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# FOREWORD

Judge Peter M. Reyes, Jr.  
Minnesota Court of Appeals

The concept of the Hispanic National Bar Association/Microsoft Intellectual Property Law Institute (IPLI) began in 2011 during discussions between Microsoft and the HNBA. As an intellectual property (IP) lawyer and registered patent attorney, addressing the dearth of Latina/o IP practitioners was a priority for me, as well as Microsoft and the HNBA. Conversations with Microsoft representatives continued regarding the creation of a program to introduce Latina/o law students (Scholars) to opportunities in IP law, and I was proud to have the inaugural IPLI program launched July 7–12, 2013, in Washington, D.C. during my term as HNBA national president.

To date, approximately 150 Scholars have completed this week-long, intensive, immersion program. This unique and multi-faceted program includes pairing Scholars with IP practitioners (Fellows) across the country through the IPLI Fellowship Program to improve their legal skills. The IPLI also includes presentations to the Scholars from representatives from Congress, the USPTO, Copyright Office, ITC, FTC, and prominent IP practitioners. One of the highlights is a visit to the Court of Appeals for the Federal Circuit, hosted by Circuit Judge Jimmie V. Reyna, to hear oral arguments in a patent case and to tour the court. The program also offers opportunities to IPLI Scholars for substantive writing such as the articles in this second edition of the HNBA Journal of Law and Policy.

There are many people who have contributed to the creation and success of the IPLI. Horacio Gutierrez, then CVP & Deputy General Counsel of Microsoft and now GC of Spotify, was instrumental in forming the IPLI. The tireless efforts of Microsoft's Mick Konowal and Catherine Romero to ensure the success of the IPLI, year after year, cannot be overstated. Pablo Tapia from Microsoft has continued Microsoft's strong substantive support of the IPLI. Jennifer Salinas, who will be HNBA national president in September 2018, has also contributed greatly to the program. And of course, the Honorable Jimmie V. Reyna's personal and professional contributions to the IPLI are without equal. It has been my true pleasure to work with each and every one of these outstanding individuals. And it is my sincere hope that the IPLI will continue on for many years to come!



# THE SEC'S ROLE IN REGULATING INITIAL COIN OFFERINGS

Jimmy Rodriguez

## INTRODUCTION

Cryptocurrency is a word loaded with ideas of boom and overnight success; it is like a gold-plated sign outside of an Old Western town, enticing those seeking fortune to inquire within. The allure of new opportunities has led to an explosion of fundraising for fledgling companies. Technology start-ups are raising billions of dollars—\$6.3 billion dollars in 2018 alone<sup>1</sup>—with Initial Coin Offerings (ICOs). An ICO occurs when an entity<sup>2</sup> offers digital tokens<sup>3</sup> in exchange for an investor's cryptocurrency, usually Bitcoin or ether.<sup>4</sup> Those tokens may serve as in-app currency for a project under development or function like ownership shares.<sup>5</sup> So investors often buy the tokens expecting an increase in value if the company's

project takes off.<sup>6</sup> The cryptocurrency market is novel and, with its promise of riches, has experienced a rapid growth. But with that growth also comes attention. After all, when there is a newfound gold rush it does not take long for bandits to take advantage, and with bad behavior, the sheriffs soon follow.

On July 25, 2017, the Securities and Exchange Commission (SEC) warned ICO issuers and investors that certain tokens may be securities, and as such, their offering might be subject to federal securities laws.<sup>7</sup> On September 29, 2017, the SEC filed a complaint against a purported issuer of digital tokens for allegedly engaging in illegal-unregistered-securities offerings and defrauding investors.<sup>8</sup> On December 1, 2017, the SEC's new Cyber Unit filed charges against a recidivist

<sup>1</sup> See generally David Floyd, *\$6.3 Billion: 2018 ICO Funding Has Passed 2017's Total*, CoinDesk (2018), <https://www.coindesk.com/6-3-billion-2018-ico-funding-already-outpaced-2017> (last visited Jun. 19, 2018).

<sup>2</sup> A token issuer may organize into an incorporated entity but doing so is not necessary.

<sup>3</sup> Tokens are also referred to as coins. A myriad of adjectives such as virtual, crypto, and digital are likewise used in combination with the words coin, token, or asset.

<sup>4</sup> Token issuers may also accept fiat or government-issued currency. *E.g.* TokenMarket, *TokenMarket ICO hosting and services*, <https://tokenmarket.net/ico-professional-services> (last visited Jun. 19, 2018).

<sup>5</sup> See Micha Benoliel, *Understanding the difference between coins, utility tokens and tokenized securities*, Medium (2017), <https://medium.com/startup-grind/understanding-the-difference-between-coins-utility-tokens-and-tokenized-securities-a6522655fb91> (last visited Jun. 19, 2018).

<sup>6</sup> See generally Jim Edwards, *Cryptocurrency ICOs are the tech bubble we've been waiting for*, Business Insider (November 21, 2017), <http://www.businessinsider.com/cryptocurrency-ico-bubble-2017-11> (last visited Jun. 19, 2018).

<sup>7</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207 (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf>.

<sup>8</sup> Complaint, SEC v. RECoin Group Foundation, LLC et al., No. 17 Civ. 5725 (E.D.N.Y. Sep. 29, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-185.pdf>.

securities-law violator in connection with an alleged ICO scam.<sup>9</sup> In 2018, the SEC has brought multiple actions against bad actors including the Centra ICO that was widely promoted by celebrities like DJ Khaled and Floyd Mayweather on their social media pages.<sup>10</sup> Despite the SEC's actions, many companies are moving forward with their ICOs. But even with the SEC's increased scrutiny in this market, cybersecurity failures,<sup>11</sup> suspect sales tactics,<sup>12</sup> and widely-circulated celebrity endorsements<sup>13</sup> are common occurrences in the ICO marketplace.

This Article defines necessary terms and provides an overview of the problems in the ICO space (Section II). The SEC's actions regarding bad actors and bulletins to market participants are reviewed (Section III) and the Commission's role in regulating the space moving forward is discussed (Section IV). The aim of this Article is to argue that, to protect investors, the SEC must continue to enforce existing laws and educate market participants because the danger to the public does not lie in the novelty of blockchain technology but in old problems like the sales and marketing practices of fraudsters and bad actors.

## OVERVIEW OF THE TECHNOLOGY & ICO MARKETPLACE

### Blockchain

A blockchain is a digital ledger maintained by a peer-to-peer network of computers.<sup>14</sup> Network participants share and retain identical, cryptographically secured records in a decentralized manner.<sup>15</sup> Blockchain is essentially the technology underlying cryptocurrencies. In it, the transactions are both public and recorded chronologically.<sup>16</sup>

In a January 2017 report titled *Distributed Ledger Technology: Implications of Blockchain for the Securities Industry*, the Financial Industry Regulatory Authority (FINRA) recognized the importance of blockchain and its many existing and forthcoming applications in the financial industry.<sup>17</sup> Such applications include systems to track trading and ownership of company shares, settle and clear loans, and automate redemption of bond coupons.<sup>18</sup> And legislatures have begun recognizing those applications. For example, on July 21, 2017, Delaware passed a law allowing the use of distributed ledger technology to store corporate records, including stock ledgers.<sup>19</sup>

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<sup>9</sup> Complaint, SEC v. PlexCorps et al., No. 17 Civ. 7007 (E.D.N.Y. Dec. 1, 2017), <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-219.pdf>.

<sup>10</sup> See Lucinda Shen, <http://fortune.com> Fortune (2018), <http://fortune.com/2018/04/03/floyd-mayweather-dj-khaled-centra-tech-ico-sec-fraud/> (last visited Jun. 19, 2018).

<sup>11</sup> See Jen Wiczner, *Hackers Just Stole \$7 Million in a Brazen Ethereum Cryptocurrency Heist*, Fortune (Jul. 18, 2017), <http://fortune.com/2017/07/18/ethereum-coindash-ico-hack/>; See Alyssa Hertig, *Ethereum Client Bug Freezes User Funds as Fallout Remains Uncertain*, CoinDesk (Nov. 7, 2017), <https://www.coindesk.com/ethereum-client-bug-freezes-user-funds-fallout-remains-uncertain/> (last visited Jun. 19, 2018).

<sup>12</sup> See Oscar Williams-Grut, *People are worried the boom in selling digital coins could mean 'boiler room is resurrected'*, Business Insider (Oct. 24, 2017), <http://www.businessinsider.com/ico-scams-fraud-boiler-room-resurrected-2017-10>; See also Arjun Kharpal, *Confido ICO 'exit scam': Founders disappear with \$375,000 and delete website*, CNBC (Nov. 21, 2017), <https://www.cnbc.com/2017/11/21/confido-ico-exit-scram-founders-run-away-with-375k.html> (last visited Jun. 19, 2018).

<sup>13</sup> See Rachel Rose O'Leary, *DJ Khaled Is the Latest Celebrity to Promote an ICO*, CoinDesk (Sep. 29, 2017), <https://www.coindesk.com/dj-khaled-is-the-latest-celebrity-to-promote-an-ico/> (last visited Jun. 19, 2018). See also Floyd Mayweather (@FloydMayweather), Twitter (Aug. 23, 2017 4:46 PM), <https://twitter.com/FloydMayweather/status/900459256784334851>.

<sup>14</sup> Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, Bitcoin.org (2017), <https://bitcoin.org/bitcoin.pdf> (last visited Jun 18, 2017). The Bitcoin whitepaper does not use the combined term "blockchain" but describes the technology in terms of a "chain of blocks."

<sup>15</sup> Id.

<sup>16</sup> Id.

<sup>17</sup> FINRA, *Distributed Ledger Technology: Implications of Blockchain for the Securities Industry* (Jan. 2017), [http://www.finra.org/sites/default/files/FINRA\\_Blockchain\\_Report.pdf](http://www.finra.org/sites/default/files/FINRA_Blockchain_Report.pdf)

<sup>18</sup> Id.

<sup>19</sup> Del. Code Ann. tit. 8, § 224 (West) ("Any records administered by or on behalf of the corporation in the regular course of its business, including its stock ledger, books of account, and minute books, may be kept on, or by means of, or be in the form of, any information storage device, method, or one or more electronic networks or databases (including one or more distributed electronic networks or databases) . . .")

## Cryptocurrency

A cryptocurrency is a digital asset represented on a blockchain.<sup>20</sup> Cryptocurrencies exist on a blockchain as balances associated with public addresses (a complex series of letters and numbers).<sup>21</sup> Any user can see how much cryptocurrency is associated with a public address.<sup>22</sup> But to use the coins the user needs the private key to that address,<sup>23</sup> which is a digital signature unique to a public address that is necessary to authorize transactions.<sup>24</sup> And to make these transactions, users depend on desktop, mobile, and online applications called wallets to send and receive cryptocurrencies as well as generate new addresses.<sup>25</sup>

Cryptocurrencies can generally be obtained in two ways: mining or purchasing. Mining is a process in which a computer's processing power is used to solve complex math problems, which in turn yields coins (units of cryptocurrency) as a reward.<sup>26</sup> Coins can also be purchased for fiat (government-issued) currencies and other cryptocurrencies at various online and in-person exchanges.<sup>27</sup>

Bitcoin (BTC) is the largest cryptocurrency by market capitalization.<sup>28</sup> And its value works much like a government-issued currency or publicly traded stock; it is determined by how much people are willing to pay for it. But Bitcoin has become widely popular in

particular because of its drastic surge in value. In 2010, a BitcoinTalk user exchanged 10,000 BTC for two pizzas, in what is known as the first real-world Bitcoin transaction.<sup>29</sup> If the user had held on to their BTC, its value would have accumulated to a staggering amount of \$67,668,000, as of June 11, 2018.<sup>30</sup>

## Ethereum

Ethereum is a decentralized platform that runs “smart contracts”—self-executing contracts where the terms between parties are embedded within the lines of code.<sup>31</sup> Smart contracts permit trusted transactions and agreements to be carried out among disparate and anonymous parties without the need for a central authority, legal system, or external enforcement mechanism.<sup>32</sup> Because of this, some companies execute their ICOs through Ethereum. These smart contracts also help automate token sales, liquidations, token-holder voting rights, and other corporate functions.<sup>33</sup>

Ether (ETH) is Ethereum's cryptocurrency. And Ether's two purposes are (1) to be a primary liquidity layer allowing efficient exchanges of different tokens issued using the Ethereum platform, and (2) to provide a payment method for transaction fees.<sup>34</sup> As of June 11, 2018, the exchange rate of USD to ETH is \$521.31 USD to 1 ETH.<sup>35</sup>

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<sup>20</sup> Timothy Lee, *Want to really understand how bitcoin works? Here's a gentle primer*, Ars Technica (2017), <https://arstechnica.com/tech-policy/2017/12/how-bitcoin-works/> (last visited Jun. 19, 2018).

<sup>21</sup> Id.

<sup>22</sup> Id.

<sup>23</sup> Id.

<sup>24</sup> Id.

<sup>25</sup> See Prableen Bajpai, *Bitcoin Wallet*, Investopedia (2017), <https://www.investopedia.com/terms/b/bitcoin-wallet.asp> (last visited Jun. 19, 2018).

<sup>26</sup> See John Kelleher, *Bitcoin Mining*, Investopedia (2017), <https://www.investopedia.com/terms/b/bitcoin-mining.asp> (last visited Jun. 19, 2018). (“Bitcoin mining is the process by which transactions are verified and added to the public ledger, known as the block chain, and also the means through which new bitcoin are released. Anyone with access to the internet and suitable hardware can participate in mining. The mining process involves compiling recent transactions into blocks and trying to solve a computationally difficult puzzle. The participant who first solves the puzzle gets to place the next block on the block chain and claim the rewards. The rewards, which incentivize mining, are both the transaction fees associated with the transactions compiled in the block as well as newly released bitcoin.”).

<sup>27</sup> See generally *List of all cryptocurrency exchanges*, Cryptocoincharts.info (2017), <https://cryptocoincharts.info/markets/info> (last visited Jun. 19, 2018).

<sup>28</sup> See generally *Cryptocurrency Market Capitalizations*, Coinmarketcap.com (2017), <https://coinmarketcap.com/> (last visited Jun 11, 2018).

<sup>29</sup> Rob Price, *Someone in 2010 bought 2 pizzas with 10,000 bitcoins — which today would be worth \$100 million*, Business Insider (Nov. 28, 2017), <http://www.businessinsider.com/bitcoin-pizza-10000-100-million-2017-11> (last visited Jun. 19, 2018).

<sup>30</sup> See generally *Cryptowatch—live Bitcoin price charts*, Cryptowat.ch (2017), <https://cryptowat.ch/> (last visited Jun 11, 2018).

<sup>31</sup> See *Smart Contracts*, Investopedia (2017), <https://www.investopedia.com/terms/s/smart-contracts.asp> (last visited Jun. 19, 2018).

<sup>32</sup> Id.

<sup>33</sup> Id.

<sup>34</sup> See generally *ethereum/wiki*, GitHub (2017), <https://github.com/ethereum/wiki/wiki/White-Paper> (last visited Jun. 19, 2018).

<sup>35</sup> *Cryptowatch—live Bitcoin price charts*, *supra* note 30.

## Initial Coin Offerings

An ICO is a fundraising event. A company offers its tokens in exchange for capital in the form of BTC or ETH.<sup>36</sup> Tokens can exist on their own independent blockchains, but many occur on the Ethereum platform.<sup>37</sup> Ethereum is popular because it is easy to use<sup>38</sup> and its smart-contract feature automates token sales and reduces transaction costs.<sup>39</sup> And like cryptocurrencies, tokens are valued based on demand.

Groups that hold ICOs—generally referred to as token issuers or token offerors—are usually start-ups with a project under development. The team may consist of only a few developers and officers. And the project itself is often little more than a concept explained in a whitepaper.<sup>40</sup> Sometimes, an ICO will be held by an incorporated entity. Some issuers may follow the example of the major cryptocurrencies and create an affiliated non-profit; the goal of nonprofits like the Litecoin Foundation is to promote a coin's use and to advance the development of its underlying technology.<sup>41</sup>

## Cybersecurity Failures and Cryptocurrency Theft

The massive amounts of capital being raised via ICOs have attracted the attention of hackers and thieves. Hackers have begun to target a token issuer's website to manipulate prospective buyers into sending cryptocurrency contributions to the wrong address.<sup>42</sup> Hackers also expose website visitors to malicious software like keyloggers or screen-grabbers to steal their personal information. Fake cryptocurrency wallets containing malware are a common trick<sup>43</sup> as well as phishing e-mails.<sup>44</sup> These various scamming devices have made theft a common occurrence in the cryptocurrency space. For example, in 2014, Mt. Gox, the largest Bitcoin exchange at the time, was the victim of a multi-million-dollar theft.<sup>45</sup> And recently, the SEC investigated the theft of ether from an ICO.<sup>46</sup>

## Sales Tactics and Celebrity Endorsements

ICOs are promoted through banner advertisements, blog posts, online videos, and social media. Promotional pieces

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<sup>36</sup> See generally *How to contribute to the Brickblock ICO with fiat currency (credit card, debit card, bank transfer)*, Brickblock.io (2017), <https://blog.brickblock.io/brickblock-ico-credit-debit-fiat-384e3df571d7> (last visited Jun. 19, 2018). Some ICOs accept contributions via credit cards, debit cards, and bank transfers, as well as other cryptocurrencies.

<sup>37</sup> See Rachel Rose O'Leary, *Ethereum's ERC-20 Token Standard Has Been Formalized*, CoinDesk (Sep. 11, 2017), <https://www.coindesk.com/ethereums-erc-20-token-standard-formalized/> (last visited Jun. 19, 2018). "A token is a script running on top of the Ethereum blockchain, with an associated database keeping track of ether payments."

<sup>38</sup> See generally Jason Rowley, *How Ethereum became the platform of choice for ICO'd digital assets*, TechCrunch (2017), <https://techcrunch.com/2017/06/08/how-ethereum-became-the-platform-of-choice-for-icod-digital-assets/> (last visited Jun. 19, 2018). "This ease of development, combined with the rising price of Ether and a desire by early stakeholders to re-invest in the Ethereum ecosystem, has made Ethereum the platform of choice for crypto-asset entrepreneurs . . ."

<sup>39</sup> See generally *Create a cryptocurrency contract in Ethereum*, Ethereum.org (2017), <https://www.ethereum.org/token>.

<sup>40</sup> See Cal Evans, *How to Develop White Paper for ICO: Do's and Don'ts*, Cointelegraph (2017), <https://cointelegraph.com/news/how-to-develop-white-paper-for-ico-dos-and-donts> (last visited Jun. 19, 2018).

<sup>41</sup> See Stan Higgins, *Tezos Founders Sued for Securities Fraud in Potential Class Action*, CoinDesk (2017), <https://www.coindesk.com/tezos-founders-sued-securities-fraud-potential-class-action/> (last visited Jun. 19, 2018). ("The lawsuit represents the latest twist in the ongoing spat between Tezos founders Kathleen and Arthur Breitman and Johann Gevers, the head of the Tezos Foundation, a non-profit created to promote and support development of the project"); see generally *About Us | Litecoin Foundation*, Litecoin-foundation.org (2017), <https://litecoin-foundation.org/about-us/>. ("[Litecoin Foundation's] mission is to advance Litecoin for the good of society by developing and promoting state-of-the-art blockchain technologies.")

<sup>42</sup> See Lorenzo Franceschi-Bicchierai & Jordan Pearson, *Hacker Allegedly Steals \$7.4 Million in Ethereum with Incredibly Simple Trick*, Motherboard (2017), [https://motherboard.vice.com/en\\_us/article/zmvg58/hacker-allegedly-steals-dollar74-million-in-ethereum-with-incredibly-simple-trick](https://motherboard.vice.com/en_us/article/zmvg58/hacker-allegedly-steals-dollar74-million-in-ethereum-with-incredibly-simple-trick) (last visited Jun. 19, 2018). ("The hacker allegedly took control of the Coindash official website and changed the text on the site, publishing their own ether wallet address instead of Coindash's. When people went to 'invest' in Coindash, they actually sent their ether to the hacker, not the company."); see also Catalin Cimpanu, *Hacker Steals \$8.4 Million Worth of Ethereum From Veritaseum Platform*, BleepingComputer (2017), <https://www.bleepingcomputer.com/news/security/hacker-steals-8-4-million-worth-of-ethereum-from-veritaseum-platform/> (last visited Dec 4, 2017).

<sup>43</sup> See Juan Galt, *OpalCoin Developer: Hacker Used Fake-Wallet Attack to Steal 17% of Supply*, Cointelegraph (2017), <https://cointelegraph.com/news/opalcoin-developer-hacker-used-fake-wallet-attack-to-steal-17-of-supply> (last visited Jun. 19, 2018).

<sup>44</sup> See Danny Palmer, *Trojan malware attacks by North Korean hackers are attempting to steal Bitcoin*, ZDNet (2017), <http://www.zdnet.com/article/trojan-malware-attacks-by-north-korean-hackers-are-attempting-to-steal-bitcoin/> (last visited Jun. 19, 2018).

<sup>45</sup> See generally Robert McMillan, *The Inside Story of Mt. Gox, Bitcoin's \$460 Million Disaster*, WIRED (2017), <https://www.wired.com/2014/03/bitcoin-exchange/> (last visited Jun 18, 2018).

<sup>46</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, *supra* note 7.

offer big returns and are laced with technical jargon.<sup>47</sup> Most ads attempt to capitalize on the “fear of missing out”<sup>48</sup> by highlighting limited token selling periods and special pricing for first movers. Additionally, to project a sense of ethos, ads may name-drop institutional investors or industry leaders involved with the offering.<sup>49</sup> Other times, mainstream celebrities are recruited for direct promotion via their social media platforms.<sup>50</sup> This star-powered marketing can be effective to promote an offering because of its reach since a celebrity’s Instagram and Twitter pages may have millions of followers.

A star-powered marketing campaign occurred in July 2017, when Floyd Mayweather promoted the Stox ICO on Instagram by boasting that he would “make a \$hit t\$N of money on August 2nd on the Stox.com ICO.” The same post included a picture of Mayweather looking out of the window of a plane with stacks of hundred-dollar bills in front of him.<sup>51</sup> The post also included a caption with several cryptocurrency-related hashtags.<sup>52</sup> Stox has since reached its goal of raising \$30 million dollars in ether.<sup>53</sup> Mayweather’s enthusiasm for ICOs is so great that he asked his social media followers to call him “Floyd Crypto Mayweather.”<sup>54</sup>

In a now-deleted Instagram post, rap producer and artist DJ Khaled promoted Centra, a cryptocurrency debit

card to his 8.7 million followers.<sup>55</sup> The post was a photo of the artist holding a Centra card and a bottle of Ciroc vodka, with a caption describing Centra as the “ultimate winner” in debit cards powered by tokens.<sup>56</sup> Centra, which was also promoted by Floyd Mayweather, is now a defendant in a class-action lawsuit filed on December 13, 2017, in federal court.<sup>57</sup> The plaintiffs in the case allege that Centra misled investors about relationships with Visa and Mastercard.<sup>58</sup> In April 2018, the SEC charged the founders of Centra with securities fraud.<sup>59</sup>

These celebrity ICO endorsements tend to follow a pattern: the celebrity highlights the ICO’s name, includes a few tech buzzwords describing the ICO in vague terms, and then suggests that it is a good investment. But soon after the SEC’s investor bulletin on celebrity ICO endorsements was published, many celebrities deleted such posts.<sup>60</sup>

## THE SEC WEIGHS IN ON INITIAL COIN OFFERINGS

### Tokens May Be Securities

On July 25, 2017, the SEC released a report titled *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO* to “advise parties who would use a blockchain-enabled means for capital-raising, to take appropriate steps to ensure compliance with

<sup>47</sup> See generally Anthony Zeoli, Priming the ICO Pump: Don’t Get Sucked In, *Crowdfund Insider* (2017), <https://www.crowdfundinsider.com/2017/11/125161-priming-ico-pump-dont-get-sucked/> (last visited Jun. 19, 2018). (“Be especially cautious of: (a) publically traded companies touting an ICO or other cryptocurrency/blockchain related activity with no prior or demonstrable experience in the space; and (b) companies raising money which describe its ICO/cryptocurrency in vague, or nonsensical terms, using undefined technical or legal jargon and/or without a clear plan as to how to accomplish its long-term business objectives.”).

