “smooth out” the streaming. In either case, the content is copied to a device in the home, but only as a necessary means to permit the viewing of the content. Under the rationale of Cartoon Network, such copying appears to be permissible.

In this digital age, most license agreements for the distribution of copyrighted content are likely to contain provisions that broadly authorize distribution in almost any media. The truly savvy will even address and preapprove (or not) the technical copying that by necessity may accompany distribution via certain channels. But even in the absence of any express authorization, it seems clear that, so long as the copying is of minimal duration and intended only to facilitate the real-time or time-shifted viewing of a program or movie, courts will not intervene. For once, escaping liability on a technicality is actually a desirable result.

1 RealNetworks, Inc. v. DVD Copy Control Ass’n, Inc., 641 F. Supp. 2d 913 (N.D. Cal. 2009).
3 Digital Millennium Copyright Act, 17 U.S.C. §§1201 et seq.
6 Cartoon Network LP, LLLP, 536 F. 3d at 123-25.
7 Id. at 124-25.
8 Id. at 125-26.
9 Id. at 127-30.
11 Cartoon Network LP, LLLP, 536 F. 3d at 131-32.
12 Id. at 134-38.
13 The chief executive officer of Real testified that Real commenced its efforts to develop the RealDVD product after learning that a California state trial court had refused to enjoin the distribution of a comparable product manufactured by Kaleidescape, Inc. See RealNetworks, Inc. v. DVD Copy Control Ass’n, Inc., 641 F. Supp. 2d 913, 925 (N.D. Cal. 2009). Ironically, the California Court of Appeal reversed the denial of that injunction on August 12, 2009, the day after the district court’s decision in the RealNetworks case, on the grounds that the trial court had erroneously concluded that certain manufacturing specifications (regarding the presence of the DVD for playback) were not incorporated into the party’s contract. See DVD Copy Control Ass’n, Inc. v. Kaleidescape, Inc., 176 Cal. App. 4th 697 (2009).
14 RealNetworks, Inc., 641 F. Supp. 2d at 926.
15 Id. at 931-32.
16 Id. at 932-36.
17 Id. at 932-35.
18 Id. at 935-36.
19 Id. at 940-43.
20 Id. at 946-51.
21 Id. at 953.
22 Max Bloom, The IPTV/VOD Landscape, STREAMING MEDIA MAGAZINE, April/May 2009, at 64.
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16.5 CLE hours, including 1 hour in ethics and 2 hours in prevention of substance abuse

ON TUESDAY, MAY 11, the Business and Corporations Law Section will host a seminar on the sale of troubled companies and their assets, whether or not they are in bankruptcy. Panelists Barry L. Burten, David M. Poitras, and Robert K. Rasmussen will discuss the legal and business issues that arise in these sales from the perspective of the seller, buyer, and other interested parties (landlords, secured lenders, and trade creditors, among others). The panel will also discuss what is going on in the current marketplace concerning troubled company sales and what future opportunities may lie ahead in this expanding area. The registration code number is 010825. The seminar will take place at Jeffer Mangels Butler & Marmaro LLP, 1900 Avenue of the Stars, 7th floor, Los Angeles, 90067. On-site registration and the meal will begin at 6 P.M., with the program continuing from 6:30 to 8. The prices below include the meal.

$25—CLE+Plus member
$85—Business and Corporations Law Section member
$100—LACBA member
$120—all others

1.5 CLE hours

ON THURSDAY, MAY 13, the Los Angeles County Bar Association and the Small and Solo Division will host a program on the new Federal Rules of Civil Procedure amended to address electronic discovery practices and the more recent California Electronic Discovery Act. Attorneys now need to be aware of how the exchange of electronic evidence and other electronically stored information (ESI) must proceed. This seminar, led by Alexander H. Lubarsky, will discuss the statutory rules and case law that direct California attorneys how to preserve, identify, request, exchange, review, and produce ESI. There will be demonstrations of leading industry tools (software and hosted online solutions) and “war stories” by the presenters highlighting what to do and what not to do when exchanging electronic evidence with clients, opposing counsel, or a regulatory authority conducting an audit. The session will culminate with an interactive discussion of the newly articulated ethical requirements that are at play when exchanging ESI.

This event is also available as a live Webcast with a price range of $120 to $160. Webinar registration for this program closes on Monday, May 10. Login information will be forwarded to each Webinar registrant 24 hours before the event. To receive full CLE credit for viewing the Webinar, registrants must log in individually at least five minutes early. The registration code number is 010709. On-site registration will begin at 5 P.M., with the program continuing from 5:30 to 7:30. The prices below include the meal.