<sup>48</sup> See generally Lorenzo Franceschi-Bicchieri, *How I Learned to Deal with My Bitcoin FOMO*, *Motherboard* (2017), [https://motherboard.vice.com/en\\_us/article/ywnnm/how-i-learned-to-deal-with-my-bitcoin-fomo](https://motherboard.vice.com/en_us/article/ywnnm/how-i-learned-to-deal-with-my-bitcoin-fomo) (last visited Jun. 19, 2018).

<sup>49</sup> Id.

<sup>50</sup> See Jeff John Roberts, *The SEC Is Cracking Down on Celebrity ICOs*, *Fortune* (2017), <http://fortune.com/2017/11/01/bad-news-for-mayweather-the-sec-is-cracking-down-on-celebrity-icos/> (last visited Jun. 19, 2018).

<sup>51</sup> See Stan Higgins, *The ICO Boxing Champ Floyd Mayweather Promoted Has Raised \$30 Million Already*, *CoinDesk* (2017), <https://www.coindesk.com/ico-boxing-champ-floyd-mayweather-promoted-raised-30-million-already/>.

<sup>52</sup> Id. Hashtags included “#CRYPTO #CRYPTOCURRENCY #BLOCKCHAIN #ETHEREUM #BITCOIN.” See also Stan Higgins, *Boxing Champ Floyd Mayweather Just Promoted an ICO on Instagram*, *CoinDesk* (2017), <https://www.coindesk.com/boxing-champ-floyd-mayweather-just-promoted-ico-instagram/>.

<sup>53</sup> Id.

<sup>54</sup> Floyd Mayweather, *supra* note 13. See also Frank Chaparro, *Floyd Mayweather is promoting another initial coin offering: ‘You can call me Floyd Crypto Mayweather’*, *Business Insider* (2017), <http://www.businessinsider.com/floyd-mayweather-promoting-hubii-network-ico-floyd-crypto-mayweather-2017-8> (last visited Jun. 19, 2018).

<sup>55</sup> O’Leary, *supra* note 13.

<sup>56</sup> Id.

<sup>57</sup> See Stan Higgins, *Class-Action Suit Targets ICO Promoted By Floyd Mayweather, Jr.*—*CoinDesk* *CoinDesk* (2017), <https://www.coindesk.com/class-action-suit-targets-ico-promoted-floyd-mayweather-jr/>. Neither DJ Khaled nor Floyd Mayweather are named in the suit.

<sup>58</sup> Id.

<sup>59</sup> Shen, *supra* note 10.

<sup>60</sup> Securities and Exchange Commission, *infra* note 88.

U.S. federal securities laws.<sup>61</sup> In the report, the SEC stated that depending on the facts and circumstances of each individual ICO, the virtual coins or tokens that are offered or sold may be securities.<sup>62</sup> It explained that, in analyzing whether something is a security, the form should be disregarded over substance.<sup>63</sup> The focus of the inquiry should be on the economic realities underlying a transaction, not on the name given to an instrument.<sup>64</sup>

The SEC investigated whether The DAO, an unincorporated organization, and Slock.it, a German corporation, violated federal securities laws.<sup>65</sup> The DAO was the first implementation of a Decentralized Autonomous Organization.<sup>66</sup> It existed on the Ethereum blockchain and used smart contracts to automate corporate governance.<sup>67</sup> Slock.it sold DAO Tokens to investors in exchange for ETH. These Tokens gave owners voting rights and access to “rewards,” which were payouts comparable to company dividends.<sup>68</sup> The DAO would fund projects voted on by the token-holders.<sup>69</sup> If the project yielded a return, the token-holders could vote to either invest in new projects or distribute.<sup>70</sup> From April 30, 2016, to May 28, 2016, the DAO Token Offering raised \$150 million in ETH.<sup>71</sup> There were no restrictions over who could buy the Tokens, and offering participants were only identifiable by their Ethereum addresses.<sup>72</sup> On June 17, 2016, an unknown attacker diverted 3.6 million ETH—one third of the total ETH raised by the DAO offering—to their own Ethereum

blockchain address.<sup>73</sup> But a “hard fork” to the Ethereum blockchain restored the diverted ETH.<sup>74</sup>

The SEC determined that DAO Tokens were investment contracts and therefore securities under Section 2(a)(1) of the Securities Act.<sup>75</sup> In doing so, it relied on the *Howey* test, which directs that an investment contract is: (1) an investment of money in a common enterprise, (2) with a reasonable expectation of profits, (3) to be derived from the entrepreneurial or managerial efforts of others.<sup>76</sup> The DAO Tokens were an investment of money, despite the capital being in the form of cryptocurrency, and the DAO’s investors reasonably expected that their tokens would rise in value due to the efforts of others—mainly Slock.it’s founders and the DAO’s Curators, experts in charge of vetting potential DAO investments.<sup>77</sup>

### Public Companies Making ICO-Related Claims

On August 28, 2017, The SEC’s Office of Investor Education and Advocacy warned investors of fraudsters who may be using the media attention garnered by ICOs to affect the price of their stock.<sup>78</sup> The alert mentioned potential pump-and-dump and market manipulation schemes in which false or misleading information is spread through websites, press releases, email spam, social media, and chat rooms.<sup>79</sup> It also suggested that investors do their own research into companies and be aware that online information, even from the company’s own

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<sup>61</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, *supra* note 7 at 1.

<sup>62</sup> *Id.* at 11.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* at 1.

<sup>66</sup> See Christoph Jentzsch, *DECENTRALIZED AUTONOMOUS ORGANIZATION TO AUTOMATE GOVERNANCE* (2017), <https://download.slock.it/public/DAO/WhitePaper.pdf> (last visited Jun. 19, 2018).

<sup>67</sup> *Id.*

<sup>68</sup> *Id.* (“Rewards are defined as any ether received by a DAO generated from products the DAO funded so far.”).

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, *supra* note 7, at 3.

<sup>72</sup> *Id.* at 14.

<sup>73</sup> *Id.* at 1.

<sup>74</sup> *Id.* at 9. “The “Hard Fork,” called for a change in the Ethereum protocol on a going forward basis that would restore the DAO Token holders’ investments as if the Attack had not occurred.”

<sup>75</sup> Securities Act of 1933, § 2(a)(1).

<sup>76</sup> *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946).

<sup>77</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, *supra* note 7, at 12.

<sup>78</sup> Securities and Exchange Commission, Investor Alert: Public Companies Making ICO-Related Claims, Sec.gov (2017), [https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia\\_ico-related-claims](https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_ico-related-claims).

<sup>79</sup> *Id.*

website, may be inaccurate and potentially intentionally misleading.<sup>80</sup> Other warning signs of ICO-related fraud included companies that claim their ICOs are SEC-compliant without explaining how, or companies that purport to raise capital through an ICO described in vague or nonsensical terms or through undefined technical language.<sup>81</sup> Moreover, the alert recommended investors to be cautious when considering stocks that were subject to a trading suspension as they may be a warning sign of microcap fraud.<sup>82</sup> For example, Companies subjected to trading suspensions on their common stock include First Bitcoin Capital Corp., CIAO Group, Strategic Global, and Sunshine Capital.<sup>83</sup>

### **Complaint against RECoin, Diamond, and Zaslavskiy**

On September 29, 2017, the SEC filed a complaint in the Eastern District of New York against Maksim Zaslavskiy and his companies, REcoin Group Foundation, LLC and DRC World, Inc., alleging violations of the anti-fraud and registration provisions of the federal securities laws in connection with two ICOs.<sup>84</sup> The complaint sought permanent injunctions and disgorgement plus interest and penalties.<sup>85</sup> REcoin offered a token purportedly backed by real estate.<sup>86</sup> And Diamond Reserve Club (DRC) offered a token purportedly backed by diamonds.<sup>87</sup> The SEC claimed that the tokens offered by Zaslavskiy and his companies had no real operations.<sup>88</sup> According to the SEC, alleged misstatements to investors regarding the ICOs included: touting that REcoin had a team of lawyers, professionals,

brokers, and accountants that would invest ICO proceeds into real estate, when in fact no such professionals were hired; claiming that REcoin had raised between \$2 and \$4 million dollars from investors when the actual amount was close to \$300,000; and claiming that DRC invested in diamonds and obtained retail discounts for its members.<sup>89</sup>

### **Potentially Unlawful Promotion of Initial Coin Offerings and Other Investments by Celebrities**

On November 1, 2017, the SEC released a statement addressing celebrity endorsements of ICOs on social media networks.<sup>90</sup> The SEC encouraged investors to conduct their own research and not to rely on paid endorsements from artists, sports figures, and other icons.<sup>91</sup> Additionally, the SEC stated that a failure to disclose “the nature, source and amount of any compensation paid, directly or indirectly, by the company in exchange for the endorsement” is a violation of the anti-touting provisions of federal securities laws. Persons making such endorsements may also be liable for potential violations of the anti-fraud provisions of the federal securities laws for participating in an unregistered offer and sale of securities and for acting as unregistered brokers.<sup>92</sup>

### **Cyber Unit and Complaint Against Lacroix**

On September 25, 2017, the SEC announced the creation of a Cyber Unit to tackle violations involving distributed ledger technology and ICOs among other things.<sup>93</sup> The Unit’s creation is evidence that the SEC

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<sup>80</sup> Id.

<sup>81</sup> Id.

<sup>82</sup> Id.

<sup>83</sup> Id.

<sup>84</sup> RECoin, Complaint, *supra* note 8.

<sup>85</sup> Id.

<sup>86</sup> See RECoin, 101recoin.com (2017), <https://101recoin.com/uploads/en/REcoin-Technical-Whitepaper.pdf> (last visited Dec 19, 2017). “The REcoin tokens are designed to facilitate a wide range of financial transaction, which is supported by hedging of REcoin by real estate investments...”

<sup>87</sup> See Max Zaslavsky, [ANN] [Pre-IMO] DRC (Diamond Reserve Club), The Bitcoin Forum (2017), <https://forum.bitcoin.com/alternative-cryptocurrencies-altcoins/drc-diamond-reserve-club-t52944.html>. “The basis for the Diamond Reserve Club tokenized membership is the ownership of Diamond Reserve Coin (DRC), which is hedged by physical diamonds.”

<sup>88</sup> RECoin, Complaint, *supra* note 8.

<sup>89</sup> Id.

<sup>90</sup> Securities and Exchange Commission, *Statement on Potentially Unlawful Promotion of Initial Coin Offerings and Other Investments by Celebrities and Others*, Sec.gov (2017), <https://www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-ico>.

<sup>91</sup> Id.

<sup>92</sup> Id.

<sup>93</sup> U.S. Securities and Exchange Commission, *SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors* (Sep. 25, 2017), <https://www.sec.gov/news/press-release/2017-176>. Other Cyber Unit priorities include market manipulation schemes involving false information spread through electronic and social media, hacking to obtain material nonpublic information, misconduct perpetrated using the dark web, intrusions into retail brokerage accounts, and cyber-related threats to trading platforms and other critical market infrastructure.

can adapt to face the problems in the ICO space. On December 1, 2017, the SEC's Cyber Unit filed its first complaint against "recidivist Quebec securities violator" Dominic Lacroix and Plexcorps for unregistered sales of securities and investor fraud.<sup>94</sup> Since August, the PlexCoin ICO raised \$15 million dollars from investors worldwide and the SEC alleges Lacroix and his partner used the funds for extravagant personal expenditures.<sup>95</sup> The PlexCoin offer promised investors a 1354% return in 29 days.<sup>96</sup> The PlexCoin case is an example of an old problem—a recidivist bad actor—in a new setting.

### SEC Halts the Sale of MUN Tokens

On December 11, 2017, the SEC halted the sale of MUN tokens offered by Munchee, Inc., the company behind an iPhone restaurant-review app.<sup>97</sup> The MUN tokens were described as units in a payment system for restaurant reviews.<sup>98</sup> The Munchee token whitepaper stated that Munchee had "conducted a Howey analysis" and that "as currently designed, the sale of MUN utility tokens does not pose a significant risk of implicating federal securities laws."<sup>99</sup> Munchee considered its tokens "utility tokens" and not "securities" because the tokens were meant to be used

as part of a functional network and the funds raised would be used to run that network<sup>100</sup>

The SEC disagreed. It determined that Munchee engaged in the unregistered sale of securities<sup>101</sup> after applying the *Howey* Test to MUN tokens. First, the SEC found that Munchee offered and sold digital tokens to raise \$15 million in capital to improve its existing app and recruit users to buy ads and write reviews.<sup>102</sup> Second, Munchee promoted MUN Tokens and purchasers had a reasonable expectation of receiving a future profit.<sup>103</sup> In blog posts, Munchee claimed that the more users join the new Munchee ecosystem, the more valuable tokens would become.<sup>104</sup> Munchee also promoted the secondary market for its token<sup>105</sup> and endorsed public statements by other parties claiming that MUN tokens would rise in value.<sup>106</sup> The fact that Munchee targeted people looking to get into ICOs instead of potential ecosystem users severely undermined its claim that it was selling a utility token and not a security.<sup>107</sup> Third, the SEC found that MUN token purchasers reasonably expected they would profit from the efforts of Munchee and its agents.<sup>108</sup> The company's representations about its ecosystem informed the SEC's finding; Munchee often touted the credentials

<sup>94</sup> *PlexCorps*, Complaint, *supra* note 9.

<sup>95</sup> Id. The complaint lists thousands of dollars of home-improvement expenses, including \$75,000 CAD for ceramic work and \$52,000 CAD for aluminum work.

<sup>96</sup> See Laura Shin, *\$15 Million ICO Halted By SEC For Being Alleged Scam*, *Forbes* (Dec. 4, 2017), <https://www.forbes.com/sites/laurashin/2017/12/04/15-million-ico-halted-by-sec-for-being-alleged-scam/#4e3c2be41569> (last visited Jun. 19, 2018).

<sup>97</sup> Munchee Inc., SEC Securities Act Release No. 10445, File No. 3-18304 (Dec. 11, 2017).

<sup>98</sup> Id.

<sup>99</sup> See Sanjeev Verma, Nghi Bui & Chelsea Lam, *Munchee Token: A decentralized Blockchain based food review/rating social media platform* (2017), <https://s3.amazonaws.com/munchee-docs/Munchee+White+Paper+-+EN.pdf> (last visited Dec 12, 2017). "Although the Howey test has not yet been directly applied by the courts to any digital currency or blockchain token, a Howey analysis has been conducted to determine that, as currently designed, the sale of MUN utility tokens does not pose a significant risk of implicating federal securities laws. As such, the MUN tokens, have not and will not be registered or filed under the securities laws or regulations of any jurisdiction."

<sup>100</sup> Id.

<sup>101</sup> Munchee, Inc., *supra* note 95.

<sup>102</sup> Id.

<sup>103</sup> Id.

<sup>104</sup> Id.

<sup>105</sup> Id. ("Munchee will ensure that MUN token is available on a number of exchanges in varying jurisdictions to ensure that this is an option for all token-holders." Munchee represented that MUN tokens would be available for trading on at least one U.S.-based exchange within 30 days of the conclusion of the offering. It also stated that Munchee would buy or sell MUN tokens using its retained holdings in order to ensure there was a liquid secondary market in MUNtokens.").

<sup>106</sup> Id.

<sup>107</sup> Id.

<sup>108</sup> Id. The SEC provides evidence of investors' reasonable belief. "For example, on or about October 25, 2017, a person posted a video on YouTube to describe the MUN token offering . . . In the video review, the person discussed that MUN token purchasers would profit only after Munchee did years of work: "If you are investing in [MUN tokens] now, you do need to keep in mind that it will be awhile before the [Munchee] platform becomes active. So if you are looking at it as a speculative—I want to get it and flip it straight away—you really need to hold on to this one at least until it hits the app in 2018. Obviously, if you can hold this a bit longer until 2019, that is when I think the real value of Munchee is going to be delivered on once it, sort of, gets a lot of users on it.""

of its founders, who had worked at prominent technology companies, and highlighted their skills both in running businesses and creating software.<sup>109</sup>

Munchee ceased selling its token and refunded \$15 million in ETH to its investors.<sup>110</sup>

## DISCUSSION: THE SEC'S ROLE MOVING FORWARD

The problems in the ICO marketplace—namely market manipulations schemes, shady promotions, and outright scams—are old problems with new twists.<sup>111</sup> Pump-and-dump schemes are still the same. The new twist is that the trading and hyping of investments happens online through cryptocurrency.<sup>112</sup> ICOs are conducted entirely online and numerous exchanges allow trading of different tokens and cryptocurrencies collectively worth billions of dollars instantaneously, sometimes with no exchange fees.<sup>113</sup> Ether and Bitcoin move pseudonymously, meaning that the coins can be tracked to an address but

learning who the address belongs to is very difficult.<sup>114</sup> Promotions are done through advertisements on websites and social media platforms.

A person running an ICO scam only needs to know how to create a convincing internet presence. A quick view of any ICO website will teach a would-be fraudster all the fundamentals. First, the fraudster gives the project a catchy name (ending with -coin or -token), creates a logo, and writes a short and vague description using buzzwords. Second, the fraudster creates a professional-looking website with headshots of his team of “experts in the field”<sup>115</sup> and buys fake interactions for his social media pages.<sup>116</sup> Third, he creates a convincing whitepaper with generous amounts of jargon re-hashing other projects’ ideas. This is easy to do because of the vast amount of ICOs, which serve as a source of numerous whitepaper templates. Whitepaper creation can even be outsourced for just \$100.<sup>117</sup> Fourth, he buys online banner ads and celebrity endorsements.<sup>118</sup> And lastly, the

<sup>109</sup> Id.

<sup>110</sup> See Pete Schroeder, *SEC halts initial coin offering from restaurant review app*, Reuters (2017) <https://www.reuters.com/article/munchee-ico/sec-halts-initial-coin-offering-from-restaurant-review-app-idUSL1N10B17Q> (last visited Jun. 19, 2018).

<sup>111</sup> See generally John Detrixhe, *Initial coin offerings, penny stocks, and lessons from the “Wolf of Wall Street”*, Quartz (2017), <https://qz.com/1095313/initial-coin-offering-lessons-from-the-wolf-of-wall-street/> (last visited Jun. 19, 2018).

<sup>112</sup> Id. (“The chairman of the US Securities and Exchange Commission recently said pump-and-dump schemes are easier to pull off for ICOs than penny stocks, because trading in tokens is all electronic and anonymous, making it ‘harder to catch the bad guys.’”).

<sup>113</sup> *24 Hour Volume Rankings (Exchange) | CoinMarketCap*, Coinmarketcap.com (2017), <https://coinmarketcap.com/exchanges/volume/24-hour/>.

<sup>114</sup> *If you’ve used Bitcoin to buy anonymously, the transaction may not have been private at all*, MIT Technology Review (2017), <https://www.technologyreview.com/s/608716/bitcoin-transactions-arent-as-anonymous-as-everyone-hoped/> (last visited Jun. 19, 2018). (“Security experts call it pseudonymous privacy, like writing books under a nom de plume. You can preserve your privacy as long as the pseudonym is not linked to you. But as soon as somebody makes the link to one of your anonymous books, the ruse is revealed. Your entire writing history under your pseudonym becomes public. Similarly, as soon as your personal details are linked to your Bitcoin address, your purchase history is revealed too.”).

<sup>115</sup> See Kelly Weill, *Cryptocurrency Company That Scammed Investors Was Run by Fake People*, The Daily Beast (2017), <https://www.thedailybeast.com/cryptocurrency-company-that-scammed-investors-was-run-by-fake-people> (last visited Jun. 19, 2018) (“On its face, Confido looked like a trustworthy operation. Someone registered a website for Confido the last day of August, records show, and outfitted the site with friendly animated tutorial videos and biographies of four smiling men, whom Confido claimed were its employees.”).

<sup>116</sup> Id. (“Despite Confido only having 558 Twitter followers, the company regularly racked up hundreds of retweets, with no likes or comments: an indication that the company may have been buying retweets from bots . . .”)

<sup>117</sup> See Joon Wong, *It’s never been easier to launch an ICO—just outsource your whitepaper on Fiverr for \$100*, Quartz (2017), <https://qz.com/1135177/the-ico-boom-means-whitepapers-can-now-be-outsourced-on-fiverr-for-100/> (last visited Jun. 19, 2018) (“Freelance workers on the task outsourcing platform Fiverr can now write an ICO whitepaper for \$100 a pop . . . . A search for ‘ICO’ on Fiverr shows 32 entries under the ‘research and summaries’ category of services . . . . Here is a sampling of the advertised services on Fiverr and what they cost: ‘I will write a perfect whitepaper or blockchain ICO or newsletter’—\$54 for 2,000 words or \$120 for 5,000 words; ‘I will write an ICO white paper to boost your chances in selling shares and raising funds’—\$100 for 3,000 words; ‘I Will Write A Professional Blockchain Ico White Paper’—\$150-\$350 depending on length and graphics; ‘I Will Cook Up An Ico White Paper On Blockchain Technology’—\$100 for 3,000 words.”).

<sup>118</sup> See Jordan Pearson, *Inside Floyd Mayweather’s Cryptocurrency Promotion Campaign*, Motherboard (2017), [https://motherboard.vice.com/en\\_us/article/wjj4vm/inside-floyd-mayweathers-cryocurrency-promotion-campaign-hubii-ico](https://motherboard.vice.com/en_us/article/wjj4vm/inside-floyd-mayweathers-cryocurrency-promotion-campaign-hubii-ico) (last visited Jun. 19, 2018) (“The playbook for the Crypto Media Group looks something like this, according to Schauer: First, the celebrity partner posts their message to social media. Then, a network of social media accounts controlled by the Crypto Media Group shares the promotion to raise awareness. According to Schauer, this network of accounts has more than 100 million followers across Facebook, Twitter, and Instagram. The company also negotiates shares with accounts they don’t own through “value-for-value” trades—offering in-kind promotion for sharing the Crypto Media Group ad. Basically, saturating social media with a celebrity endorsement engineered by the company.”)

fraudster adds a nifty countdown clock on his website and generates an ETH or BTC address to receive his victim's cryptocurrency. The REcoin, Diamond, PLEXcoin, and Confido<sup>119</sup> ICO scams reveal that all a person needs to defraud investors is a convincing online presence.

The SEC illustrated how easy it is for a potential scammer to launch a convincing ICO scam by publishing a website for its own fictional ICO: Howeycoin.<sup>120</sup> Howeycoin, named in honor of the Howey test, includes many ICO scam mainstays: a jargon-laden whitepaper, exorbitant promises of guaranteed returns, and vague descriptions of what the ICO proceeds will be used for.

### The SEC Must Support Self-Regulating Efforts.

A token issuers' greatest concern is being able to keep the money they raise through ICOs. Accordingly, ICO market self-regulation efforts are underway.<sup>121</sup> The recent enforcement actions, as well as the guidance imbedded in the complaints, are motivating market leaders to act. Waves Platform, a token-launching platform like Ethereum, has announced plans to start a Swiss-based independent regulatory body, which will provide reporting, legal, tax and accounting, Know Your Customer, and due-diligence standards for ICOs.<sup>122</sup> Ethereum and Deloitte CIS have expressed support

for the planned association.<sup>123</sup> The new regulatory body will work with market players to provide best business practices for token sales on all platforms.<sup>124</sup> Waves Platform's founder claims that, by being proactive, market participants can have a seat at the table when the regulators come knocking.<sup>125</sup>

Another attempt at self-regulation is the Simple Agreement for Future Tokens (SAFT) Project, which a collaboration between Protocol Labs, Cooley, AngelList, and CoinList.<sup>126</sup> The SAFT whitepaper describes a suggestion for a compliant token sale framework in which the ordinary ICO scenario is split into smaller parts.<sup>127</sup> First, accredited investors and the token issuer sign an agreement that gives the investors the rights to future utility tokens (tokens to be used with the token issuer's project) in exchange for capital.<sup>128</sup> The token issuer then develops its project, and after it is completed, the investors receive tokens.<sup>129</sup> Lastly, the token issuer can resell their tokens to anyone on the open market.<sup>130</sup>

Under this framework, only accredited investors as allowed by Rule 506(c) of the Securities Act could enter into an agreement to buy securities and bear the risk of the project.<sup>131</sup> Additionally, the SAFT Project's proponents believe that the tokens sold to the public would not be considered securities because only the early investors would reasonably expect to

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<sup>119</sup> Kharpal, *supra* note 12.

<sup>120</sup> See HoweyCoins, Howeycoins.com (2018), <https://www.howeycoins.com> (last visited Jun 7, 2018).

<sup>121</sup> See generally Evelyn Cheng, *The people behind the hype-filled ICO craze are trying to regulate themselves*, CNBC (2017), <https://www.cnbc.com/2017/10/03/people-behind-the-hype-filled-ico-craze-are-trying-to-regulate-themselves.html> (last visited Jun. 19, 2018).

<sup>122</sup> See *Waves and leading market players are founding a new self-regulatory body to set standards for ICOs*, Waves Platform (2017), <https://blog.wavesplatform.com/waves-platform-with-the-support-of-leading-market-players-is-founding-a-new-self-regulatory-body-b8bfc0c4ca84> (last visited Jun. 19, 2018).

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.* See also Aaron Stanley, *ICO Pros Call for Self-Regulation Citing SEC Risk*, CoinDesk (2017), <https://www.coindesk.com/ico-pros-call-for-self-regulation-citing-risk-of-sec-crackdown/> (last visited Jun. 19, 2018). "The initial coin offering (ICO) community needs to embrace self-regulation now to lessen the blows likely to come from enforcement and regulatory actions, according to speakers at CoinDesk's Consensus: Invest yesterday."

<sup>126</sup> See Juan Batiz-Benet, Marco Santori & Jesse Clayburgh, *The SAFT Project: Toward a Compliant Token Sale Framework*, Saftproject.com (2017), <https://saftproject.com/static/SAFT-Project-Whitepaper.pdf> (last visited Jun. 19, 2018).

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.* ("The SAFT obligates investors to immediately fund the developers. In exchange, the developers use the funds to develop genuinely functional network, with genuinely functional utility tokens, and then deliver those tokens to the investors once functional.").

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

make a profit from the efforts of others.<sup>132</sup> But Critics of the SAFT Project, like the Cardozo Blockchain Project, argue that accredited investors would serve as gatekeepers who would buy tokens solely to flip them.<sup>133</sup> Gatekeepers would make it more difficult for the public to participate in new networks and ecosystems created by token issuers.<sup>134</sup> The Cardozo Blockchain project also criticized the SAFT Project's reliance on bright-line rules.<sup>135</sup> Despite facing criticism, the SAFT is the default agreement for investments on CoinList, a platform for listing ICOs that offers a number of financial services.<sup>136</sup>

The SEC's actions, from the investigative report on The DAO to the recent complaints filed against ICO scams, are a solid foundation from which to build a partnership between the SEC and the ICO marketplace. The report on The DAO settled long-standing questions about whether tokens were securities. Until that point, market participants debated among themselves whether tokens were going to be treated like their cryptocurrency predecessors or traditional securities. Many token issuers relied on the armchair-lawyering of cryptocurrency bloggers instead of retaining legal counsel. For example, Protostarr—a project that touted itself as a way for YouTube and Twitch streamers to get funding from their fans—

shut down in late August after being contacted by the SEC.<sup>137</sup> According to ProtoStarr's chief executive Josh Gilson, the ProtoStarr team was not aware of the SEC's DAO report until mid-August.<sup>138</sup> And after they learned of the report, the team determined that ProtoStarr was structured differently from The DAO and would not be subject to securities laws.<sup>139</sup> Still, ProtoStarr has since refunded investors.<sup>140</sup>

Despite not taking action against The DAO, the SEC's report was the reintroduction of the law into the Wild West. It is time for the SEC to support self-regulation efforts by offering more guidance in the form of similar investigative reports, no-action letters, and if necessary, cease-and-desist procedures. The SEC should also comment on the SAFT Project's framework and suggest specific improvements and revisions. Weak analogies<sup>141</sup> are not enough for a meaningful dialogue. When Waves Platform's self-regulatory body begins publishing its best practices for token offerings, the SEC should comment directly on the association's suggestions. Market participants are eager to participate in a dialogue with the SEC and would make useful allies. Token issuers are in the best position to inform the SEC of technological developments and shifting trends. Bridging the gap between the SEC and the market will increase the efficacy of its investor protection aims.

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<sup>132</sup> Id. (“To be sure, public purchasers may still be profit-motivated when they buy a post-SAFT utility token. Unlike a pre-functional token, though, whose market value is determined predominantly by the efforts of the sellers in imbuing the tokens with functionality, a genuinely functional token’s value is determined by a variety of market factors, the aggregate impact of which likely predominates the ‘efforts of others.’ Sellers of already functional tokens have likely already expended the ‘essential’ managerial efforts that might otherwise satisfy the Howey test.”).

<sup>133</sup> See *Not So Fast — Risks Related to the Use of a “SAFT” for token sales*, Cardozo Blockchain Project (2017), [https://cardozo.yu.edu/sites/default/files/Cardozo%20Blockchain%20Project%20-%20Not%20So%20Fast%20-%20SAFT%20Response\\_final.pdf](https://cardozo.yu.edu/sites/default/files/Cardozo%20Blockchain%20Project%20-%20Not%20So%20Fast%20-%20SAFT%20Response_final.pdf) (last visited Jun. 19, 2018).

<sup>134</sup> Id. (“[T]he SAFT approach could heighten the exuberance manifesting in markets for blockchain-based tokens and make it even more difficult to provide consumers access to potentially impactful new technology.”).

<sup>135</sup> Id. (“[C]ourts and the SEC have repeatedly, and unambiguously, explained that the test for whether a particular instrument will be deemed a security depends not on bright-line rules but rather on the relevant facts, circumstances and economic realities.”).

<sup>136</sup> *Help & FAQs—What is the SAFT?—CoinList*, Coinlist.co (2017), <https://coinlist.co/help/what-is-the-saft> (last visited Jun. 19, 2018).

<sup>137</sup> Laura Shin, *After Contact By SEC, Protostarr Token Shuts Down Post-ICO, Will Refund Investors*, Forbes (2017), <https://www.forbes.com/sites/laurashin/2017/09/01/after-contact-by-sec-protostarr-token-shuts-down-post-ico-will-refund-investors/#e31084d192ec> (last visited Jun. 19, 2018).

<sup>138</sup> Id.

<sup>139</sup> Id.

<sup>140</sup> Id.

<sup>141</sup> Securities and Exchange Commission, “Company Halts ICO After SEC Raise Registration Concerns,” Press Release (Dec. 11, 2017), available at <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>. (using a book club analogy to illustrate the offering of a non-security) (“For example, a token that represents a participation interest in a book-of-the-month club may not implicate our securities laws, and may well be an efficient way for the club’s operators to fund the future acquisition of books and facilitate the distribution of those books to token holders.”).

Other potential allies for the SEC include the U.S. Federal Trade Commission<sup>142</sup> and the U.S. Commodity Futures Trading Commission.<sup>143</sup> Together, these three agencies could tackle the challenge of celebrity ICO endorsements.<sup>144</sup>

### The SEC Must Regularly Pursue Enforcement Actions Against Fraudsters

The SEC must continue to shut down ICO scams regularly. Keeping the pressure on fraudsters will deter such activity. Market participants welcome enforcement actions against scams because fraudsters tarnish the image of the cryptocurrency and ICO space. The image that cryptocurrency is intertwined with illegal activity dates to Bitcoin's early days and the crackdown on Silk Road.<sup>145</sup> Token issuers do not want potential customers to be wary of heavy-handed regulation of ICOs or an outright government ban.<sup>146</sup> Enforcement actions also provide numerous side benefits for the marketplace. In an enforcement action against a sham ICO, there will be additional guidance within the complaint. Market participants paying attention to the details can discern which practices are viewed positively by the SEC

and which are not. For example, in the REcoin and PLEXcoin complaints, there is noticeable disdain for promises of giant investment returns<sup>147</sup> and overuse of unnecessary technical jargon.<sup>148</sup> Both practices are aimed at disorienting investors and preying on the fear of missing out. Shutting down ICO scams regularly is a good way to show ICO market participants the boundaries of responsible behavior. Knowing what factors will trigger enforcement actions gives market participants the tools to identify future fraud and police their own marketplace.

### CONCLUSION

The recent spectacular rise in the USD trading value of cryptocurrencies in 2017 and the continued success of ICOs in 2018<sup>149</sup> make addressing the problems in the ICO marketplace imperative. Blockchain technology is relatively new but the problems in the ICO marketplace are not.<sup>150</sup> Outright scams, misleading online promotions, and market manipulation can be defeated with a combination of cooperation with self-regulation efforts, continuous enforcement actions against fraudsters, and investor education.

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<sup>142</sup> See generally Federal Trade Commission, Guides Concerning the Use of Endorsements and Testimonials in Advertising, 16 C.F.R. Part 255. "Endorsements must reflect *the* honest opinions, findings, beliefs, or experience of the endorser. Furthermore, *an* endorsement may not convey any express or implied representation that would *be* deceptive if made directly by the advertiser."

<sup>143</sup> 17 C.F.R. § 180.1. "It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, to intentionally or recklessly . . . make, or attempt to make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading."

<sup>144</sup> See generally *17-275-enr | Celebrity ICO Endorsements SEC FTC and CFTC Oversight*, Reed Smith LLP (2017), <https://sites-reedsmith.vulture.net/24/790/november-2017/celebrity-ico-endorsements--sec-ftc-and-cftc-oversight.asp?sid=8c1ad453-a982-4839-b317-a2e4f3e434af> (last visited Jun. 19, 2018).

<sup>145</sup> See generally Jose Pagliery, *FBI shuts down online drug market Silk Road: FBI busts black market bazaar Silkroad, arrests its alleged mastermind*, CNNMoney (2017), <http://money.cnn.com/2013/10/02/technology/silk-road-shut-down/index.html>.

<sup>146</sup> See Tian Chuan & Rachel Rose O'Leary, *China Outlaws ICOs: Financial Regulators Order Halt on Token Trading*, CoinDesk (2017), <https://www.coindesk.com/china-outlaws-icos-financial-regulators-order-halt-token-trading/> (last visited Dec 19, 2017). See Rachel Rose O'Leary, *South Korean Regulator Issues ICO Ban—CoinDesk* CoinDesk (2017), <https://www.coindesk.com/south-korean-regulator-issues-ico-ban/> (last visited Jun. 19, 2018).

<sup>147</sup> *PlexCorps*, Complaint, *supra* note 9, at 3 ("LaCroix and PlexCorps enticed potential investors to purchase PlexCoin Tokens early on during the ICO, with promises that if all 400 million PlexCoin Tokens for sale were sold, the early investors would reap outlandish rewards of 1,354% in 29 days or less . . . and by comparing the supposed returns to those in other ICOs or investments in cryptocurrencies -returns as high as 88,000%.").

<sup>148</sup> *REcoin*, Complaint, *supra* note 8, at 11 ("[The REcoin Whitepaper] specified, for example, that REcoin is a cryptocurrency 'powered by blockchain technology,' that REcoin tokens are 'digital currencies which use cryptography for their security,' that the 'management of the REcoin supply and its security is guaranteed through the latest blockchain cryptocurrency technology,' and that '[t]he most unique feature of REcoin is smart contracts.'").

<sup>149</sup> See generally Stan Higgins, *\$600 Billion: Cryptocurrency Market Cap Sets New Record*, CoinDesk (2017), <https://www.coindesk.com/600-billion-cryptocurrency-market-cap-sets-new-record/> (last visited Jun. 19, 2018).

<sup>150</sup> Oscar Williams-Grut, *supra* note 12.

# TIFFANY & CO. VS. COSTCO WHOLESALE CORP.— THE “BETTER” VALUE FOR LUXURY DIAMONDS

Heather Bowen & Chezare Palacios

The notable case of *Tiffany & Co. vs. Costco Wholesale Corp.*<sup>1</sup> involves the applicability of the Lanham Act and New York state law claims of trademark infringement, unfair competition, dilution, counterfeiting, false advertising, as well as false and deceptive business practices as it relates to the online and in-person sale of diamond engagement rings. The key issue in this case was whether general members of the public associated the jewelry company Tiffany & Company’s (“Tiffany”) registered trademark “Tiffany” when sold in a wholesale store as having a generic meaning when speaking about ring settings, thereby rendering the trademark unprotectable. This note will address the Southern District of New York’s principal findings in this case under the trademark infringement claim and the genericism counterclaim and subsequently provide some strategies to trademark owners to avoid losing their trademark protections to genericism claims.

## FACTS OF THE CASE

Tiffany is a large jewelry store headquartered in the state of New York and is well known for its luxury diamonds and sterling silver packaged in blue boxes.

At the time this case was before the court, Tiffany owned 97 trademarks. At issue are U.S. Registration No. 1,228, 409 “TIFFANY” in the International Class 014 and U.S. Registration No. 133,063 for the style of the “TIFFANY” mark for jewelry and other goods, both of which were first used in commerce in 1868 and are registered on the USPTO’s Principal Register. Under Class 14, Registration No. 1,228,409 covers “decorative art objects made in whole or in part of precious or semi-precious metals—namely, figurines, boxes, bowls, trays, [and flowers,] jewelry, semi-precious stones, and natural and cultured pearls.”<sup>2</sup> Registration No. 133,063 covers “jewelry for personal wear, not including watches, precious stones, and flat and hollowware made of or plated with precious metal.”<sup>3</sup> Tiffany claims that its trademarks also refer to one of its styles of engagement rings which exhibit a six-prong setting that holds one diamond and serves as a presumption that members of the public associate the ring setting with the Tiffany brand.<sup>4</sup>

Costco Wholesale Corporation (“Costco”) is a global retailer headquartered in Washington state operating membership-only warehouse clubs. The store retails items

<sup>1</sup> 274 F. Supp. 3d 216 (S.D.N.Y. 2017); See also *Tiffany & Co. v. Costco Wholesale Corp.*, 127 F. Supp. 3d 241 (S.D.N.Y. Sept. 8, 2015).

<sup>2</sup> TIFFANY Trademark Details, available at <https://trademarks.justia.com/733/04/tiffany-73304915.html>

<sup>3</sup> *Tiffany & Co. v. Costco Wholesale Corp.*, 994 F. Supp. 2d 474, 477 (S.D.N.Y. 2014).

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

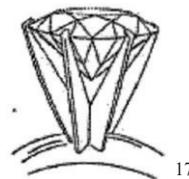
including, but not limited to, automobile parts, baby and children items, articles of clothing, jewelry, electronics, furniture, food, florals, gifts, and fitness supplies.<sup>5</sup> In November 2012, Tiffany was notified by a customer who was shopping at a Costco location in Huntington Beach, California that Costco was selling diamond engagement rings to Costco customers under the “Tiffany” mark. Tiffany subsequently went to the store in Huntington Beach, investigated the situation, and found that Costco was selling two styles of engagement rings not in any way manufactured by Tiffany.<sup>6</sup> Costco had described the rings it was selling in the store as “639900—Platinum Tiffany.70CT, VS2, 1 Round Diamond Ring—3199.99”<sup>7</sup> and “605880—Platinum Tiffany VS2.1 1.00CT, Round Brilliant Diamond Solitaire Ring—6399.99.”<sup>8</sup> In December 2012, Tiffany demanded that Costco no longer sell diamond engagement rings in its stores under the “Tiffany” brand. Costco subsequently notified any of its customers who had purchased a “Tiffany” ring that they could return the diamond ring to Costco for a full refund of the purchase price “if they were unsatisfied” with their purchase.<sup>9</sup>

The results of this investigation led Tiffany to believe that “hundreds if not thousands of people [had] mistakenly believe[d] they purchased and owned a Tiffany engagement ring from Costco.”<sup>10</sup> Tiffany filed a complaint against Costco in February 2013, and Costco filed its answer and counterclaim in March 2013.<sup>11</sup> Costco denied having described all of its engagement rings as being of the “Tiffany” brand or that the rings had a “setting comprising multiple slender prongs extending upward from a base to hold a single gemstone.”<sup>12</sup> Costco further denied that it used the “Tiffany” name to sell diamond engagement rings extensively online<sup>13</sup> and additionally claimed that fewer than ten customers had

indicated that they were misled by Costco’s marketing and advertising into buying what they believed to have been a Tiffany ring.<sup>14</sup> Tiffany, however, believed that Costco had been selling diamond engagement rings under its name for several years, but had been able to conceal its trademark-infringing actions because it had not been abundantly selling the rings online. The case then proceeded in federal court.

## PROCEDURAL HISTORY

Tiffany filed a claim against Costco in 2013 in the United States District Court, Southern District of New York, for Costco’s alleged attempt at benefiting off the “Tiffany” brand’s reputation.<sup>15</sup> In its counterclaim, Costco alleged that the “Tiffany” name and the term “Tiffany setting” are basic terms that have become generic over time due to being so widespread. Specifically, Costco asked the court to dismiss Tiffany’s complaint because the “Tiffany Registrations are invalid . . . to describe or refer to Tiffany [ring] settings,” that “Tiffany is a generic term for the general type or style of [pronged setting depicted in the diagram included in the Counterclaim, and reproduced below],” and that “Costco’s past use of the word Tiffany ha[d] not infringed or invaded any legal rights.”<sup>16</sup>



In filing its counterclaim, Costco intended to motivate the court to prevent Tiffany from being

<sup>5</sup> Costco website of categories <https://www.costco.com/view-more.html>.

<sup>6</sup> *Tiffany & Co.*, 994 F. Supp. 2d 474, 477.

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

<sup>8</sup> *Id.*

<sup>9</sup> *Tiffany & Co.*, 127 F. Supp. 3d 241.

<sup>10</sup> Complaint at ¶ 8, *Tiffany & Co. v. Costco Wholesale Corp.*, 2015 WL 5231240 (S.D.N.Y. Sept. 8, 2015) (No. 13CV1041).

<sup>11</sup> *Tiffany & Co.*, 994 F. Supp. 2d at 477.

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

<sup>13</sup> *Id.*

<sup>14</sup> Costco owes Tiffany more than \$19 million for selling counterfeit rings, CNN MONEY, <http://money.cnn.com/2017/08/14/news/tiffany-costco-lawsuit/index.html> (last visited May 6, 2018).

<sup>15</sup> *Tiffany & Co.*, 994 F. Supp. 2d at 477.

<sup>16</sup> *Id.* at 478.

<sup>17</sup> Counterclaim at p. 1, *Tiffany and Co., v. Costco Wholesale Corp.*, 2015 WL 5231240 (S.D.N.Y. Sept. 8, 2015) (No. 13CV1041).

unduly broad with its trademark registrations.<sup>18</sup> On January 17, 2014, Judge Laura Taylor Swain denied Tiffany's motion to dismiss Costco's counterclaim and held that there was a genuine issue of material fact as to whether members of the relevant public identified "Tiffany" as having a generic meaning in the context of ring settings. In coming to this conclusion, Judge Swain relied on case precedent including, but not limited to, *Star Industries, Inc. v. Bacardi & Co. Ltd.*,<sup>19</sup> *Feathercombs Inc. v. Solo Prods. Corp.*,<sup>20</sup> and Section 14 of the Lanham Act which states:

A registered mark shall not be deemed to be the generic name of goods or services solely because such mark is also used as a name of or to identify a unique product or service. The primary significance of the registered mark to the relevant public rather than purchaser motivation shall be the test for determining whether the registered mark has become the generic name of goods or services on or in connection with which it has been used.<sup>21</sup>

Additionally, Judge Swain found that none of the types of evidence used in *Pilates, Inc. v. Current Concepts, Inc.*<sup>22</sup> nor *In re Reed Elsevier Prop. Inc.*,<sup>23</sup> including "(1) dictionary definitions; (2) generic use of the term of competitors or other persons in the trade; (3) plaintiff's own generic use; (4) generic use in the media; [nor] (5) consumer surveys"<sup>24</sup> led to a definitive determination that the "Tiffany" mark or "Tiffany setting" term had become generic in the minds of the relevant public.<sup>25</sup>

In her September 2015 decision, Judge Swain ultimately found in favor of Tiffany, holding that

Costco had willfully infringed on Tiffany's trademark.<sup>26</sup> Specifically, Judge Swain found that Tiffany held a mark that was entitled to protection and that Costco's use of the Tiffany mark was likely to cause confusion among consumers.<sup>27</sup> The court considered the validity of Tiffany's mark and the likelihood of consumer confusion, as well as the resulting Lanham Act infringement liability.<sup>28</sup>

With respect to Tiffany's trademark infringement claim under the Lanham Act, the court found that under 15 U.S.C. §1115, Tiffany established a prima facie case for the validity of the "Tiffany" mark.<sup>29</sup> Specifically, the court relied on *Lane Capital Mgmt., Inc.*<sup>30</sup> and *American Ort, Inc.*<sup>31</sup> where the respective courts determined that a mark registered with the United States Patent and Trademark Office ("USPTO") is conclusive evidence that the registered mark is valid, that the individual who registered the mark has ownership over the mark, and that the owner of the registered mark has exclusive rights to use the mark in commerce.<sup>32</sup> Here, Tiffany owned 97 registered trademarks including the word "Tiffany," recorded as Registration No. 1,228,409 and which was first used in commerce in 1868.<sup>33</sup> Costco provided no material facts to the contrary that the "Tiffany" mark was not a registered mark, nor that Tiffany was not the owner of the mark, nor that the mark was in any way invalid on its face. Judge Swain, therefore, found that Tiffany had satisfied the first prong of the infringement test.<sup>34</sup>

The court then addressed Tiffany's likelihood of consumer confusion claim, applying the Second Circuit's seven-factor test under *Polaroid Corp. v. Polarad Elecs.*

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<sup>18</sup> *Tiffany & Co.*, 994 F. Supp. 2d at 478.

<sup>19</sup> 412 F.3d 373 (2d Cir. 2005).

<sup>20</sup> 306 F.2d 251 (2d Cir. 1962).

<sup>21</sup> 15 U.S.C. §1064(3).

<sup>22</sup> 120 F. Supp. 2d 286 (S.D.N.Y. 2000).

<sup>23</sup> 482 F.3d 1376 (Fed. Cir. 2007).