$20—CLE+Plus member
$75—Small and Solo Division member
$100—LACBA member
$140—all others

2 CLE hours
How Can a Lawyer Become a Producer?

TWO WOULD-BE TELEVISION PRODUCERS consult an entertainment lawyer regarding a reality show they seek to develop. During the initial meeting with the duo, the lawyer realizes that his prospective clients have no credits, no pending offers, no significant contacts, no family in the business, no money, and no real idea of how to get their reality show concept off the ground. The lawyer wonders why the two are seeking legal representation. They reply that agents, managers, and networks have refused to meet with them because of their lack of credits. The lawyer now is sure that he is the only accessible link in the entertainment chain for these novices.

The lawyer starts brainstorming with his prospective clients and spends nearly an hour building a show concept. The lawyer provides talent suggestions, recommends showrunners to attach, offers likely budget forecasts, explains the difference between shooting a character reel and a presentation, gives his take on which networks to approach, and tells them how to prepare the written materials they need for pitching and building a show bible. The more the lawyer talks, the more the prospective clients modify their idea.

Ultimately, the lawyer knows that if this project is going to have any chance, the would-be producers are going to need someone to guide them through every facet of the industry. All of a sudden, the entertainment lawyer becomes the show’s coproducer.

This scenario occurs every day for transactional entertainment lawyers. By connecting clients and prospective clients with others in the entertainment business, attorneys may find themselves in a position to produce the resulting entertainment projects. For entertainment lawyers, this opportunity is alluring in ways both creative and pecuniary. After all, simply being an attorney generally does not lead to getting one’s name on a poster.

Unfortunately, as a result of an entertainment lawyer taking the dual role of counsel and coproducer, conflicts of interest may arise, among a host of other concerns. This is especially true when producer-clients want their lawyer to step away from the project and return to his or her more traditional legal duties—despite all the lawyer’s hard work bringing the project to life. The ethical questions abound. Are attorneys entitled to be producers? If so, what are the pitfalls, and how does an entertainment attorney avoid them?

Conflicts may develop when the lawyer explains to clients the role of the attorney and the fee arrangement. In the scenario of the reality show producers, perhaps the lawyer decides to take a 5 percent commission of the team’s income. Most likely the novices will be ecstatic to pay the lawyer 5 percent if he helps them get their show on the air. But the lawyer soon realizes that after all his producing efforts, the duo will receive the 95 percent bounty. Must the lawyer, or other similarly situated practitioners, be so selfless?

The lawyer may decide on another approach. He might say to his prospective clients, “I am willing to help put all the pieces in place. However, I want to be credited as an executive producer, with a line item fee in the budget to be negotiated in good faith. I also want my firm to be engaged as legal counsel to negotiate our collective deals ‘if and when.’ I completely understand if this is not the deal you were looking for, so you can keep all the contributions I have already made on your behalf—and should another deal come your way, I will be happy to negotiate for you at our customary 5 percent commission.” The lawyer wants the duo to sign waivers acknowledging the conflict that exists between them, the lawyer, and the lawyer’s firm.

Conflict waivers are crucial. Lawyers have an ethical responsibility to avoid interests adverse to their clients. Rule 3-300 of the California Rules of Professional Conduct provides that an attorney shall not enter into a business transaction with a client unless: “(A) The transaction…and its terms are fair and reasonable to the client and are fully disclosed…in writing…; and (B) [t]he client is advised in writing that [he or she] may seek the advice of…independent [counsel]…; and is given a reasonable opportunity to seek that advice; and (C) [t]he client…consents in writing to the terms of the transaction.”

Lawyers planning to coproduce a project with prospective clients should prepare a term sheet setting forth the principal terms of their joint venture and the delineation between legal fees and producer fees. They should strictly follow the requirements of Rule 3-300 and encourage the prospective clients to find other legal representation until the negotiation is complete.

Lawyers who do this may find that the attorney chosen by the prospective coproducer clients will take on the representation with guns blazing, requesting that the lawyers take a lesser compensation and hurling accusations of unfair advantage. Even when a lawyer knows that he or she essentially created the concept of the show, the lawyer all too frequently, for the benefit of the prospective clients, caves in and accepts the lesser share as well as a lesser form of credit.

While Rule 3-300 outlines a mechanism that theoretically protects both lawyers and clients, a lawyer-producer often is in an intractable position even after complying with that rule. Many producers will never get the green light for their first show without the valuable efforts of an entertainment lawyer. Shouldn’t lawyers be rewarded for their creative contributions to a successful entertainment venture?

Michael J. Weiss is a partner in the law firm of Abrams Garfinkel Margolis Bergson, LLP, where he specializes in the representation of writers, actors, directors, and producers in entertainment litigation and transactions.
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