<sup>24</sup> *Tiffany & Co.*, 994 F. Supp. 2d at 482.

<sup>25</sup> *Id.*

<sup>26</sup> *Tiffany & Co.*, No. 13CV1041, 127 F. Supp. 3d 241.

<sup>27</sup> *Id.* at 264.

<sup>28</sup> *Id.*

<sup>29</sup> 15 U.S.C. §1115

<sup>30</sup> *Lane Capital Mgmt., Inc. v. Lane Capital Mgmt., Inc.*, 192 F.3d 337, 345 (2d Cir. 1999).

<sup>31</sup> *American Ort, Inc. v. Israel*, No.07CV2332-KMK, 2007 WL 2049733, at \*4 (S.D.N.Y. July 17, 2007).

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

<sup>33</sup> *Id.* at 247.

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

*Corp.*<sup>35</sup> The court looked at the following factors to decide whether Costco offered any evidence raising a genuine issue of material fact:

1. the strength of the Plaintiff's mark;
2. the degree of similarity between the Plaintiff's and Defendant's marks;
3. the proximity of the products or services in the marketplace;
4. evidence of actual confusion;
5. the Defendant's good faith in adopting its own mark;
6. the quality of the defendant's product;
7. and the sophistication of the relevant population of consumers.<sup>36</sup>

In addressing the first factor, the court was not convinced by Costco's argument that the word "Tiffany" was a descriptive term under the dictionary definition because Costco had failed to specifically provide evidence that the word "Tiffany" was not strong when used as a mark.<sup>37</sup> Further, Costco failed to persuade the court that the use of the word "Tiffany" as a generic mark led to a true and significant reduction in the strength of the registered "Tiffany" mark.<sup>38</sup>

Next, with the second factor, the court addressed the similarity of Tiffany's mark to Costco's mark as displayed for other types of goods. Tiffany offered photographs of the word "Tiffany" displayed next to the rings in a way that Costco typically places its branding next to other manufactured goods in its store. Applying the Second Circuit's ruling in *Nabisco*<sup>39</sup> and *Jim Beam Brands Co.*<sup>40</sup> to the evidence of Tiffany's ownership of the word as a

mark, and Costco's inability to provide evidence to the contrary, allowed the court to easily determine that there was no genuine issue of material fact on this issue.

Then, for the third factor, the court addressed the proximity of the rings to determine whether the two products were in competition with each other.<sup>41</sup> In applying the Second Circuit's rationale under *Savin Corp.*,<sup>42</sup> the court agreed that the goods serve the same purpose, fall within the same general class, or are used together.<sup>43</sup> The products were both diamond engagement rings marketed under the "Tiffany" name. In addition to emailed and photographed evidence, Tiffany offered an email from a Costco.com employee who suggested that the "Costco ring boxes have more of the Tiffany or upscale look."<sup>44</sup> Because Costco provided no legal argument to the contrary, the court found that there was no issue of material fact on this point.<sup>45</sup>

With respect to the fourth factor of "actual confusion," Tiffany offered depositions of six Costco customers who had been confused by Costco's signs, thinking that Costco was selling genuine and/or discounted Tiffany rings.<sup>46</sup> A female customer, for instance, had been "brought to tears"<sup>47</sup> when the diamond fell out of what she truly believed to have been a "Tiffany" diamond ring.<sup>48</sup> Tiffany had also conducted and gathered 944 results from an online consumer confusion survey created by expert Dr. Jacob Jacoby.<sup>49</sup> More than 600 of these surveys were completed by Costco customers.<sup>50</sup> This survey was designed to determine the potential for marketplace confusion and demonstrated that a majority of the individuals were confused in believing that Tiffany had provided the rings to Costco for sale.<sup>51</sup> Costco

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<sup>35</sup> 287 F.2d 492 (2d Cir. 1961).

<sup>36</sup> *Id.* at 495.

<sup>37</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 248.

<sup>38</sup> *Id.*

<sup>39</sup> *Nabisco, Inc. v. Warner-Lambert Co.*, 220 F.3d 43, 47 (2d Cir. 2000).

<sup>40</sup> *Jim Beam Brands Co. v. Beamish & Crawford Ltd.*, 937 F.2d 729, 735 (2d Cir. 1991).

<sup>41</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 249.

<sup>42</sup> *Savin Corp. v. Savin Group*, 391 F.3d 439, 458 (2d Cir. 2004).

<sup>43</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 249.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 250.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 250.

attempted to refute the reliability of the expert's survey but offered no evidence disputing the depositions and demonstrated none of its own evidence that customers had not been confused.<sup>52</sup>

In support of the fifth factor of "good faith," Tiffany demonstrated Costco's bad faith and intent to mislead the public based on one of Costco's employees suggesting a more upscale look for the ring boxes to reflect the Tiffany brand. Costco opposed the argument by merely asserting that it was selling rings without any affixation of the Tiffany mark and by pointing to a number of dictionary definitions and one publication of "Tiffany" as a descriptive word. The court was not in the least bit phased by Costco's argument, noting that no reasonable fact finder would find in Costco's favor under a good faith rationale.<sup>53</sup>

The final two factors of the quality of the defendant's product and the sophistication of consumers both leaned in Tiffany's favor. As to the quality of the product, Tiffany pointed to the deposed female customer who was visibly upset when the diamond fell out of the asserted Tiffany ring. In addition, Tiffany included deposition testimony of one of the company's senior vice presidents, testimony of the CEO and general counsel of a jewelry advertising and manufacturing compliance organization, as well as one of Costco's gemologists who was not certified to provide jewelry appraisals. Further, Tiffany pointed to quality control documents detailing the company's requirements for the jewelry's "comprehensive standards and specifications."<sup>54</sup> All of this evidence, in the absence of controverted evidence from Costco, led the court to find that Tiffany's level of sophistication in quality control for their jewelry far outweighed Costco's techniques in selling inferior rings to customers. With the final factor, the court also found no genuine issue of material fact by referring back to Dr. Jacoby's consumer confusion survey and rejected Costco's argument that

"ring buyers [don't] exercise due care when choosing an engagement ring."<sup>55</sup>

Ultimately, the court found that Tiffany had sufficiently proven a likelihood of confusion based on the totality of the *Polaroid* factors and granted Tiffany's motion for summary judgment in its entirety regarding Costco's trademark infringement.<sup>56</sup> Because the court dismissed Tiffany's claim for the accounting of profits, determination of punitive damages and monetary relief based on the Lanham Act, Tiffany appealed the decision in September 2017 for recovery of profits and Costco was ordered to pay \$11.1 million in treble profits and \$8.25 million in punitive damages.<sup>57</sup> Costco was also ordered to no longer use the "Tiffany" mark alone or in connection with "setting," "set" or "style" for purposes of advertisement or sale of products manufactured by Costco or its affiliates.<sup>58</sup>

### **COSTCO'S GENERICISM COUNTERCLAIM**

After granting Tiffany's motion for summary judgment on its trademark infringement and counterfeiting claims, the Court analyzed Costco's genericism counterclaim on Tiffany's renewed motion to dismiss the counterclaim.<sup>59</sup> The Second Circuit previously held that the key determination when analyzing a genericism claim is "the primary significance of the registered mark to the relevant public."<sup>60</sup> "Essentially, a mark is generic if, in the mind of the purchasing public it does not distinguish products on the basis of source but rather refers to the type of product."<sup>61</sup>

In support of its renewed motion to dismiss Costco's genericism counterclaim, Tiffany proffered an expert study with surveys demonstrating that the Tiffany trademark had not become generic.<sup>62</sup> The survey was administered by Dr. Jacoby to "a population of 464 men and women ages 21 and older who said that they would consider purchasing certain types of

<sup>52</sup> Id. at 251.

<sup>53</sup> Id. at 252.

<sup>54</sup> Id.

<sup>55</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 253.

<sup>56</sup> Id.

<sup>57</sup> *Tiffany & Co.*, 274 F. Supp. 3d 216 (S.D.N.Y. 2017).

<sup>58</sup> Id.

<sup>59</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 256.

<sup>60</sup> Id. (quoting *Tiffany & Co.*, 944 F.2d at 480).

<sup>61</sup> Id. (quoting *Courtenay Commc'ns Corp. v. Hall*, 334 F.3d 210, 214 n.2 (2d Cir. 2003)).

<sup>62</sup> Id.

jewelry over the course of two years.<sup>63</sup> Further, Dr. Jacoby provided the Court with the method by which the study and surveys were conducted to demonstrate the objectivity of the study.<sup>64</sup>

The population first received ‘training’ for the survey, in which they were provided with lists of sample words and asked to identify which they believed were brand names and which they believed were descriptive terms. The population was then split into groups, each of which was presented with the word “Tiffany” in a different context: some respondents were shown the word Tiffany in isolation, other were shown point of sale signage like that used by Costco. In all instances, respondents were asked to identify whether they thought Tiffany was being used as a brand name or a descriptive term.<sup>65</sup>

The survey determined that 9 out of 10 likely consumers found that, when used in isolation, the word “Tiffany” was a brand identifier.<sup>66</sup> When used as point of sale signage, 4 out of 10 believed the word “Tiffany” to be a brand identifier, and 3 out of 20 believed it to be both a brand identifier and descriptive word.<sup>67</sup> Based on the results of the survey, Dr. Jacoby determined that the primary significance to the consuming public of the term “Tiffany” is as a brand or source identifier, not as a descriptive term.<sup>68</sup> Based on Dr. Jacoby’s study, Tiffany moved the Court to find that, as a matter of law, the trademark Tiffany cannot be considered generic.<sup>69</sup>

To counter Tiffany’s expert study, Costco provided declarations from its own experts. Two declarations opined that the word Tiffany is the only word that

denotes the type of pronged diamond ring setting that is at issue in the case, and that the word “Tiffany” and “Tiffany setting” have descriptive meanings that are different from any meaning the words may have when used as a brand name.<sup>70</sup> The Court acknowledged that the most significant evidence provided by Costco to support its genericism claim were two declarations from one of its expert, Dr. Geoffrey Nunberg.<sup>71</sup> The Nunberg declarations criticized the methodology of Tiffany’s expert study and surveys and provided its own genericism report based on a lexicographical study of the word Tiffany.<sup>72</sup> Costco’s expert lexicographical study determined that “the style name Tiffany and the trademark Tiffany are, and for more than 100 years have been, two different words having two very different meanings.”<sup>73</sup>

The Court first criticized Costco’s failure to address precedential law or make any factual demonstration related to the precedential authority.<sup>74</sup> The Court had previously recognized the “dual usage” doctrine in trademark law.<sup>75</sup> The dual usage doctrine finds that a mark may begin as a proprietary word and gradually become generic as to some segments of the public.<sup>76</sup> The Court found that Costco failed to address the line of authority and declined to explore the argument *sua sponte*.<sup>77</sup>

The Court also found that, though Costco’s evidence called into question the soundness of Tiffany’s expert study, it failed to undermine Tiffany’s expert’s ultimate methodology and did not demonstrate that the expert’s conclusions were based on unreliable “junk” science.<sup>78</sup> An expert’s testimony can be challenged on a Daubert motion, which seeks to undermine

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<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 256.

<sup>66</sup> *Id.* at 257.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 257.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* at 257-58.

<sup>74</sup> *Id.* at 258.

<sup>75</sup> *Id.*

<sup>76</sup> See *Harley Davidson, Inc. v. Grottanelli*, 164 F.3d 806, 812 (2d Cir. 1999).

<sup>77</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 258.

<sup>78</sup> *Id.* at 258.

the reliability of the expert's evidence.<sup>79</sup> A Daubert analysis focuses on the principles and methodology underlying an expert's testimony, giving the court the discretion necessary to keep out junk science and ensure that only reliable expert testimony that will assist the trier of fact gets admitted.<sup>80</sup> The Court found that Costco criticized Tiffany's evidence by addressing the weight the evidence should be given as opposed to its admissibility.<sup>81</sup> Further, the Court found that Costco proffered no evidence to demonstrate that the primary significance of the Tiffany mark to the relevant public was as a generic descriptor.<sup>82</sup> The Court, therefore, held that Costco had not raised a genuine issue of material fact with respect to its genericism claim and granted Tiffany's summary judgment dismissal of the counterclaim.

## OVERCOMING GENERICISM AND BALANCING BRAND RECOGNITION

Though the Court determined that the Tiffany trademark had not become generic, the Court's finding turned on the insufficiency of Costco's evidence to raise a genuine issue of material fact, rather than the strength of Tiffany's evidence. The Court's analysis of Costco's declarations and ultimate holding that Costco failed to raise a genuine issue of material fact should worry famous brands. The Court's analysis gave an outline to challengers of famous trademarks describing what type of evidence raises or fails to raise a genuine issue of material fact. Challengers of a famous trademark can learn from Costco's mistakes and provide expert studies and surveys to support their genericism claims and survive the motion to dismiss stage. Further, to defend its mark from genericide,<sup>83</sup> Tiffany had to invest substantial amounts of money to hire an expert to conduct a study and an extensive survey simply to combat the general genericism pleadings made by Costco.

Trademark owners, famous and non-famous, should be wary of the conflicting principles of business growth and trademark protection. From a business

growth perspective, a trademark owner would likely find it valuable to have such a strong association of its trademark with its goods or services that the trademark becomes synonymous with the good or service. However, from a trademark law perspective, the trademark owner should want to prevent its mark from becoming so famous that it becomes a descriptor of the goods or services, and therefore not protectable.

In essence, the trademark owner would want the trademark to become famous enough that it is at the top of the market for its associated goods or services but not so famous that the relevant public uses the trademark primarily to describe the goods or services. This goal is achievable through brand policing and smart marketing. One way trademark owners are working to prevent genericide is their marketing campaigns. Trademark owners, in their marketing, are differentiating the trademark from the descriptive words for the goods or services provided. For example, Dr. Pepper is the trademark and soda is the good with which the brand is associated. Dr. Pepper, in its marketing campaigns, should refer to their sodas as "a Dr. Pepper soda" as opposed to "a Dr. Pepper" to prevent the public from using the brand name as a descriptor for the soda. As a rule of thumb, brands should seek to only use their brand names as an adjective for the goods or services they provide. Brands should avoid using the brand name as a noun or verbs, such as "can I get a Dr. Pepper" or "Let me Google that." Though this level of brand recognition is desired by entrepreneurs and businessmen, it could lead to the trademark becoming generic for its goods or services resulting in the loss of its trademark protection.

Another means of preventing trademark genericide is through educating the public on the proper use of the trademark. Trademark owners can develop marketing campaigns to inform the public of the proper use of the trademark as an adjective for its goods and services and the threat of genericide. Xerox famously employed this strategy in 2003 with an advertisement stating "[w]hen you use 'Xerox' the way you use 'aspirin,' we get a

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<sup>79</sup> *In re Fosamax Products Liability Litigation*, 645 F. Supp. 2d 164, 172-73 (S.D.N.Y. 2009).

<sup>80</sup> *Id.* at 174.

<sup>81</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 258.

<sup>82</sup> *Id.* at 259.

<sup>83</sup> *Id.*

headache.”<sup>84</sup> This strategy, while capable of educating the public on genericide, is an expensive option and unlikely to deter the public from using the trademark as a descriptor for its goods or services if the public is already using it as such.

Trademark owners should also actively be policing for trademark misuse to prevent genericism of their trademark. Trademark owners should be policing the internet and other media for improper and fraudulent use of the trademarks. There are companies created to provide these services to trademark owners. These companies will scour the internet and media for improper use of the trademark and then stamp it out. NetNames is one such company. In 2014, NetNames had more than 2,000 clients and charged approximately \$ 66,000 to \$ 265,000 per year.<sup>85</sup> This is also an expensive option for trademark owners but could be more valuable to a trademark that is prone to misuse across the internet.

## CONCLUSION

The Court in *Tiffany* noted many examples of trademarks that suffered genericide.<sup>86</sup> Those examples include “aspirin” for acetylsalicylic acid, “cellophane” for transparent cellulose sheets and films, “escalator” for a moving stairway, and “Murphy Bed” for a bed that folds into a closet.<sup>87</sup> Even more notably, the trademarks for “Thermos” and “Pilates” had become so synonymous

with their respective goods and services that courts found them to have been genericized and therefore lost their trademark protection.<sup>88</sup> Trademark owners should note the lessons to be learned from those cases. Those companies invested a lot in the marketing campaigns and were so successful that they wound up losing their trademark protection. Those lessons are especially important when companies with such strong marks such as Tiffany and Google are becoming vulnerable to genericism claims.<sup>89</sup>

Trademark owners can avoid the threat of genericide by combatting their business instincts and preventing the use of their mark as a descriptive name for their respective goods or services. Trademark owners can achieve this through marketing campaigns that educate the public on the proper use of the trademark as an adjective for its respective goods and services, such as “two Dr. Pepper sodas.” This option is particularly valuable to younger brands with which the public is just becoming familiar. Trademark owners that currently fear genericism claims could also seek to educate the public on genericism itself or hire outside companies to police the trademark’s use across media. Regardless of the options employed, trademark owners that fear genericism of their trademarks should learn how to combat a genericism claim from this case, especially the importance of having a qualified expert who bases their findings on reliable principles and methods.

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<sup>84</sup> Simon Tulett, ‘Genericide’: Brands destroyed by their own success, Business reporter, BBC News (May 28, 2014), <https://www.bbc.com/news/business-27026704>.

<sup>85</sup> Id.

<sup>86</sup> *Tiffany & Co.*, 127 F. Supp. 3d at 259.

<sup>87</sup> Id. (citing *Horizon Mills Corp. v. QVC, Inc.*, 161 F. Supp. 2d 208, 214 (S.D.N.Y. 2001)).

<sup>88</sup> See *King-Seeley Thermos Co. v. Aladdin Industries, Inc.*, 321 F.2d 577, 580-81 (2d Cir. 1963); see also *Pilates Inc. v. Current Concepts, Inc.*, 120 F. Supp. 2d 286 (S.D.N.Y. 2000).

<sup>89</sup> See *Tiffany & Co.*, 994 F. Supp. 474; See also *Elliott v. Google, Inc.*, 860 F.3d 1151 (9th Cir. 2017).

# DISPARAGING, IMMORAL, AND SCANDALOUS . . . OH MY!

## The Lanham Act On Its Knees

Mireya Martinez

### INTRODUCTION

One of the most recent controversies in the protection of rights is at the intersection of intellectual property and the fundamental freedom of speech as it relates to disparaging and scandalous or immoral trademarks. After a long history of jurisprudence, the United States Supreme Court and the Federal Circuit recently issued two decisions making it clear that protecting the public from off-putting or offensive marks was not a sufficiently valid reason to suppress or limit the commercial and trademark rights of applicants nationwide.<sup>1</sup> As a result of these recent legal challenges, the United States Patent and Trademark Office (USPTO) has had to re-evaluate its review process and will no longer refuse to register a mark on the grounds that it is disparaging or immoral, no matter how offensive or distasteful it is. In response to the *Brunetti* decision, the USPTO filed a petition with the Federal Court for a rehearing *en banc* alleging, among other subjects, some keen differences between disparaging marks and sexually explicit marks.<sup>2</sup> As was expected

by many experts in the field, that request was denied, and it remains uncertain if the USPTO will appeal the ruling to the Supreme Court.<sup>3</sup> However, to read the recent cases as holding that the government can never withhold trademark registration benefits due to the repugnance of the mark is to read them too broadly.

This paper argues that more narrowly drafted exclusions would survive First Amendment scrutiny. In particular, that Congress could amend the Lanham Act to create two narrow bars. The first would bar any mark that “is obscene or lewd in a way that violates an individual’s right to be left alone.” The second would bar any mark that is “in any way . . . designed to organize, promote, encourage, incite, participate in, or carry out any type of criminal activity, or any type of hate action based on race, nationality, gender, political, or religious affiliation.” These bars could serve important government interests and be appropriately tailored to survive First Amendment scrutiny.

Thus, it is appropriate that we begin Part I of this paper with § 2(a) (15 U.S.C.S. § 1052(a)) of the Lanham

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<sup>1</sup> See *Matal v. Tam*, 137 S. Ct. 1744, 1747 (2017); *In re Brunetti*, 877 F.3d 1330, 1335 (Fed. Cir. 2017).

<sup>2</sup> Trevor Little, “A steep uphill battle”: experts pessimistic over USPTO bid for U-turn on scandalous marks, *World Trademark Rev.* (Apr. 10, 2018), <http://www.worldtrademarkreview.com/blog/detail.aspx?g=1ede06dd-191c-4359-beb1-ec9a98821852>.

<sup>3</sup> Bill Donahue, *Federal Circuit Won't Rethink 'Scandalous' Trademark Ruling*, *Law 360* (June 19, 2018), <https://www.law360.com/articles/1032891/fed-circ-won-t-rethink-scandalous-trademark-ruling>.

Act and the surrounding jurisprudence. This part will illustrate the factors, standards and levels of scrutiny that the courts used in reaching their decisions. Further, the part lays the groundwork that establishes how the recent decisions have stemmed from the gradual shift to a progressive judicial body from a traditionally culturally conservative one.

Part II reviews the two major cases tackling the subject of trademarks involving disparaging or scandalous and immoral marks and addresses the Freedom of Speech question. The first case, *Matal v. Tam*, stripped the USPTO of its ability to reject a trademark application on the basis of a trademark being disparaging or bringing into contempt or disrepute any person, living or dead.<sup>4</sup> The second case, *In re Brunetti*, further stripped the USPTO of its ability to regulate offensive speech when the Federal Circuit held that it could not reject a mark for immoral or scandalous content.<sup>5</sup> *Brunetti* also establishes that the government cannot restrict speech unless: 1) it is for a justified and substantial interest, and; 2) the regulation is narrowly tailored to justify that purpose.<sup>6</sup>

Part III reviews the USPTO's previous guidelines and the guidance it has issued to its examining attorney's during the progression of these developments in trademark law. Part III also discusses the reasoning behind the USPTO's reluctance to issue a new set of guidelines following *Brunetti* and the status of applications under the scandalous and immoral provision at the USPTO. Lastly, Part III also discusses the rehearing petition filed by the USPTO, what leading legal minds had to say about the subject and the USPTO's response to the Federal Circuit Court's recent denial.

Finally, following the decisions and the expert opinions, Part IV discusses the proposed amended provisions more in depth. Setting the framework by first establishing the historical precedents that allow the limits on the areas of speech the provisions seek to bar, both provisions are put through a theoretical analysis under both strict scrutiny and the more

relaxed *Central Hudson* framework.<sup>7</sup> Thus, proving that this proposed amended provision is the better route for the USPTO to pursue via legislative avenues rather than through the judiciary.

In conclusion, it seems that the courts have practically dismantled section 2(a) of the Lanham Act as it is written. Due to the level of scrutiny applied for the freedom of speech protection, it will be very difficult for Congress to revamp this subsection in a way that would reverse the holdings that now make disparaged, immoral or scandalous marks eligible for registration in the national registry. However, the court's opinions on these cases did leave some clues from which the USPTO can start. Their opinions made clear that we cannot suppress speech simply because we find it offensive as this has been deemed unconstitutional. But, the USPTO can start by trying to limit the spread of hate speech or speech that incites or encourages violence and/or mistreatment against others through the enactment of this proposed provision.

## I. THE LANHAM ACT AS CHALLENGED: THE REFUSAL TO REGISTER IMMORAL, SCANDALOUS OR DISPARAGING MARKS

Section 2(a) of the Lanham Act states that a trademark is registrable on the principal register unless it—

(a) Consists of or comprises *immoral, deceptive, or scandalous matter, or matter which may disparage or falsely suggest a connection with persons, living or dead, institutions, beliefs, or national symbols, or bring them into contempt, or disrepute;*<sup>8</sup>

The USPTO has been able to rely on this sub-section since its enactment in 1946. It must be noted that there are protections afforded to owners of unregistered marks within commerce that fall into this category. Federal registration, however, “confers important legal rights and benefits on trademark owners who register their marks.”<sup>9</sup>

Examples of the rights and benefits that registration on the principal register offers are: (1) it serves as

<sup>4</sup> 137 S. Ct. 1744, 1747 (2017).

<sup>5</sup> 877 F.3d 1330, 1335 (Fed. Cir. 2017).

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

<sup>7</sup> *Cent. Hudson Gas & Elec. Corp. v. Public Serv. Comm'n*, 447 U.S. 557 (1980).

<sup>8</sup> 15 U.S.C.S. § 1052(a) (emphasis added).

<sup>9</sup> *B&B Hardware, Inc. v. Hargis Indus.*, 135 S. Ct. 1293, 1293 (2015).

‘constructive notice of the registrant’s claim of ownership’ of the mark,<sup>10</sup> (2) once a mark has been registered for five years, it can become “incontestable,”<sup>11</sup> and (3) it is “conclusive evidence of the validity of the registration of the mark, of the registrant’s ownership of the mark, and of the registrant’s exclusive right to use the registered mark in commerce on or in connection with the goods or services specified in the affidavit.”<sup>12</sup> Registration also enables the trademark holder to stop the importation into the United States of articles bearing an infringing mark.<sup>13</sup> Recognizing these benefits, it should come as no surprise that many trademark owners want to register and protect their marks. Equally foreseeable is the government’s desire to protect the public from speech it considers to be disparaging, immoral or offensive and scandalous in nature.

Before the recent court decisions, a USPTO examining attorney generally applied a two-part test when deciding whether a trademark was disparaging. The examining attorney first considered “the likely meaning of the matter in question, taking into account not only dictionary definitions, but also the relationship of the matter to the other elements in the mark, the nature of the goods or services, and the manner in which the mark is used in the marketplace in connection with the goods or services.”<sup>14</sup> This essentially meant that whether a mark was deemed disparaging could hinge on the examining attorney’s subjective views because deciphering the “likely meaning of the matter in question” was left to the examining attorney’s discretion. This is the regulatory scheme that was challenged under the First Amendment’s guarantee of freedom of speech.

As expressed *supra*, trademarks are normally used by their owners in connection with their goods and/or services.<sup>15</sup> They are used to build recognition for a

product or to convey a commercial message. But, at times they can be created for other reasons such as raising awareness for a cause. Either way, there is no doubt that the reason that marks are created is to disseminate information. Nevertheless, in the majority of cases, a trademark is commercial speech. As such, in order to be able to limit trademarks—even immoral or scandalous ones—the State must show that it has a substantial governmental interest and that the measure to restrict or ban the trademark registration has been taken to achieve that interest.

Further limiting the USPTO’s ability to reject trademarks on the basis of immorality or scandalousness are historical precedents that have established that content-based statutes are presumptively invalid.<sup>16</sup> To survive, such statutes must withstand strict scrutiny review, which requires the government to “prove that the restriction furthers a compelling interest and is narrowly tailored to achieve that interest.”<sup>17</sup> Strict scrutiny applies whether a government statute bans or merely burdens protected speech.<sup>18</sup>

However, if the USPTO is able to demonstrate that it has a compelling interest in rejecting a trademark or limiting speech, then the courts review a case under intermediate scrutiny, reviewing the government’s asserted interest under a four-part test known as the *Central Hudson* standard, which asks whether (1) the speech concerns lawful activity and is not misleading; (2) the asserted government interest is substantial; (3) the regulation directly advances that government interest; and (4) the regulation is not more extensive than necessary to serve that interest.<sup>19</sup> It must be noted that it does not necessarily mean that the least restrictive means were used, but that the government used the least restrictive method available to reach its desired objective.

<sup>10</sup> 15 U.S.C. §1072

<sup>11</sup> 15 U.S.C. §1065

<sup>12</sup> 15 U.S.C. §1115(b)

<sup>13</sup> See 15 U.S.C. §1124

<sup>14</sup> *Trademark Manual of Examining Procedure* (“TMPE”) §1203.03(b)(i) (Apr. 2017), <http://ttmp.uspto.gov>.

<sup>15</sup> 15 U.S.C. §1115(b)

<sup>16</sup> *RAV v. City of St. Paul, Minn.*, 505 U.S. 377, 382 (1992)

<sup>17</sup> *Reed v. Town of Gilbert*, 135 S. Ct. 2218, 2224 (2015) (quoting *Ariz. Free Enter. Club’s Freedom Club PAC v. Bennett*, 564 U.S. 721, 734 (2011)); *United States v. Playboy Entm’t Grp., Inc.*, 529 U.S. 803, 813 (2000) (“If a statute regulates speech based on its content, it must be narrowly tailored to promote a compelling Government interest. If a less restrictive alternative would serve the Government’s purpose, the legislature must use that alternative.”).

<sup>18</sup> See *Playboy*, 529 U.S. at 812 (“The Government’s content-based burdens must satisfy the same rigorous scrutiny as its content-based bans.”).

<sup>19</sup> *In re Brunetti*, 877 F.3d 1330, 1335 (Fed. Cir. 2017) (quoting *Cent. Hudson Gas & Elec. Corp. v. Public Serv. Comm’n*, 447 U.S. 557 (1980)).

“Under a commercial speech inquiry, it is the State’s burden to justify its content-based law as consistent with the First Amendment.”<sup>20</sup> The USPTO has not been successful at arguing that the immoral and scandalous provisions in Section 2(a) of the Lanham Act are speech it should be able to regulate because it has not been able to establish a compelling interest, and because of its inconsistent approvals and rejections of trademarks with almost identical subject matter—making it appear like it is largely subjective.

## II. THE SUCCESSFUL CONSTITUTIONAL CHALLENGES TO REGISTRATION REFUSALS BASED ON DISPARAGEMENT OR SCANDALOUSNESS

The first damaging affront that the Lanham Act faced with regards to speech was on June 19, 2017, when the Supreme Court released its decision in *Matal v. Tam* that held unconstitutional the rejection of trademark registrations on the basis that they disparaged or brought into contempt or disrepute any person, living or dead.<sup>21</sup> In this case, Simon Tam, the lead singer of a group named “The Slants”<sup>22</sup> sought to empower Asians by taking this derogatory term and reappropriating it as their own. He took this matter to federal court after administrative appeals failed because the trademark registration was rejected by the USPTO under the Lanham Act provision that prohibited the registration of trademarks that may “disparage . . . or bring . . . into contemp[er] or disrepute” any “persons, living or dead.”<sup>23</sup>

In response, the government put forth the arguments that 1) trademarks were government speech, 2) trademarks are a form of government subsidy, and 3) that the constitutionality of the disparagement clause should be tested under a new “government-program” doctrine.<sup>24</sup>

However, addressing the first point, Justice Alito quickly dispenses with the idea that trademarks are government speech by addressing the incoherency of that argument.<sup>25</sup> For example, the USPTO takes no part in designing or editing trademarks.<sup>26</sup> An examining attorney may not reject a mark based on a viewpoint, even if it is inconsistent with government policy or consistent with others already expressed by registered marks; instead, if the Lanham’s viewpoint neutral requirements are met, then registration is mandatory.<sup>27</sup> Further, if trademarks were indeed government speech, for example, then one could argue that the government was conveying a warning to the American people when it approved registration of “EndTime Ministries.”<sup>28</sup>

Second, the government’s argument that trademarks are subsidies is flawed because every case it relied on involved the government paying some type of cash or equivalent to the party. Specifically, the federal trademark registration program is not structured as suggested by the government, which actually receives money from the applicant seeking to register a trademark.<sup>29</sup> Accordingly, in this case, the argument that federal trademark registration is a government program, just like tax exemption and federal funding, and therefore the government can choose who can and cannot participate, is erroneous.

Lastly, the government attempts to merge both the subsidy and the government speech arguments into a new “government-program.”<sup>30</sup> The government argues that §2(a) is not an impermissible viewpoint-based restriction on speech. Instead, it asserts that §2(a) simply sets out criteria for a government benefit in a way that the Court has upheld. The government contends that §2(a)’s criteria serve legitimate government interests not to encourage the use of disparaging terms and to disassociate itself from racial slurs and other offensive

<sup>20</sup> *Sorrell v. IMS Health Inc.*, 564 U.S. 552, 571 (2011).

<sup>21</sup> *Matal v. Tam*, 137 S. Ct. 1744(2017).

<sup>22</sup> Tam chose to reappropriate “Slants,” a term often used in a derogatory manner towards Asians as a reference to the appearance of their eyes.

<sup>23</sup> *Tam*, 137 S. Ct. at 1747.

<sup>24</sup> *Id.* at 1757.

<sup>25</sup> *Id.* at 1758—60.

<sup>26</sup> *Id.* at 1758.

<sup>27</sup> *Tam*, 137 S. Ct. at 1758.

<sup>28</sup> *Id.* at 1759.

<sup>29</sup> 37 CFR §2.6(a)(1)

<sup>30</sup> *Tam*, 137 S. Ct. at 1761.

speech.<sup>31</sup> In short, “[t]he Constitution does not put Congress to the choice of either eliminating the federal trademark registration program altogether or promoting the use of racial slurs in interstate commerce.”<sup>32</sup> The Supreme Court finds that this has only limited viability in cases where a limited public forum is created, such as a government-sponsored speech at a local school. Even then, one cannot discriminate against and forbid based on viewpoint. Consequently, one of the biggest takeaways expressed in *Tam* is that “the public expression of ideas may not be prohibited merely because the ideas are themselves offensive to some of their hearers.”<sup>33</sup> In short, the USPTO tries unsuccessfully to make the argument that because it provides a government benefit through the principal registry system, it is creating a limited forum and thereby has a legitimate government interest to reject marks it deems offensive or disruptive to interstate commerce, but it is once again rejected based on the same reasoning as the limited forum argument *supra*, and because of the lack of viewpoint neutrality.

The other equally significant idea that *Tam* established is that disparaging trademarks cannot be rejected on the basis that they are commercial speech that is regulated to protect the flow of commerce.<sup>34</sup> This is because the Lanham Act and its disparagement clause were not narrowly drawn to only exclude those trademarks that would disrupt commerce. To the contrary, the Lanham Act is broadly drawn so that any mark that disparages against *any person, group, or institution, whether living or dead*, would be rejected.<sup>35</sup>

On the heels of that decision, and capitalizing on its momentum, came *Brunetti* challenging the “scandalous and immoral” provision of §2(a).<sup>36</sup> In this case, Eric

Brunetti owned the clothing brand “FUCT” and sought to obtain a federal registration for that mark. The USPTO and the Trademark Trials and Appeals Board (TTAB) denied the registration because the mark resembled the past tense of the verb “fuck,” which they deemed vulgar and therefore scandalous.<sup>37</sup> Mr. Brunetti then appealed the TTAB’s decision in the United States Court of Appeals for the Federal Circuit, where he argued that his mark was not vulgar and, in the alternative, even if it were to be found vulgar—and by extension scandalous—to bar it from being registered under §2(a) would be unconstitutional.<sup>38</sup>

Evidence supporting a finding of vulgarity in Mr. Brunetti’s mark was found in the marketplace, including T-shirts depicting sexual imagery and captioned “FUCT Orgy,” and the word “FUCT” in yellow letters with the “T” superimposed over a “K” that was still visible underneath.<sup>39</sup> Mr. Brunetti argued that these were outdated designs and offered that his mark stood for “Friends yoU Can’t Trust.”<sup>40</sup> The Federal Circuit was not persuaded and affirmed the Board’s decision that the mark was vulgar and scandalous, but then addressed the remaining concern of the constitutionality of the bar on the registration of scandalous and immoral marks.

Before *Tam*, Mr. Brunetti’s argument on the constitutionality of the bar was silent based on the precedent set by *McGinley*.<sup>41</sup> After *Tam*’s case found that the USPTO’s denial of mark registration had a chilling effect on speech and that marks were private speech rather than government speech, briefing was requested to evaluate the impact on cases like *Brunetti*, which dealt with other provisions on the Latham Act’s §2. Both parties submitted letters. The government contended that

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<sup>31</sup> Steven D. Schwinn, *The Curious Case of The Slants*, 81(2) SOC. EDUC. 74 (Mar/Apr 2017), available at [https://www.americanbar.org/content/dam/aba/events/public\\_education/MarApr\\_LeevTam.authcheckdam.pdf](https://www.americanbar.org/content/dam/aba/events/public_education/MarApr_LeevTam.authcheckdam.pdf).

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

<sup>33</sup> *Tam*, 137 S. Ct. at 1763; see *Street v. New York*, 394 U.S. 576, 592(1969); see also *Texas v. Johnson*, 491 U.S. 397, 414(1989) (“If there is a bedrock principle underlying the First Amendment, it is that the government may not prohibit the expression of an idea simply because society finds the idea itself offensive or disagreeable”); *Hustler Magazine, Inc. v. Falwell*, 485 U.S. 46, 55-56(1988)

<sup>34</sup> *Tam*, 137 S. Ct. at 1764.

<sup>35</sup> *Id.* at 1765 (citing that “Down with racists,” “Down with sexists,” and “Down with homophobes” would be considered disparaging even though they would not disrupt commerce) (emphasis added).

<sup>36</sup> *In re Brunetti*, 877 F.3d 1330, 1335 (Fed. Cir. 2017).

<sup>37</sup> *Brunetti*, 877 F.3d at 1337.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 1338.

<sup>40</sup> *Id.* at 1339.

<sup>41</sup> *In re McGinley*, 660 F.2d 481 (C.C.P.A. 1981) (Establishing that mark owners could still use their marks even if they could not register them, therefore the First Amendment doesn’t apply).

*Tam*'s case did not solve the issue of the scandalous and immoral provision because, unlike the disparagement provision which is viewpoint specific, the scandalous and immoral provision is viewpoint neutral.<sup>42</sup> One can argue this point, and indeed the Federal Circuit does make a point to say that it does question the viewpoint neutrality of the scandalous and immoral provision, but it was not relevant in concluding that—regardless of viewpoint discrimination—this provision is unconstitutionally discriminatory based on content and is therefore in violation of the First Amendment.

As is the case in *Tam* with the disparagement provision, in *Brunetti*, the Federal Circuit once again concluded that section 2(a)'s bar on registering immoral or scandalous marks was an unconstitutional content-based restriction on speech. As previously established, content-based statutes are presumptively invalid and must survive strict scrutiny review.<sup>43</sup> Finally, the same level of scrutiny applies whether the regulation completely bans or simply burdens protected speech.<sup>44</sup>

In *Brunetti*, similar to the position taken in *Tam*, the government conceded that §2(a)'s bar on scandalous and immoral marks was a content-based restriction on speech, but argued that it did not implicate the First Amendment because trademark registration was a subsidy program, or in the alternative, a limited public forum.<sup>45</sup> Additionally, the government contends that trademarks are commercial speech and thus subject to the *Central Hudson* intermediate level of scrutiny.<sup>46</sup>

The Federal Circuit's analysis of the subsidy argument was similar to its analysis in *Tam*. The court found that trademark registration "does not implicate Congress' power to spend funds."<sup>47</sup> The only flow of money is from the registrant to the USPTO, and it is these fees that have funded the operating expenses associated

with trademark registration since 1991.<sup>48</sup> Therefore, the government's involvement in the trademark program, or the granting of a trademark to a mark owner, make it in no way an equivalent to a grant of federal funds or a government subsidy.<sup>49</sup>

In addressing the USPTO's argument that it is a limited forum, it is necessary that we briefly discuss the three types of forums the court identified: Traditional public forums; designated public forums; and limited public forums. Traditional public forums are places such as streets and parks which have historically been held for the use of the public and, oftentimes, for purposes of assembly, communicating with citizens, and discussing public questions. Designated public forums are created when government property that has not traditionally been regarded as a public forum is intentionally opened for that purpose. In these forums, the government's ability to restrict expressive conduct is very limited. Content-based restrictions on speech must be narrowly tailored to serve a compelling government interest, and restrictions based on viewpoint are prohibited. The last forum, the limited public forum, is usually a place that the government has limited to certain groups or for discussion of certain subjects. In these forums, the government can constitutionally restrict speech if it is consistent with the forum's purpose as long as the regulation is reasonable and not simply an effort to suppress a view that the officials oppose.<sup>50</sup>

As discussed *supra*, along with traditional and designated public forums, regulations that discriminate based on viewpoint in limited public forums are presumed unconstitutional.<sup>51</sup> However, content-based restrictions on speech are subject to a lesser degree of scrutiny and remain constitutional as long as the distinctions drawn are reasonable in light of the purpose

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<sup>42</sup> *Brunetti*, 877 F.3d at 1341.

<sup>43</sup> *Reed*, 135 S. Ct. at 2231 (quoting *Ariz. Free Enter. Club's Freedom Club PAC v. Bennett*, 564 U.S. 721, 734 (2011)); see *Playboy*, 529 U.S. at 812 (holding that if speech is regulated due to its content, it must be narrowly tailored to the Government's interest and must be the least restrictive alternative).

<sup>44</sup> See *Playboy*, 529 U.S. at 812.

<sup>45</sup> *Brunetti*, 877 F.3d at 1342.

<sup>46</sup> *Id.*; see also *Central Hudson*, 447 U.S. at 566.

<sup>47</sup> *Brunetti*, 877 F.3d at 1344.

<sup>48</sup> *Figueroa v. United States*, 466 F.3d 1023, 1028 (Fed. Cir. 2006).

<sup>49</sup> *Brunetti*, 877 F.3d at 1345.

<sup>50</sup> *Brunetti*, 877 F.3d at 1346.

<sup>51</sup> See *Rosenberger v. Rector & Visitors of Univ. of Va.*, 515 U.S. 819, 830 (1995).

served by the forum.<sup>52</sup> Accordingly, where a government entity has opened its doors for a limited purpose, it can restrict speech consistent with that purpose as long as the restrictions are reasonable and not simply because the officials don't agree with the speaker's views.<sup>53</sup>

The government argues that trademarks are a limited forum in a metaphysical form as they are tethered to the federal register similar to the case in *Rosenberger*.<sup>54</sup> However, in *Rosenberger*, the university's funds intended for student extracurricular activities were being used, and thus an argument for a limited forum could be made, in the form of a metaphysical tether and possible association to the university. By contrast, any message conveyed by a trademark cannot be said to be tied to the USPTO. Likewise, one would be hard-pressed to say that the Nike swoosh or its "Just Do It" mark printed on a shirt or on a storefront window is creating a limited forum for the government.<sup>55</sup>

Finally, on the subject of commercial speech and the level of scrutiny applicable to trademarks, the Federal Circuit concedes that trademarks often convey a commercial message, providing information as to "who is producing and selling what product, for what reason, and at what price."<sup>56</sup> But, marks can often carry expressive content and espouse powerful political messages in only a small amount of words.<sup>57</sup>

Perhaps more telling of all is the test that the USPTO uses to weed out scandalous and immoral marks. In particular, a mark is evaluated as to whether it would be "shocking to the sense of truth, decency, or propriety; disgraceful; offensive; disreputable; . . . giving offense to the conscience or moral feelings; . . .

or calling out for condemnation."<sup>58</sup> In other words, whether a mark is rejected or approved hinges entirely on the subject matter it expresses—it is *value-based*—and not based on the source identifying nature of the mark.<sup>59</sup> Because of this, the regulation of expressive content must be subject to strict scrutiny, making the bar on the registration of scandalous and immoral marks under §2(a) unconstitutional.<sup>60</sup>

The Federal Circuit delves quite deeply into the scenario in which trademarks are treated as purely commercial speech and reviewed under intermediate scrutiny. In this case, the Court analysis marks using the *Central Hudson* framework.<sup>61</sup> "Under a commercial speech inquiry, it is the State's burden to justify its content-based law as consistent with the First Amendment."<sup>62</sup>

The Federal Circuit concedes that the immoral or scandalous provision easily meets the first prong of the *Central Hudson* test, requiring the confirmation that the speech "concern lawful activity and not be misleading," stating Section 2(a)'s provision barring immoral or scandalous marks, much like the disparagement provision, is concerned with whether a mark is offensive, scandalous, or vulgar to a substantial portion of the public, and not with addressing misleading, deceptive, or unlawful marks.<sup>63</sup>

However, *Central Hudson's* second prong, requiring a substantial government interest, is not met because the government failed to establish a discernable interest—switching its position on what exactly that interest was during the review of the case.<sup>64</sup> Following the narrative of *Tam*, the Federal Circuit once again reiterated that the government has no substantial interest in promoting

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<sup>52</sup> *Cornelius v. NAACP Legal Def. & Educ. Fund, Inc.*, 473 U.S. 788, 806 (1985).

<sup>53</sup> *Perry Educ. Ass'n v. Perry Local Educators' Ass'n*, 460 U.S. 37, 45(1983).

<sup>54</sup> *Rosenberger*, 515 U.S. at 830.

<sup>55</sup> *Brunetti*, 877 F.3d at 1347-48.

<sup>56</sup> *Brunetti*, 877 F.3d at 1349 (quoting *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council*, 425 U.S. 748 (1976)).

<sup>57</sup> See e.g. FUCK HEROIN, Appl. No. 86,361,326; FUCK CANCER, Appl. No. 86,290,011; FUCK RACISM, Appl. No. 85,608,559; See also, DEMOCRAT.BS, Appl. No. 77,042,069, or REPUBLICAN.BS, Appl. No. 77,042,071.

<sup>58</sup> *Brunetti*, 877 F.3d at 1336 (quoting *In re Fox*, 702 F.3d 633 (Fed. Cir. 2012)).

<sup>59</sup> *Id.* at 1336 (emphasis added).

<sup>60</sup> *Id.* at 1349; see *Sorrell*, 564 U.S. at 565.

<sup>61</sup> See *Central Hudson*, 447 U.S. at 566; see also *Bd. of Tr. of State Univ. of N.Y. v. Fox*, 492 U.S. 469, 479-80 (1989) (explaining the fourth prong of *Central Hudson* requires "not necessarily the least restrictive means but . . . a means narrowly tailored to achieve the desired objective").

<sup>62</sup> *Sorrell*, 564 U.S. at 565.

<sup>63</sup> *Brunetti*, 877 F.3d at 1353 (quoting *Central Hudson*, 447 U.S. at 566).

<sup>64</sup> *Id.* (noting USPTO switched from "protecting public order and morality." Gov't Letter Br. 15 & n.6, *In re Brunetti*, No. 15-1109, Docket No. 60 (Fed. Cir. July 20, 2017) to shielding its examiners from immoral or scandalous marks, and finally to "the promotion of the use of non-scandalous marks in commerce.").

certain trademarks over others and rejected the claim that it is government speech. The government cannot justify restricting speech because it offends the general public. As Justice Alito's now famous quote affirmed in his opinion: "It offends a bedrock First Amendment principle: Speech may not be banned on the ground that it expresses ideas that offend."<sup>65</sup>

The government attempted to justify its interest by pointing to a previous Supreme Court decision in which it allowed the suppression of indecent and potentially sanctionable speech, but it was unable to sway the Federal Circuit Court.<sup>66</sup> This is because that holding, even at the time that it was issued, was narrow by applying only in scenarios where the mark would invade "the privacy of the home, where the individual's right to be left alone plainly outweighs the First Amendment rights of an intruder."<sup>67</sup> Likewise, the USPTO's assertions that a trademark registration was not necessary for a mark owner to have rights proved to be detrimental to their case. Because the government repeatedly expressed that a federal registration under §2(a) does not keep a mark owner from using their mark in commerce or advertising within the public realm (barring any other reason it may be an unlawful act), the Federal Circuit held the government could not meet the third prong of *Central Hudson*, which requires the regulation directly advance the government's asserted interest.<sup>68</sup>

Finally, the fourth prong of *Central Hudson* ensures that the regulation is not more extensive than necessary to serve the regulation's interest. In *In re Brunetti*, the

USPTO's inconsistent application of the immoral or scandalous provision created uncertainty and undermined the likelihood that the provision had been properly tailored. This was because several nearly identical marks had garnered different results from different examiners.<sup>69</sup> For instance, the USPTO registered the mark FUGLY for use on clothing but refused registration for use on alcoholic beverages.<sup>70</sup> Granted, the language may be considered offensive to some, but there also seems to be no discernable logic to the standard or review being used to approve or deny these registrations. For example, as was noted in *Brunetti*, the acronym MILF alone had several acceptances and rejections in one year alone.<sup>71</sup>

In general, the court's analysis found wide inconsistencies in the application of the scandalous and immoral provision, even when it came to the term in question in *Brunetti*.<sup>72</sup> Because these inconsistencies demonstrated that the provision was too broad and was subject to the examiner's subjective principles, it failed to meet the government's claimed interests and was deemed unconstitutional. On December 15, 2017, the Federal Circuit held that trademarks rejected on the basis that a mark is immoral or scandalous is unconstitutional. As a result, the USPTO can no longer use § 2(a) (15 U.S.C. § 1052(a)) of the Lanham Act to reject a trademark for content it considers either of a scandalous or immoral nature. Although the government must accept the decision in *Tam* as final, it has decided to file a petition for rehearing *en banc* for *Brunetti* on the issues it feels remain to be resolved.

<sup>65</sup> *Tam*, 137 S. Ct. at 1751.

<sup>66</sup> *FCC v. Pacifica Foundation*, 438 U.S. 726, 738-41 (1978) (upholding the constitutionality of the FCC's declaratory order determining an afternoon radio broadcast was indecent and potentially sanctionable for "references to excretory and sexual material [that] . . . surely lie at the periphery of First Amendment concern.").

<sup>67</sup> *Pacifica*, 438 U.S. at 749.

<sup>68</sup> *Central Hudson*, 447 U.S. at 566.

<sup>69</sup> *Brunetti*, 877 F.3d at 1353 (quoting *Reno v. Am. Civil Liberties Union*, 521 U.S. 844, 868-69 (1997)).

<sup>70</sup> *Compare* Reg. No. 5,135,615, with Appl. No. 78,866,347. See also COCAINE, Appl. No. 78,829,207 (rejected), COCAINE, Reg. No. 1,340,874 (accepted). The USPTO registered NO BS! BRASS, Reg. No. 5,053,827, for entertainment services but rejected NO BS ZONE, Appl. No. 76,626,390, for internet training. NO \$#!+, Appl. No. 85,855,449, was rejected, but \$#! MY DAD SAYS, Reg. No. 4,142,745, was allowed. See also ROLL TURD, Appl. No. 86,448,988 (rejected), TURD HERDERS, Reg. No. 5,180,286 (registered). *Brunetti*, 877 F.3d at 1354.

<sup>71</sup> *Brunetti*, 877 F.3d at 1354 (quoting Anne Gilson LaLonde & Jerome Gilson, *Trademarks Laid Bare: Marks That May Be Scandalous or Immoral*, 101 Trademark Rep. 1476, 1478-82 (2011), noting that in the year 2011, GOT MILF (clothing)(rejected), MILF MANIA (adult online services)(rejected), MILF SEEKER (adult entertainment services)(rejected), and FROM SOCCER MOM TO MILF (self-help books for women)(rejected), from the marks which were registered, including DIARY OF A MILF (adult online services)(approved), BACKROOM MILF (adult online services)(approved), FAT MILF (sandwich)(approved), and MILF NEXT DOOR (adult online services)(approved)).

<sup>72</sup> *Brunetti*, 877 F.3d at 1354 (finding that the USPTO registered the mark FCUK but rejecting the marks FUCT and F\*\*K PROJECT; approving MUTHA EFFIN BINGO, Reg. No. 4,183,272, and IF WE TOUCH IT, IT'S FN GOLDEN, Reg. No. 4,100,978, but rejecting F ALL F'S APPAREL FOR THE F'N ANGRY, Appl. No. 78,420,315).

### III. THE AFTERMATH: THE USPTO'S ACTIONS AFTER THE DISPARAGEMENT AND SCANDALOUSNESS EXCLUSIONS ARE HELD UNCONSTITUTIONAL

Before these types of cases came into focus, the USPTO had existing guidance for its trademark examiners regarding the review of marks under §2(a) of the Lanham Act in the Trademark Manual of Examining Procedure § 1203. Once both *Tam* and *Brunetti* brought the constitutionality of the disparagement and scandalous provisions into question, the USPTO issued “Examination Guide 01-16” on March 10, 2016. The Examination Guide’s main purpose is to inform examiners that all action pending on applications involving marks subject to rejection based on the disparaging or scandalous provisions were to be suspended.<sup>73</sup>

The guidance changed once again in June 2017 when the Supreme Court issued the *Tam* decision holding that the disparaging provision is unconstitutional and barred the rejection of marks under that portion of §2(a). This time, the USPTO issued “Examination Guide 1-17,” which gives examiners guidance on how to proceed in the wake of the *Tam* decision and the still pending *Brunetti* case.<sup>74</sup> Although the guidance remained the same for applications involving marks subject to the scandalous provision, the language of the examination guide informed examiners that the disparagement provision that previously existed would no longer apply.<sup>75</sup> The guidance required that any and all previously issued advisory refusals under the disparagement provision that had been suspended be removed from suspension and examined for any other requirements or refusals. Further, an applicant could file a new application if a registration had been previously rejected under the disparagement provision and the registration was beyond the filing deadline for a petition to revive.<sup>76</sup>

Oddly enough, the USPTO opted not to issue a new examiners guide following the Federal Circuit’s decision affirming *Brunetti*’s previous holding that the bar on registration of marks due to the scandalous nature of their subject matter is unconstitutional and therefore no longer permissible. Instead, the USPTO continued to issue advisory refusals and temporarily suspended pending applications involving the “scandalous” provision.

As mentioned *supra*, on December 15, 2017, the Federal Circuit issued its decision on *Brunetti*. On February 14, 2018, the USPTO filed a petition for rehearing, arguing that they had gone too far in their broad analysis compared to *Tam*, because they wrongly equate the denial of a trademark registration with a direct regulation on speech, and fail to recognize the government’s legitimate interest in limiting the inclusion of sexually explicit marks in a governmental program.<sup>77</sup> The filing argues that unlike the disparagement clause, the scandalous marks provision is viewpoint neutral (denying federal registration of sexual and excretory terms and images to all commercial actors), and that content-based restrictions on federal registration are a long-standing feature of trademark law. It adds, “While the government generally cannot restrict the use of sexually explicit images in commerce, it is not constitutionally compelled to publish them in order to promote their use.”<sup>78</sup>

From a moral standpoint, it is understandable that the government does not want to be pegged as the publisher, promoter, or panderer of sexually explicit imagery or goods. But having a registrar of these marks does not mean that the government is in any way endorsing them.<sup>79</sup> Those are the thoughts that the author of *Gilson on Trademarks*, Anne Gilson LaLonde, contributed to Trevor Little’s article when asked what her view is on the USPTO’s petition for a rehearing:

<sup>73</sup> “Exam Guide 1-16 Compliance with Section 2(a)’s Scandalousness and Disparagement Provisions While Constitutionality Remains in Question,” USPTO (March 10, 2016), available at <https://www.USPTO.gov/trademark/guides-and-manuals/trademark-examination-guides>

<sup>74</sup> “Examination Guide 1-17: Examination Guidance for Section 2(a)’s Disparagement Provision after *Matal v. Tam* and Examination for Compliance with Section 2(a)’s Scandalousness Provision While Constitutionality Remains in Question,” USPTO (June 26, 2017), available at <https://www.USPTO.gov/trademark/guides-and-manuals/trademark-examination-guides>.

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> Trevor Little, “A steep uphill battle”: experts pessimistic over USPTO bid for U-turn on scandalous marks, *World Trademark Rev.* (Apr. 10, 2018), <http://www.worldtrademarkreview.com/blog/detail.aspx?g=1ede06dd-191c-4359-beb1-ec9a98821852>.

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

The government faces a steep and rocky uphill battle with this petition. True, the *Tam* decision isn't a perfect blueprint for eliminating the scandalous mark bar, but the *Tam* court would almost certainly overrule any opinion upholding that bar as constitutional. *Tam* emphasized that the protection of hateful, offensive and demeaning speech is at the core of the First Amendment tradition in the US. Scandalous trademarks fit solidly into that category.<sup>80</sup>

This is because, in the *Tam* decision, the Supreme Court also found that the government is not endorsing the content of the marks and is therefore not promoting speech.<sup>81</sup> Further, Ms. Gilson explains, the category of sexually explicit material represents only a small part of what the USPTO has rejected as “scandalous.” It has, for example, also found to be scandalous: marks promoting violence (such as WIFE BEATER), marks synonymous with terrorism (such as AL-QAEDA), anti-religious marks (such as BONG HITS 4 JESUS), marks containing drug references (such as MARIJUANA COLA) and marks containing vulgar terms (such as BULLSHIT, LISTEN UP ASSHOLE, NO FUCKS GIVEN, GRANDPA SCHITTHED'S INKY STINKY PALE ALE). Given the Supreme Court's unequivocal statement in *Tam* that “[s]peech may not be banned on the ground that it expresses ideas that offend”, the scandalousness bar is unlikely to survive.<sup>82</sup>

Marsha Gentner, Senior Counsel at Dykema, believes the Federal Circuit will rehear *Brunetti en banc* because it not only deals with the constitutionality of the Lanham Act but also because the USPTO has raised issues not completely resolved by the recent Supreme Court decision in *Tam*.<sup>83</sup> Gentner points out that although the USPTO's argument of trademark registration being a government subsidy and creating a limited forum is unlikely to succeed because it has already been rejected by both the *en banc* Federal Circuit's analysis and a

Supreme Court plurality opinion of *Tam*, she believes that the USPTO has a good chance its petition for a rehearing will be granted.<sup>84</sup> In her view, the USPTO has presented a valid question not previously foreclosed in *Tam*: whether the prohibition against registration of “immoral” or “scandalous” marks is viewpoint neutral, and if so, is this a distinction to the First Amendment analysis. Additionally, Gentner adds, the USPTO also raised the issue of whether “the trademark registration scheme is a ‘limited public forum’ in which the government can more freely restrict speech.”<sup>85</sup>

Despite this, Gentner is equally pessimistic that the USPTO will prevail in a rehearing; she cites that:

“[T]he critical principle of both the plurality Supreme Court opinion and Justice Kennedy's opinion in *Tam* was that speech may not be banned on the ground that it expresses ideas that offend; for the plurality, the asserted government interest, which is essentially the same as that argued by the government here, could not overcome this principle, and for the remaining four justices, this principle controls no matter what the government interest asserted. So, I think the government has a difficult road ahead to persuade either the Federal Circuit, or should it come to that, the Supreme Court, that viewpoint based versus content based is a distinction of constitutional significance in this context (even if the government can show the provision is not viewpoint based, which by no means is a given).”<sup>86</sup>

Indeed, this past April the expert's predictions proved to be correct when the Federal Court of Appeals denied the rehearing petition.<sup>87</sup>

The USPTO has until July 11 to file an appeal with the Supreme Court. In the meantime, the agency has issued its latest guidance—still instructing its examiners to “tentatively refuse trademarks that violate the

<sup>80</sup> *Id.* (quoting Anne Gilson LaLonde).

<sup>81</sup> *Tam*, 137 S. Ct. at 1759.

<sup>82</sup> *Tam*, 137 S. Ct. at 1759.

<sup>83</sup> Trevor Little, “A steep uphill battle”: experts pessimistic over USPTO bid for U-turn on scandalous marks, *World Trademark Rev.* (Apr. 10, 2018).

<sup>84</sup> See generally *Matal v. Tam*, 137 S. Ct. 1744 (2017); see also *In re Tam*, 808 F.3d 1321 (Fed. Cir. 2015).

<sup>85</sup> Trevor Little, “A steep uphill battle”

<sup>86</sup> Trevor Little, “A steep uphill battle” (quoting Marsha Gentner, Senior Counsel at Dykema)

<sup>87</sup> Bill Donahue, *Federal Circuit Won't Rethink 'Scandalous' Trademark Ruling*, *Law 360* (June 19, 2018), <https://www.law360.com/articles/1032891/fed-circ-won-t-rethink-scandalous-trademark-ruling>.

scandalous rule.”<sup>88</sup> Whether the USPTO decides to pursue the argument of a limited public forum remains undetermined, although it seems the likelihood of the Supreme Court siding with the government looks equally improbable.

#### IV. TOWARDS NARROWER EXCLUSIONS THAT WILL SURVIVE FIRST AMENDMENT SCRUTINY

As these expert legal minds speculated, the likelihood of courts siding with the government was improbable. Perhaps a clue to the best way to circumvent the situation and place some sort of rational limit on what can be registered can be found in the words of the court opinions themselves. In the *Brunetti* decision, the concurrence opinion proposes that they “narrow the immoral-scandalous provision’s scope to obscene marks in order to preserve its constitutionality,” which Judge Moore quickly points out should be a task left for the legislative body, not the judiciary.<sup>89</sup>

The concurring judges are not the only ones that are suggesting a change to the Lanham Act’s “scandalous” provision. Ms. Gilson in Trevor Little’s article also suggested that Congress should rewrite §2(a)’s “scandalous” provision to bar only obscene material from registration.<sup>90</sup> Legislative changes to section 2(a) of the Lanham Act should be more extensive than just narrowing it to obscene materials. There is an opportunity to frame the wording in a way that the government can still protect the interests of the public without infringing on the rights of the American populace.

To address the government’s concern with the disparaging and sexually explicit nature of the marks in a way that would be consistent with the First Amendment, Congress can amend the Lanham Act’s §2(a) to allow refusal to register marks that consist of any material that falls within any of the act’s exceptions. The first set of exceptions are for marks that are obscene or lewd in a way that violates an individual’s right to be

left alone. The second set are for marks that are in any way designed to organize, promote, encourage, incite, participate in, or carry out any type of criminal activity or hate action based on race, nationality, gender, political, or religious affiliation. Rationally, this makes sense because the government would be obliged to register any mark regardless of whether it was disparaging or contained scandalous subject matter, but it is not in any manner obliged to assist in the further protection or legitimization of any mark that seeks to spread an obscene or negative message, or otherwise espouse criminal activity in any form.

Amending Section 2(a) in this manner would also ensure that it would withstand any strict scrutiny challenge or intermediate scrutiny challenge under the *Central Hudson* standards. Specifically, the government restricts speech based on content when a law applies to particular speech because of the topic discussed or the idea or message expressed. Content-based statutes are presumptively invalid. To survive, such statutes must withstand strict scrutiny review, which requires the government to prove that the restriction furthers a compelling interest and is narrowly tailored to achieve that interest. If a statute regulates speech based on its content, it must be narrowly tailored to promote a compelling government interest, and if a less restrictive alternative is available to serve that purpose, the legislature must use it. Strict scrutiny applies whether a government statute bans or simply places barriers to exercising protected speech. The government’s content-based burdens must satisfy the same rigorous scrutiny as its content-based bans.<sup>91</sup>

Each part of the proposed amendment is narrowly tailored to promote a government interest that courts have recognized as compelling. For the exception of obscene marks, the Supreme Court has upheld government limitations on free speech in relation to the production and distribution of obscene materials.<sup>92</sup>

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<sup>88</sup> *Id.*

<sup>89</sup> *Brunetti*, 877 F.3d at 1355.

<sup>90</sup> Trevor Little, “A steep uphill battle”

<sup>91</sup> *Brunetti*, 877 F.3d at 1341-42; see also *Playboy*, 529 U.S. at 812.

<sup>92</sup> *Roth v. United States*, 354 U.S. 476 (1957) (holding that the ‘lewd’ and ‘obscene’ are certain well-defined and narrowly limited classes of speech, the prevention and punishment of which have never been thought to raise any Constitutional problem. That such speech has no essential part in the development of ideas and are of such small social value that any benefit one could gain from them is outweighed by the interest in maintaining morality) (emphasis added).

The Supreme Court has also upheld limitations on speech that provokes “imminent lawless action.”<sup>93</sup> Similarly, the Court has upheld limitations on speech that can cause harm to others.<sup>94</sup> Thus, theoretically, if a mark owner were to attempt to register a mark that stated: “Kill a Pedophile; God Will Thank You,” since it incites and encourages criminal activity, it would be justifiably rejected by the USPTO under the amended provision.

In relation to the hate action portion of the amendment, the Supreme Court has on various occasions expressed that combatting discrimination is a compelling government interest. This ideal, first articulated in a 1957 Justice Frankfurter concurrence, that state action requiring “a citizen to . . . forego even a part of so basic a liberty as his political autonomy” serves not simply a legitimate, but, still more, a compelling state interest.<sup>95</sup> Eventually, the compelling interest requirement seeped into all race or religion-based claims requiring strict scrutiny review and a narrowly tailored state action to serve that state action.<sup>96</sup> Further, the court applies intermediate scrutiny to sex-based claims.<sup>97</sup> In short, where the government finds that there is a compelling, legitimate interest to restrict speech—e.g., rejecting a mark that is promoting hate action based on race, nationality, gender, political, or religious affiliation—it will be able to do so.

Should the Board conclude that these decisions should be examined under the commercial speech standard, the amended provisions would be subject to the four-part

test delineated under *Central Hudson*.<sup>98</sup> In the case of the “scandalous or immoral” provision, because it has been amended to only obscene material, it clearly meets the first prong of the *Central Hudson* test, which requires first confirming that the speech “concern lawful activity and not be misleading.”<sup>99</sup> Rather, the amended provision is concerned with whether the mark would be considered obscene to a substantial composite of the general public.

*Central Hudson*’s second prong, requiring a substantial government interest, is also met. The government’s interest in barring the obscene material is in protecting public order and morality. The Supreme Court has previously set a precedent indicating that where obscenity is involved, suppression is justified.<sup>100</sup> The Supreme Court reinforced that the government has a substantial interest in protecting the public obscene material, even if in a narrower form in *Pacifica* years later.<sup>101</sup> The Court explained that “references to excretory and sexual material . . . surely lie at the periphery of First Amendment concern.”<sup>102</sup> The Court allowed this suppression due to the unique nature of radio broadcasting. Specifically, it comes into our homes and is part of the daily lives of all Americans, young and old, whether they have the ability to read or write; thus, the Court—stressing the narrowness of the holding—found the individual’s right to be left alone plainly outweighed the First Amendment rights of an intruder.<sup>103</sup> Under the revised provision, the USPTO would be able to reject applications with marks that had obscene or lewd

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<sup>93</sup> *Brandenburg v. Ohio*, 395 U.S. 444 (1969) (holding that the constitutional guarantees of free speech and free press do not permit a state to forbid or proscribe advocacy of the use of force or of law violation except where such advocacy is directed to inciting or producing imminent lawless action and is likely to incite or produce such action).

<sup>94</sup> *Schenck v. United States*, 249 U.S. 47 (1919) (holding that Congress had the right to evaluate in every case whether the words used in circumstances presented were of such nature as to create a clear and present danger that they would bring about the substantive evils that Congress had a right to prevent).

<sup>95</sup> *Sweezy v. New Hampshire*, 354 U.S. 234, 265 (1957) (Frankfurter, J., concurring in the result).

<sup>96</sup> See, e.g., *Williams-Yulee v. Fla. Bar*, 135 S. Ct. 1656, 1665–66 (2015) (holding that the statute was constitutional because it was narrowly tailored to meet government’s interest in maintaining an impartial judiciary, regardless of viewpoint or means of solicitation during political campaigning); *Regents of Univ. of Cal. v. Bakke*, 438 U.S. 265, 269 (1978) (holding that with regard to state universities, the state has a substantial interest that legitimately may be served by a properly devised admissions program involving the competitive consideration of race and ethnic origin).

<sup>97</sup> See *Craig v. Boren*, 429 U.S. 190, 197 (1976) (holding that gender did not represent a legitimate, accurate proxy for the regulation of drinking and driving, and therefore, the classification was not substantially related to the achievement of a legitimate government objective).

<sup>98</sup> *Central Hudson*, 447 U.S. 557 at 566.

<sup>99</sup> *Id.*

<sup>100</sup> See generally *Roth*, 354 U.S. 476 (1957).

<sup>101</sup> *FCC v. Pacifica Foundation*, 438 U.S. 726, 738-41 (1978) (upholding the constitutionality of an FCC declaratory order holding an afternoon radio broadcast was indecent and sanctionable).

<sup>102</sup> *Id.* at 742.

<sup>103</sup> *Id.* at 749-50.

material, especially if they related to clothing brands using the *Pacifica* logic. This is because of the lack of predictability and control involved in marks that are used in clothing and accessories. An individual cannot control what they can and cannot see walking towards them or what they encounter in public. There is always an element of surprise. Therefore, here, just like in *Pacifica*, the government could reject marks it considers obscene or lewd.

The third prong of *Central Hudson* requires that the regulation directly advance the government's asserted interest.<sup>104</sup> Because the Supreme Court has previously set a precedent allowing for the suppression of certain well-defined and narrowly limited classes of speech considered "lewd" or "obscene," the amended provision is written in a way that would directly advance the government's asserted interest.<sup>105</sup> Unlike the court's analysis in *Brunetti*, in this case, not having § 2(a) federal registration does prevent applicants having a mark with obscene material from advertising through general mail, television, radio and many other public venues, including billboards.<sup>106</sup>

Finally, the fourth prong of *Central Hudson* ensures the regulation is not more extensive than necessary to serve the regulation's interest. As mentioned *supra*, in *Brunetti*, the USPTO's previous inconsistent application of the "immoral or scandalous" provision created uncertainty and undermined the likelihood that the provision had been properly tailored. This was largely because marks with similar or identical marks could get a different outcome depending on the examiner reviewing them.<sup>107</sup> In contrast, the amended provision is more narrowly tailored to reject only obscene or lewd material that would violate an individual's right to be left alone over a registrant's First Amendment right. This ensures that examiners will be consistent in their review, rejecting only those marks which meet that standard.

Similarly, analyzing the amended disparagement provision: "designed to organize, promote, encourage, incite, participate in, or carry out any type of hate action or criminal activity" under the relaxed, intermediate scrutiny outlined in *Central Hudson*, one would get a very different outcome. Under *Central Hudson*, a restriction of speech must serve "a substantial interest," must "directly advance the government's interests," and be "narrowly drawn."<sup>108</sup> In *Tam*, the government's stated interests were found to have been too broad because the clause, as written, discriminated against trademarks that disparaged against "any person, group, or institution."<sup>109</sup>

As Federal Appeals Judge Reyna asserted in *In re Tam*, commerce "is disrupted by trademarks that 'involv[e] disparagement of race, gender, ethnicity, national origin, religion, sexual orientation, and similar demographic classification.'"<sup>110</sup> But, unlike the previous disparagement provision, the proposed amendment is narrowly drafted and split into two categories; one that addresses "criminal activity" and one that addresses "hate action." If *Tam* were to come under review with the proposed amendments, it would survive because it does neither. "The Slants" does not encourage criminal activity and it does not incite hate action on any of the asserted bases. The amended provisions do what they were narrowly tailored to do: prevent the disparagement of persons based on the stated criteria, akin to an anti-discrimination clause, and in this way, serve the interest asserted and surviving First Amendment constitutional review.

The third prong of *Central Hudson* requires the regulation directly advance the government's asserted interest.<sup>111</sup> Here, once again, precedent has been set in cases relating to speech that can cause or incite criminal activity or could cause harm to others.<sup>112</sup> With this precedent in mind, the amended disparagement provision is written in a way that would directly advance the government's asserted interest because it

<sup>104</sup> *Central Hudson*, 447 U.S. at 566.

<sup>105</sup> *Roth v. United States*, 354 U.S. 476 (1957).

<sup>106</sup> *Brunetti*, 877 F.3d at 1353.

<sup>107</sup> See *Brunetti*, 877 F.3d at 1353 (quoting *Reno*, 521 U.S. at 868).

<sup>108</sup> *Central Hudson*, 447 U.S. at 566.

<sup>109</sup> *Tam*, 137 S. Ct. at 1749.

<sup>110</sup> *In re Tam*, 808 F.3d 1321, 1380-81 (Fed. Cir. 2015).

<sup>111</sup> *Central Hudson*, 447 U.S. at 566.

<sup>112</sup> See *Brandenburg v. Ohio*, 395 U.S. 444 (1969); *Schenck v. United States*, 249 U.S. 47 (1919).

would greatly limit the mark owner's venues, platforms, and/or modes of communicating that message to the public. Unfortunately, much like in *Brunetti*, not having § 2(a) federal registration does not fully prevent applicants having a mark with material that is "designed to organize, promote, encourage, incite, participate in, or carry out any type of hate action or criminal activity," from using it, but the government could greatly limit its impact to the general public if it violates an individual's right to be left alone.<sup>113</sup>

Finally, the fourth prong of *Central Hudson* ensures that the regulation is not more extensive than necessary to serve the regulation's interest. The long-standing practice of the USPTO under the previously existing disparaging clause was largely a viewpoint-based review.<sup>114</sup> This resulted in the rejection of marks the USPTO examiners found to be negative and disparaging in some form.<sup>115</sup> Yet the USPTO approves marks that refer to particular ethnic groups or religions in positive or neutral ways—for example, NAACP, THINK ISLAM, NEW MUSLIM COOL, MORMON SAVINGS, JEWISHSTAR, and PROUD 2 B CATHOLIC.<sup>116</sup> Thus, the previous disparagement provision was used to deny additional protection to speech the USPTO deemed offensive in some way.

The amended provision is viewpoint neutral, shifting the focus, not on the negativity or positivity of the mark, but on its potential for getting others to "organize, promote, encourage, incite, participate in, or carry out any type of hate action or criminal activity." This more narrowly tailored provision achieves two goals: it gives much clearer direction to eliminate viewpoint discretion and it ensures that the regulation does not go further than needed to serve the government's interests.

## CONCLUSION

In closing, as the experts have suggested, the USPTO has an uphill battle convincing the Supreme Court to overturn the decision to bar registration on scandalous and immoral marks with the way the Lanham Act's §2(a) is currently written. Indeed, the sounder path for the government is to introduce narrowly tailored amendments to §2(a)'s provisions so that they allow the USPTO to bar obscene material and material that would disrupt commerce due to its disparaging nature and potential to incite criminal activity. Whether legislation can actually be passed by Congress on this issue is an entirely different question and is beyond the scope of this paper, but this proposed amendment should survive a First Amendment constitutional challenge.

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<sup>113</sup> *Brunetti*, 877 F.3d at 1353.

<sup>114</sup> *In re Tam*, 808 F.3d 1321, 1330 (Fed. Cir. 2015).

<sup>115</sup> *Id.*, at 1330. (e.g. REDSKINS, Pro-Football, Inc. v. Blackhorse, No. 1-14-CV-01043-GBL, 112 F. Supp. 3d 439, 2015 U.S. Dist. LEXIS 90091, 2015 WL 4096277 Va. (July 8, 2015); STOP THE ISLAMISATION OF AMERICA, *In re Geller*, 751 F.3d 1355 (Fed. Cir. 2014); THE CHRISTIAN PROSTITUTE (2013); HAVE YOU HEARD THAT SATAN IS A REPUBLICAN? (2010); DEMOCRATS SHOULDN'T BREED (2007); 2 DYKE MINIMUM (2007); WET BAC/WET B.A.C. (2007); FAGDOG (2003); N.I.G.G.A. NATURALLY INTELLIGENT GOD GIFTED AFRICANS (1996); a mark depicting a defecating dog, *Greyhound Corp. v. Both Worlds, Inc.*, 6 U.S.P.Q.2d 1635 (T.T.A.B. Mar. 30, 1988) (found to disparage Greyhound's trademarked running dog logo).

<sup>116</sup> *In re Tam*, 808 F.3d at 1337.

# ACCESS TO MEDICINE AND INTELLECTUAL PROPERTY: THE NEW HOSTAGE IN A GLOBALIZED WORLD

Sharon L. Torres Ferreris

## INTRODUCTION

Access to medicine has been a controversial topic over the years. As new technology and scientific advances occur in developed countries more controversies are certain to rise regarding the access to medicine, the cost of medicine production and distribution, scientific advancements and licensing costs. Access to medicine and health first appeared in the World Health Organization (WHO) Constitution<sup>1</sup> in 1946 and later appeared in the Universal Declaration of Human Rights in 1948. Since then, progressive legislation has been made to ensure access to health facilities, goods and services. Over the years, the right to access medicine has also included access to new technologies that are products of medical advances.<sup>2</sup> The WHO conducted a ten-year study called *Ten years in public health, 2007–2017*, where it found that more than two billion people have no access to basic medicines and health care.

Basic medicines in developing countries can be the difference between life and death for many.<sup>3</sup> Low economic growth in developing countries could lead to people generating low income. That might mean that people would have to choose between buying groceries and paying rent or buying medicine. Governments over the years have tried to provide their citizens with a good quality of life, but it has proven to be more complex than many people think. Varying patent law, trade, tariffs and even government corruption and medicine counterfeit have become an impossible hurdle to overcome.

## I. ACCESS TO MEDICINE

The cost of medicine in many countries has become a top priority. Having proper health and access to medicine can be too expensive for some governments. Governments must work through the economic difficulties that their countries might have to guarantee health to the public. In an effort to help countries develop stable health systems, many public health practitioners have been

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<sup>1</sup> See the World Health Organization Constitution (The enjoyment of the highest attainable standard of health is one of the fundamental rights of every human being without distinction of race, religion, political belief, economic or social condition.) <http://apps.who.int/gb/bd/PDF/bd47/EN/constitution-en.pdf?ua=1>

<sup>2</sup> Ten years in public health, 2007–2017: report by Dr Margaret Chan, Director-General, World Health Organization

<sup>3</sup> Harvard International Law Journal The Economics of Access to Medicines: Meeting the Challenges of Pharmaceutical Patents, Innovation, and Access for Global Health

very vocal about how patents tend to increase the cost of medicine. Public practitioners have the important task of protecting the health of the people and communities. Public health seeks to promote healthy lifestyles, research diseases and limit health disparities. Public health policies are important for the improvement, prevention and protection of the general population's health. Access to medicine is as important and intertwined with public health. Full access to medicine provides fewer sick people and leads to a better quality of life. This is important for the developing countries; having a good quality of life by having access to medicine helps the bottom line of any government's economy. This further translates to more jobs and more economic development.

Underdeveloped countries have serious problems with public health but also with access to medicine. Counterfeit and generic medicines cause serious problems for the people and the government of these countries. Therefore, intellectual property plays an important role in a globalized economy. Having proper intellectual property laws helps countries to provide quality medicine and medical devices while regulating the industry. Having intellectual property regulations in place will ensure that any country's citizens will have access to good quality medicine and medical devices, ensuring good health and continuous development of the country.

Countries need to have good strategies to balance public health and intellectual property laws. Governments should allow new innovations to occur while ensuring access to medicine and proper health care. Some international efforts are being made to safeguard public health while making sure that new innovations are made. For example, the Agreement on Trade-Related Aspects of Intellectual Property Rights, better known as the TRIPS Agreement<sup>4</sup>, promotes and supports broad access to safe and affordable medicines.

The TRIPS Agreement<sup>5</sup> covers the following areas of intellectual property: copyright and related rights (i.e.

the rights of performers, producers of sound recordings and broadcasting organizations); trademarks including service marks; geographical indications including industrial designs; and patents including the protection of new varieties of plants; the layout designs of integrated circuits; and undisclosed information including trade secrets and test data.

The TRIPS Agreement, signed in 2001, included the agreement made in the DOHA Rounds.<sup>6</sup> The DOHA Rounds, as an international agreement, not only included regulations for countries to address public health, the cost of making medication and the access to medicine but also included flexibilities for countries regarding patents that were provided by the agreement. These flexibilities include a compulsory license issued by a government authority or court to make certain uses of a patent invention without the patent holder is convert. The agreement has the effect of lowering the costs of medicine and granting greater access to medicine. All states should decide how to enforce intellectual property rights by using methods that do not restrict legal trade of medicines while providing safeguards that will deter the abuse of the patent holder. The state that had their patent infringed may process the other state criminally or it may ask for other penalties including remuneration.

The TRIPS Agreement flexibilities provide for a compulsory licensing<sup>7</sup>, where the authorities license companies or individuals other than the patent owner to use the rights of the patent. This grants the company or individual sole control over the process of making the medicines. Consequently, the medicine may lack purity during its manufacture. As a result, there may be more problems for public health, access to medicine and medical devices. Therefore, having a comprehensive mechanism to address all aspects is necessary.

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<sup>4</sup> TRIPS: Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 299, 33 I.L.M. 1197 (1994) [hereinafter TRIPS Agreement]

<sup>5</sup> World Trade Organization Overview: the TRIPS Agreement [https://www.wto.org/English/tratop\\_e/trips\\_e/intel2\\_e.htm](https://www.wto.org/English/tratop_e/trips_e/intel2_e.htm)

<sup>6</sup> The Doha Round is the latest round of trade negotiations among the WTO membership. Its aim is to achieve major reform of the international trading system through the introduction of lower trade barriers and revised trade rules. [https://www.wto.org/english/tratop\\_e/dda\\_e/dda\\_e.htm](https://www.wto.org/english/tratop_e/dda_e/dda_e.htm)

<sup>7</sup> When the authorities license companies or individuals other than the patent owner to use the rights of the patent—to make, use, sell or import a product under patent (i.e. a patented product or a product made by a patented process)—without the permission of the patent owner. Allowed under the WTO's TRIPS (intellectual property) Agreement provided certain procedures and conditions are fulfilled. [https://www.wto.org/english/thewto\\_e/glossary\\_e/compulsory\\_licensing\\_e.htm](https://www.wto.org/english/thewto_e/glossary_e/compulsory_licensing_e.htm)

## II. INTELLECTUAL PROPERTY

The World Intellectual Property Organization (WIPO) defines intellectual property<sup>8</sup> as “creations of the mind, such as inventions; literary and artistic works; designs; and symbols, names and images used in commerce.” Intellectual property is protected by laws. For example, patents, copyright and trademarks enable people to earn recognition or financial incentives and benefit from what they invent or create. WIPO also defines patents as an “exclusive right granted for an invention, which is a product or a process that provides, in general, a new way of doing something, or offers a new technical solution to a problem”.<sup>9</sup>

Accordingly, medicine, as intellectual property, is a new product invented to solve disease problems. Further, the inventors can gain financial benefits and recognition.

Members<sup>10</sup> of the World Trade Organization (WTO) can be any state or customs territory that has full autonomy in the conduct of their trade and agrees to the WTO terms. For example, all WTO members “must make their trade policies<sup>11</sup> transparent by notifying the WTO about laws in force and measures adopted.” The TRIPS Agreement treats patents as part of the intellectual property Article, which requires the same transparency as trade for all the members of the WTO. This means that only the WTO members must abide by the rules of the TRIPS Agreement concerning patents. As of July 29, 2016, the WTO has 164 members and observants. It is important to note that the WTO regulates the global rules of trade between countries and that members not in compliance with the regulations can be sanctioned.



<sup>12</sup>Illustration 1WTO Members and Observers Map

The TRIPS Agreement<sup>13</sup> requires member countries to produce protectable patents for any invention, whether products or processes, in all fields of technology without discrimination. The TRIPS Agreement grants access to all patents and inventions in Article 27.1. The Article requires that patents be available without discrimination based on the place of invention and whether products are imported or locally produced.

Many of the new medical developments in intellectual property have been made by the pharmaceutical industry. Governments need to ensure that their pharmaceuticals comply with the TRIPS Agreement since they are the ones penalized. These methods help to guarantee that medicines are done with great quality and that the necessary research has been done.

## III. CHARTERS, TREATIES, AND INTERNATIONAL ORGANIZATIONS

In September of 2015, the members of the United Nations (UN) adopted the 2030 Agenda for Sustainable Development, which includes eradicating poverty and hunger, protecting the planet, ensuring healthy lives, and promoting well-being for everyone of all ages. New negotiations are underway before the 2030 Agenda for Sustainable Development is met and all the members of the UN can work towards a common goal. However, generating a compromise between the UN members to create a new treaty will prove to be a difficult task. The difficulties are illustrated by the different treaties previously adopted by UN members, such as access to new development, sanctions and tariffs. Different treaties have different visions on how to prioritize the topic at hand, and that may lead to incongruences in making the new treaty. Previous treaties have a different path when it comes to developed and developing countries. The different advantages that one country may have over another are always difficult to balance. For example, two developed countries might come to an understanding to lower their tariff but less developed countries can take advantage of that negotiation.

<sup>8</sup> World Intellectual Property Organization <http://www.wipo.int/about-ip/en/>

<sup>9</sup> Id. <http://www.wipo.int/patents/en/>

<sup>10</sup> [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org3\\_e.htm#join](https://www.wto.org/english/thewto_e/whatis_e/tif_e/org3_e.htm#join)

<sup>11</sup> Overview: a navigational guide [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm1\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm1_e.htm)

<sup>12</sup> Available at: [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm)

<sup>13</sup> TRIPS Agreement Article 27.1

One of the treaties that proves to be the most difficult to align with the new 2030 Agenda for Sustainable Development will be the TRIPS Agreement because the public health objectives of the 2030 Agenda are being enforced differently in every country. Developed countries need to make the changes faster than the less developed countries. That method can be a disadvantage to developed countries and it also means that public health changes will take longer to implement in less developed countries.<sup>14</sup>

The United Nations Charter Article I<sup>15</sup> states that the “four main purposes of the Charter are to maintain peace, develop friendly relations among countries, achieve international cooperation in solving economic, social, cultural, or humanitarian international problems and harmonize the actions of nations to achieve the same goals.” Article I demonstrates the UN’s purpose to have “respect for the principle of equal rights and to achieve international co-operation in solving international problems . . . humanitarian character, and in promoting and encouraging respect for human rights.” It is certain that public health and the access to medicine is an issue of equal rights and human rights; therefore, the United Nations members should have this purpose as a high-level of importance.

The 2030 Agenda is in accordance with the DOHA Declaration in respect to the flexibilities available to members, allowing a WTO Member to create patent legislation provisions for use without authorization of the patent holder, according to the Agreement on Trade-Related Aspects of Intellectual Property Rights for developing countries. According to the 2030 Agenda, one of the purposes is to enforce the Agenda for all the WTO members under the TRIPS Agreement. In accordance with the UN’s purpose, better access to medicine is a public health and humanitarian issue ensuring a better quality of life for developing and less developed countries. This is where the Report of the United Nations Secretary-General’s High-Level Panel on Access to Medicines was born.

The DOHA Declaration on the TRIPS Agreement and Public Health were adopted by the WTO. These negotiations between countries about trade and public health started before the DOHA Agreement but were finally adopted under it. The intention behind the TRIPS Agreement was to protect intellectual property, including patents for medicine, but it was aware of the public health needs of developing and less developed countries. Therefore, the TRIPS Agreement added some provisions that are more flexible for each country. The TRIPS Agreement even specifies awareness concerning medicine prices that intellectual property protection may cause. This means that even when different governments reach consensus on the DOHA Agreement, they still have some concerns about the impact that the treaty might have on developing and less developed countries.

Not only were the WTO members and communities concerned but this was also the main topic of the September 2016 Report for the United Nations Secretary-General’s High-Level Panel on Access to Medicines. The report has provoked many different sentiments in different communities. The cost implication on patents and the access to medicine in less developed countries has become the main focus in the international community. The report tackles the issues with ideas such as giving all the patents to the universities, taking away government tax exemptions among others that will be discussed next.

#### **IV. THE REPORT OF THE UNITED NATIONS SECRETARY-GENERAL’S HIGH-LEVEL PANEL ON ACCESS TO MEDICINES**

In September of 2016, The Report of the United Nations Secretary- General’s High-Level Panel on Access to Medicines was published. As previously stated, the 2030 Agenda for Sustainable Development<sup>16</sup> adopted by the members of the United Nations included several goals and targets. The agreed upon Goal 3 is to “Ensure healthy lives and promote well-being for all at all ages.” This is an important goal for the overall health of the international community.

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<sup>14</sup> United Nations. (2017). Report of the United Nations Secretary-General’s High-Level Panel on Access to Medicine. United Nations

<sup>15</sup> United Nations. (2015). Charter of the United Nations and Statute of the International Court of Justice. United Nations

<sup>16</sup> UN General Assembly, Transforming our world: the 2030 Agenda for Sustainable Development, 21 October 2015, A/RES/70/1, available at: <http://www.refworld.org/docid/57b6e3e44.html>

The report<sup>17</sup> states that “voluntary licenses<sup>18</sup>, entered into between right holders (patent holders) and third parties facilitate the market entry of more affordable health technologies, have helped to lower treatment costs in many countries.”<sup>19</sup> This is an effective way to distribute and deliver medicine where it is most needed. This is also indicated in the TRIP Agreement in its article 31b. However, for “national emergencies”, “other circumstances of extreme urgency” or “public non-commercial use” (or “government use”) or anti-competitive practices, there is no need to try for a voluntary license.”<sup>20</sup>

The TRIPS Agreement allows developed and less developed countries to negotiate with private companies to supply their population with more accessible medicine. This has been successful in many countries. For example, the European Union, which consists of 28 members inside the WTO, has a single external policy for tariff and trade. These regulations help companies understand the customs procedures on exporting and importing goods in different countries and it helps facilitate trade. If the compulsory clause in the TRIPS Agreement is working to lower costs, then the United Nations should focus on working on a solution to make this the norm between a private company and the public sector.

On the other hand, the Report states that “the policies of public funders of health technology and R&D<sup>21</sup> can also play an important role in enhancing health technology innovation and access.”<sup>22</sup> The United States, for instance, holds a central position in health technology innovation. The country’s R&D and access policies influence other actors, including private and public-sector donors and foundations, and have an impact on access to the fruits of technology worldwide. The introduction of the 1980 Bayh-Dole Act in the United States significantly changed academic research by allowing universities and public research institutions to

patent the results of federally-funded research and license private enterprises to develop them.”

This means that private enterprises can license inventions made by a university, while the university can continue to receive funds from the government to keep doing research. One purpose of the Bayh-Dole Act is to use “private facilities which would preclude them from accepting research funding from other sources to expand, to aid in completing or to conduct separate investigations closely related to research activities sponsored by the government.”<sup>23</sup>

This provision of the Bayh-Dole Act specifically discusses accepting private funding to aid in completing investigations or to conduct separate research closely related to the original study, meaning that the private funding would be fundamental to the end results of the research or to the betterment and parallel research of the original one. Taking away this funding could mean that ongoing research could be at risk of not being finished, or that new inventions and properties might not be discovered. For the new research, this can mean the request to end new medicines and treatments, because without the findings, more investment will be required, and often universities do not have enough economic resources to ensure the continuation of research. This can also mean a substantial increase in the final product price because public funding could be eliminated or could become the only type of funding available for researchers. If public funding becomes the only means for subsidizing research, then governments would need a return on investment for the final product so that they can continue to fund new and existing research.

The report also says that “Strong, enforceable policies on data sharing and data access should be a condition of public grants. Public funding agencies should . . . encourage patenting and licensing practices that benefit public health, including the use of non-exclusive licenses,

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<sup>17</sup> United Nations Secretary-General’s High-Level Panel on Access to Medicines, page 8, United Nations, 2016

<sup>18</sup> Voluntary License: A license granted by a patent holder to a third party to produce and/or market and distribute a patented product, usually in exchange for a royalty on net sales and certain other conditions (for example, geographical restrictions on where the product can be sold). (United Nations Secretary-General’s High-Level Panel on Access to Medicines, United Nations, 2016)

<sup>19</sup> TRIPS: Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 299, 33 I.L.M. 1197 (1994) [hereinafter TRIPS Agreement]

<sup>20</sup> Compulsory Licensing of pharmaceuticals and TRIPS: [https://www.wto.org/english/tratop\\_e/trips\\_e/public\\_health\\_faq\\_e.htm](https://www.wto.org/english/tratop_e/trips_e/public_health_faq_e.htm)

<sup>21</sup> Research and Development: R&D

<sup>22</sup> United Nations Secretary-Generals’ High-Level Panel on Access to Medicines, page 8, United Nations, 2016

<sup>23</sup> 37 CFR 401.1

the donation on intellectual property rights, [and] participation in public sector patent pools . . .”<sup>24</sup>

## V. CONCLUSION

Public health and access to medicine is something that governments should have in mind when structuring intellectual property laws in their countries. Governments must be able to balance a budget and to have a better management of their spending and funds allocations to ensure better access to medicine and health to their citizens while ensuring intellectual property law that helps people access affordable medicine. Having a better understanding of the funds they acquire will help them to better manage the public health budget in their respective countries. This action will prove to be easier and will provide more effective use of future spending towards improving their country population’s health. If it is true that patents generate new economies and can increase the wealth of a country, public health can have a negative impact in that growth if the populations’ health is compromised. Whereas countries might want to ensure their economic growth rather than implement secure regulations to maintain or to improve the health of their population. This mechanism must be used if an epidemic or a pandemic is most likely to affect the population or even if the odds ratio (OR)<sup>25</sup> or the risk ratio (RR)<sup>26</sup> for an infectious disease proves to be high. However, a delicate balance needs to be achieved to prevent a potential economic imbalance and a failure in public health.

Private, public and non-profit sectors concur with the idea that the market will not address this problem and that special intervention needs to happen. This could result in

a health system being the victim of a hostage situation. While some profit is necessary to complete experiments, or give way to new ones, that does not mean that because profits will be low or nonexistent, all public health should be at risk. The Universal Declaration of Human Rights<sup>27</sup> states in its preamble that “whereas the peoples of the United Nations have in the Charter reaffirmed their faith in fundamental human rights, in the dignity and worth of the human person and in the equal rights of men and women and have determined to promote social progress and better standards of life in larger freedom.” Intellectual property legislation does not need to be the impasse that stops the invention and health flow. On the contrary, intellectual property should be the solution that regulates the quality and usefulness of the invention so that every person can benefit and be able to use it.

Open collaborative research needs to encourage more scientists and inventors to work together to better the chances when dealing with public health issues that need an immediate response. Additionally, public-private partnerships and product development partnerships are a great gateway to increase non-profit and philanthropic organizations’ involvement in the public health problems of the world. These partnerships can do the research and achieve more access to funding, and they are usually located at the center of the poorest communities. Being near the poorest communities can help identify the real needs and threats to public health while allowing better access to medicine that communities might need to ensure sustainable development goals and overall good health of humankind.

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<sup>24</sup> Id. United Nations

<sup>25</sup> An odds ratio (OR) is another measure of association that quantifies the relationship between an exposure with two categories and health outcome. (<https://www.cdc.gov/ophss/csels/dsepd/ss1978/lesson3/section5.html>)

<sup>26</sup> A risk ratio (RR), also called relative risk, compares the risk of a health event (disease, injury, risk factor, or death) among one group with the risk among another group. It does so by dividing the risk (incidence proportion, attack rate) in group 1 by the risk (incidence proportion, attack rate) in group 2. (<https://www.cdc.gov/ophss/csels/dsepd/ss1978/lesson3/section5.html>)

<sup>27</sup> Universal Declaration of Human Rights Available at: <http://www.un.org/en/universal-declaration-human-rights/>

# THE PEOPLE OF THE STATE OF NEW YORK V. SERGEY ALEJNIKOV<sup>1</sup> AND UNITED STATES V. SERGEY ALEJNIKOV

## Criminal Liability for Trade Secret Misappropriation

Heather Bowen

### SUMMARY

There has been and likely always will be tension between preventing harm to owners of trade secrets and allowing employees freedom to move from one job to another. The New York Court of Appeals, however, has helped draw the line. The case of *United States v. Sergey Aleynikov* illustrates the ability of the federal government to prosecute the theft of a company's internal trade secret as it relates to high-frequency trading. Specifically, this case served as the first instance of prosecutors using the Economic Espionage Act ("EEA") to crack down on improper use of source code as it relates to high-frequency trading. The primary issue in this case was whether the defendant's actions constituted legally sufficient evidence to establish that he made a tangible reproduction or representation of the source code and did so with the intent to appropriate its use, within the meaning of the unlawful use statute.<sup>2</sup> In addition, the court considered whether the evidence stored on a hard drive

constituted tangible evidence for purposes of meeting the requirements for the alleged crime.

### BACKGROUND FACTS

In May 2007, the defendant Sergey Aleynikov was hired by the New York office of Goldman Sachs. He was a computer programmer and was employed as the Vice President in the firm's Equities Division. Aleynikov's responsibilities as a programmer included writing computer source code for Goldman Sachs' high-frequency trading ("HFT") system on securities and commodities markets including the New York Stock Exchange ("NYSE") and the NASDAQ Stock Market ("NASDAQ").<sup>3</sup>

HFT is an activity that allows programmers to make rapid decisions using a series of algorithms to generate trades or orders and create prices at which trading firms would be willing to buy and sell securities. Goldman Sachs uses its trading platform to obtain information on market movements and to execute

<sup>1</sup> *The People of the State of New York v. Sergey Aleynikov*, Appellate Division, First Department, New York State Supreme Court, [2017].

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

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

its trading decisions.<sup>4</sup> During Aleynikov's time of employment at Goldman Sachs, his salary started at \$275,000 USD per year and increased to \$400,000 in 2008. Goldman Sachs earned approximately \$300 million from high-frequency trading during the same year. Because of the high-frequency source code's value, Goldman Sachs took a number of steps to protect what the firm considered to be its proprietary information. This included Goldman Sachs limiting the number of individuals who were permitted access to the software, creating an information security group for monitoring potential security attacks, and having every employee sign both confidentiality agreements and nondisclosure agreements acknowledging that the employees were prohibited from using any of Goldman Sachs' information for its own objectives.<sup>5</sup>

While employed at Goldman Sachs, Aleynikov was authorized to access the firm's computer code which was maintained in a repository for authorized employees to subsequently work on the code. He was permitted to work on the computer code from home but only through Goldman's computer system remote log-in. Therefore, Aleynikov essentially had no need to transfer files on a separate network to work on the source code.

In June 2009, Aleynikov resigned from his position at Goldman Sachs and accepted a new position as Executive Vice President in the Platform Engineering division with Teza Technologies, LLC ("Teza"), a start-up high-frequency trading institution founded in 2009.<sup>6</sup> Teza was developing its trading system, needed to get the new system in place within six months, and requested that the team "move fast."<sup>7</sup> Teza Technologies agreed to pay Aleynikov triple his previous salary at \$1.2 million to develop its trading business, which would compete with Goldman Sachs.<sup>8</sup> Aleynikov ended his last week of working on any types of projects with Goldman Sachs on June 5th, 2009.

Pursuant to the company's month-long "garden period," Aleynikov remained on the payroll but was

not permitted to engage in any type of computer programming work. In addition, Aleynikov was required to return Goldman Sachs' property on June 5th and was not permitted to take either property or source code belonging to Goldman Sachs with him. This garden period policy was in place to prevent employees from taking any up-to-date information on company practices to a competitor employer and also to prevent Aleynikov and like employees from providing such information to a competitor employer. Therefore, because of this month-long garden period, Aleynikov's final day with the firm was approximately July 5th, 2009.

On June 1st and on June 5th, however, Aleynikov compressed hundreds of thousands of lines of encrypted source code from the Goldman Sachs' system as smaller files called "tarballs" that were then uploaded to a "subversion website"—a website designed to allow a user to move, copy and store source code—of the German server under the username "saleyn."<sup>9</sup> He later downloaded the source code to his home computer in New Jersey as well as onto a thumb drive which he retained for 33 days until his arrest. Aleynikov attempted to erase any trace of the files from his computer by deleting the history of computer commands inputted to upload and download the source code along with the "bash history."<sup>10</sup>

Goldman Sachs alleges that Aleynikov violated its confidentiality policy when Aleynikov took its intellectual property of which Goldman Sachs considered valuable and had undertaken significant steps to keep from being revealed. Aleynikov was arrested on July 3, 2009, and was still in possession of the source code. Police found no evidence that Aleynikov had attempted to sell or did in fact sell the source code to a third party. The evidence did, however, show that Aleynikov used some of the source code on one of Teza's servers and that he "made copies of the sections of Goldman Sachs' source code he thought could be helpful to him in building Teza's high-frequency trading platform."<sup>11</sup> Aleynikov admitted to uploading material from Goldman Sachs to

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<sup>4</sup> Id.

<sup>5</sup> Id.

<sup>6</sup> Id.

<sup>7</sup> *Supra*, note 1.

<sup>8</sup> Id. at 175.

<sup>9</sup> Id.

<sup>10</sup> Id.

<sup>11</sup> Defendant's reply brief in further support of his renewed motion for the trial order of dismissal, June 2, 2015 (defendant's reply brief) at 30.

the German server, choosing that server because it was not blocked by Goldman's security system, downloading the material from the German server to his personal devices, and erasing any trace of his actions because he knew they were against Goldman's security policies.<sup>12</sup>

There was no evidence that Aleynikov's actions led to Goldman Sachs' lost income or that Teza generated revenue from any of Goldman's source code. Nor was there evidence that Teza was motivated by an opportunity to take proprietary information from Goldman Sachs. Nonetheless, Teza fired Aleynikov for violating its policy that prohibits new programmers from unlawfully transferring proprietary information from prior employers.

## PROCEDURAL HISTORY

Sergey Aleynikov was first arrested and prosecuted under federal law. On February 11, 2010, a grand jury in the Southern District of New York indicted the defendant Sergey Aleynikov for theft of trade secrets, transportation of stolen goods, and illicit obtainment of data from a protected computer. The theft of trade secrets count is codified under the Economic Espionage Act (EEA) 18 U.S.C. § 1832(a)(2)<sup>13</sup> & (4)<sup>14</sup>. This section of the EEA attempts to prevent the theft of trade secrets used or intended for use in interstate commerce by one who knowingly "without authorization copies, duplicates, sketches, draws, photographs, downloads, uploads, alters, destroys, photocopies, replicates, transmits, delivers, sends, mails, communicates, or conveys such information"<sup>15</sup> or who "attempts to commit any offense described in paragraphs (1) through (3)."<sup>16</sup> Under the penal law, Sergey was committed as follows:

The defendant, in the County of New York, on or about June 1, 2009, with intent to appropriate himself and another, the use of secret scientific material, and having no right to do so and no reasonable ground to believe that he has such right, he makes a tangible reproduction and representation of such secret

scientific material by means of writing, photographing, drawing, mechanically and electronically reproducing and recording such secret scientific material.<sup>17</sup>

The second count was a further accusation by the grand jury for the transportation of stolen property in interstate commerce under the National Stolen Property Act (NSPA) 18 U.S.C. §2314. This section of the 2013 Act attempts to prevent the transportation of stolen property in interstate or foreign commerce. Under §165.07 of the penal law, Sergey was committed as follows:

The defendant, in the County of New York, on or about June 5, 2009, with intent to appropriate to himself and another, the use of secret scientific material, and having no right to do so and no reasonable ground to believe that he has no such right, he makes a tangible reproduction and representation of such secret scientific material by means of writing, photographing, drawing, mechanically and electronically reproducing and recording such secret scientific material.<sup>18</sup>

The third count was for Sergey's unauthorized computer access and his exceeding authorized access under the 2008 Computer Fraud and Abuse Act (CFAA) 18 U.S.C. §1030(a)(2)(C) which attempts to prevent one from knowingly or intentionally engaging in computer fraud and related activity. Under §156.30(1) of the penal law, Sergey was committed as follows:

The defendant, in the County of New York, on or about June 5, 2009, having no right to do so, copied, reproduced and duplicated computer data and computer programs and thereby intentionally and wrongfully deprived and appropriated from the owner thereof, to wit, Goldman Sachs, an economic value and benefit in excess of two thousand five hundred dollars.<sup>19</sup>

<sup>12</sup> *Supra*, note 1.

<sup>13</sup> 18 U.S.C. § 1832(a)(2).

<sup>14</sup> 18 U.S.C. § 1832(a)(4).

<sup>15</sup> *Supra*, note 16.

<sup>16</sup> *Supra*, note 17.

<sup>17</sup> *The People of the State of New York against Sergey Aleynikov*, Indictment.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

On July 16, 2010, Aleynikov moved to dismiss each count against him in a motion containing three counts. On September 3, 2010, the Honorable Denise Cote granted in part and denied in part Aleynikov's motion to dismiss. The court dismissed count 3 under the CFAA<sup>20</sup> but denied relief for counts 1 and 2 under the EEA and NSPA.

Aleynikov had a jury trial in the United States District Court for the Southern District of New York in December of 2010. He was convicted on the theft of trade secrets and transportation of stolen property. On December 23, 2010, Aleynikov filed a motion for acquittal or for a new trial in the alternative. The government filed its opposition to the motion on January 21, 2011. Then Aleynikov filed a reply on January 28, 2011. He was placed into the custody of the U.S. Marshal's Service on February 24, 2011, and filed an interlocutory Notice of Appeal to the Second Circuit regarding the revocation of his bail. Judge Cote ultimately denied his motion for acquittal or for a new trial in the alternative and sentenced Aleynikov to a prison term of 8 years and 1 month, in addition to a \$12,500 fine under the EEA and NSPA.

Aleynikov appealed the decision to the United States Court of Appeals for the Second Circuit on March 23, 2011. In September 2012, the Second Circuit reversed Aleynikov's convictions on the grounds that he did not violate the NSPA because the source code that Aleynikov uploaded and later downloaded did not constitute as stolen "any goods, wares, [or] merchandise" as defined under the statute.<sup>21</sup> In addition, the Second Circuit reversed Aleynikov's convictions on the grounds that he did not violate the EEA because Aleynikov had

not placed the source code used in Goldman Sachs' high-frequency trading system into the interstate or foreign stream of commerce as required under section (a) of the Act.<sup>22</sup>

## STATE COURT TRIAL AND APPEAL

After his acquittal in federal court, Aleynikov was arrested by the district attorney in New York and charged with violation of Penal Laws §165.07 (Unlawful Use of Scientific Material)<sup>23</sup> and §156.30(1) (Unlawful Duplication Of Computer Related Material)<sup>24</sup> on three separate counts based on the same conduct. After a jury trial, he was cleared of the unlawful duplication of computer-related material charge, but convicted of unlawfully using secret scientific material. The trial judge dismissed the guilty verdict, and the district attorney appealed. The Appellate Division of the New York Supreme Court, First Department, reinstated the guilty verdict. The Court found that Aleynikov misappropriated scientific information and possessed the requisite intent to commit the offense in making a tangible copy of the software.

In determining whether the software could be considered tangible, the court construed the meaning of the word using principles of statutory construction<sup>25</sup> because the Penal Law did not specifically define the word. Using Black's Law Dictionary as a guidepost, the court relied on its definition of "tangible" as 1. "having or possessing physical form"; 2. "capable of being touched and seen"; "perceptible to the touch"; and "capable of being possessed or realized"; 3. "capable of being understood by the mind."<sup>26</sup> The People and Aleynikov

<sup>20</sup> *Supra*, note 1.

<sup>21</sup> *United States v. Aleynikov*, 676 F.3d 71 [2d Cir 2012].

<sup>22</sup> *Id.*

<sup>23</sup> McKinney's Penal Law § 16.07 Unlawful Use Of Scientific Material, stating that "A person is guilty of unlawful use of secret scientific material when, with intent to appropriate to himself or another the use of secret scientific material, and having no right to do so and no reasonable ground to believe that he has such right, he makes a tangible reproduction or representation of such secret scientific material by means of writing, photographing, drawing, mechanically or electronically reproducing or recording such secret scientific material. Unlawful use of secret scientific material is a class E felony."

<sup>24</sup> McKinney's Penal Law § 156.30 Unlawful Duplication Of Computer Related Material In The First Degree, stating that "A person is guilty of unlawful duplication of computer related in the first degree material when having no right to do so, he or she copies, reproduces or duplicates in any manner: 1. any computer data or computer program and thereby intentionally and wrongfully deprives or appropriates from an owner thereof an economic value or benefit in excess of two thousand five hundred dollars; or 2. any computer data or computer program with an intent to commit or attempt to commit or further the commission of any felony. Unlawful duplication of computer related material in the first degree is a class E felony."

<sup>25</sup> *People v. Williams*, 19 NY3d 100, 103 [2012]; See also *People v. Gola*, 26 NY3d 358, 361 [2015].

<sup>26</sup> Black's Law Dictionary (10th ed. 2014), tangible.

mutually agreed that the word “tangible” means having “physical form and characteristics” but disagreed on whether Aleynikov made a “tangible reproduction or representation” of Goldman’s source code when copied onto the German server.

The court, however, concluded that Aleynikov had created a copy of the source code onto a physical medium because the source code stored on the computer’s hard drive “takes up physical space” on the drive and can be made visible.<sup>27</sup> Applying this analysis and the penal law statute, the court correctly disregarded Aleynikov’s argument that the source code had to have been printed on paper in order to be tangible because it was electronically reproduced. The court found no difference in the medium used considering that Aleynikov had downloaded the source code onto a hard drive as opposed to a piece of paper. It would have been improper and against public policy for the court to allow Aleynikov to escape criminal liability by finding that the source code would have had to be printed on paper because compact discs and thumb drives are undeniably tangible. Additionally, once the source code had been placed on a physical thumb drive, it had subsequently been placed into a secondary home apart from its original intended location on Goldman Sachs’ server.

In its analysis, the Court relied on *People v. Kent*.<sup>28</sup> There, the Court of Appeals found that the defendant had downloaded images and videos of child pornography and was thereby properly charged with procuring and possessing child pornography. The court reasoned that “the defendant downloaded and/or saved the video and the images, thereby committing them to the allocated space of his computer.”<sup>29</sup> Furthermore, in its holding, the court determined that the “hard drive is tangible” and that the computer image had a “permanent placement on a hard drive” with the possibility of being able “to access it later.”<sup>30</sup>

In this case, the NY Appellate Division reached a different conclusion than the Second Circuit, which concluded that the source code was an intangible product not stolen under the meaning of the National Stolen Property Act. The Second Circuit improperly applied the penal law and statute. The main issue in the case was whether there had been a tangible reproduction of the source code as opposed to whether the source code itself was merely tangible. There was more than enough evidence against Aleynikov proving that he had uploaded the source code to the German server and later downloaded the source code to his home computer. Further, the examiners had found the source code in question on his computer. Further, examiners concluded that Aleynikov attempted to share the source code with his future employer, cover up his illicit data transfers, and withhold source code from Goldman Sachs. Aleynikov intended to permanently exercise control over the use of the source code and had no intent to merely borrow source code from Goldman Sachs. Thus, the Appellate Division was not required to address whether Aleynikov “intended to acquire the major portion of the economic value or benefit of the source code”<sup>31</sup> or that Aleynikov “intended to deprive Goldman of the use of the source code.”<sup>32</sup> The first and only requirement that needed to be proven was that Aleynikov intended to use the source code. There were more than enough convincing facts that Aleynikov was intending to use the source code for a purpose other than as intended when employed by Goldman Sachs as a computer programmer. Therefore, the Appellate Division properly reinstated the verdict of the lower court and remanded the matter for sentencing.

The case is currently under appeal to the New York State Court of Appeals.

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<sup>27</sup> *People v. Barden*, 117 AD3d at 231 n 5; see also *United States v. Zhang*, 995 F Supp 2d 340, 349 [ED Pa 2014].

<sup>28</sup> *People v. Kent*, 19 NY3d 290 [2012].

<sup>29</sup> *Id.* at 304.

<sup>30</sup> *Id.* at 302.

<sup>31</sup> *Supra*, note 1.

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

# A CREATOR NAMED KULITTA: THE COPYRIGHTABILITY OF COMPUTER-GENERATED WORKS

Carlos J. Tirado

## INTRODUCTION

Copyright law provides an incentive to innovate by providing authors or employers exclusive rights to a copyrightable work. Given current technological developments, artificial intelligence (AI) is now a key contributor to innovation. However, works created by AI were not contemplated by the original drafters of the U.S. Constitution. The U.S. Constitution explicitly grants Congress the power to create copyright law by allowing Congress “[t]o promote the [p]rogress of [s]cience . . . by securing for limited [t]imes to [a]uthors . . . the exclusive [r]ight to their . . . [w]ritings . . . .”<sup>1</sup> This gap creates issues for copyright eligibility in computer-generated works, namely with regard to authorship.

Congress has studied the impact of computer-generated works of art on copyright law<sup>2</sup> but has yet to adopt any legislation that formally recognizes computer-

generated works of art. This paper discusses some issues and possible solutions regarding the authorship of computer-generated works of art and proposes a reinterpretation of an “employer” and “employee” in the work for hire doctrine. This reinterpretation will grant copyrights to computer-generated works of art without considering non-humans (i.e., computers) as authors.

## COMPUTER-GENERATED WORKS DEFINED

Computer-generated works are works that are created by, or with the extensive aid of a computer. Computer-generated works can generally be placed into two categories: works created with computer programs that humans use as a tool and works that are derived from AI programs that are entirely independent actors.<sup>3</sup> An example of the former is Kulitta. Kulitta is a computer

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<sup>1</sup> U.S. Const. art. I, § 8, cl. 8.

<sup>2</sup> See, e.g., Final Report of the Commission on New Technological Uses of Copyrighted Works 46, Library of Congress (July 31, 1978) (The Commission . . . concludes that no special problem exists with respect to the ‘creation of new works by the application or intervention of such automatic systems or machine reproduction’ that existing statute and case law adequately cover any questions involved[] and . . . no action by Congress is necessary at this time”); Arthur R. Miller, *Computers and Authorship: The Copyrightability of Computer-Generated Works*, in *World Intellectual Property Organization, World Wide Symposium on the Intellectual Property Aspects of Artificial Intelligence*, Stanford University (Mar. 25–27, 1991).

<sup>3</sup> See, e.g., Arthur R. Miller, *Copyright Protection for Computer Programs, Databases, and Computer-Generated Works: Is Anything New Since CONTU?*, 106 Harv. L. Rev. 977, 1044 (“The crucial question appears to be whether the “work” is basically one of human authorship, with the computer merely being an assisting instrument, or whether the traditional elements of authorship in the work (literary, artistic or musical expression or elements of selection, arrangement, etc.) were actually conceived and executed not by a man but by a machine.”); Kalin Hristov, *Artificial Intelligence and the Copyright Dilemma*, 57 IDEA 431, 435-36 (2017) (defining two categories of AI: (1) AI programs that generate works with the direct guidance, assistance or input of human beings, and (2) autonomously generated AI creations).

program that can create music by analyzing elements, such as harmony and pitch mapping, from an existing collection of compositions.<sup>4</sup> It then composes music based on these elements.<sup>5</sup> Like other programs of this type, Kulitta relies on two factors for its decision making—a pseudorandom number generator and a set of rules to refine its choices.<sup>6</sup> The analyzed compositions and set of rules are provided to Kulitta by a human end-user. Kulitta can cross different genres and create entirely new compositions based on the inputs.<sup>7</sup>

An example of a computer-generated work that is created by an independent AI actor is a work created by Narrative Science. Narrative Science is a computer program that can create news stories by analyzing data and transforming that data into a story.<sup>8</sup> Narrative Science does not require human input, and it can generate stories from data it automatically pulls from the internet. The generated human-sounding story articulates the most important and interesting information to the intended audience.<sup>9</sup> The key distinction between these two computer programs is human interaction at execution. Kulitta requires the end-user to specify the input and output parameters, and it creates a composition based on these parameters. Conversely, Narrative Science automatically retrieves predefined inputs and generates a story solely based on the inputs.

This distinction is critical because the Copyright Office currently does not provide registrations to works created by non-human authors.<sup>10</sup> Specifically, the Copyright Office “will not register works produced by a machine or mere mechanical process that operates

randomly or automatically without any creative input or intervention from a human author.”<sup>11</sup> The Copyright Office provides a non-exhaustive illustrative list of works that fall into the non-registerable category<sup>12</sup>. Although computer-generated works are not directly analogous to any of the noted illustrations, it is arguable that Narrative Science-type programs can fall within either the literal exclusion or one of the illustrative exceptions. The programs do not operate randomly or automatically without any creative input because the programmer defines the creative inputs. Similarly, one of the illustrative exceptions does not allow “[a] claim based on a mechanical weaving process that randomly produces irregular shapes in the fabric without any discernible pattern.” This, however, is distinguishable from the Narrative Science-type programs because this type of program creates a discernible pattern based on the analyzed data.<sup>13</sup>

## A PRIMER ON COPYRIGHT LAW

### Requirements for Protection Eligibility

Copyright is a method of protection provided by law to the authors of original works of authorship that are fixed in a tangible form of expression.<sup>14</sup> The “original works of authorship” was purposefully left undefined to allow the courts to establish a standard.<sup>15</sup> In the copyright sense, courts have concluded that originality means only that the work was independently created and possesses at least some minimum creativity.<sup>16</sup> The minimum threshold for creativity has been defined to be a “modicum of

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<sup>4</sup> *You'd Never Know It Wasn't Bach (or Even Human)*, YaleNews (Aug. 20, 2017), <https://news.yale.edu/2015/08/20/you-d-never-know-it-wasn-t-bach-or-even-human> [<https://perma.cc/JQF7-W5RN>].

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

<sup>6</sup> Davis Dunavin, *Computer Program Composes Music That Fools Humans*, WSHU (Aug. 31, 2015), <http://wshu.org/post/computer-program-composes-music-fools-humans> [<https://perma.cc/97WP-U7UR>].

<sup>7</sup> Mike Murphy, *People Are Confusing Computer-Generated Music with the Works of J.S. Bach*, Quartz (Aug. 26, 2015), <https://qz.com/488701/humans-are-confusing-music-composed-by-a-computer-for-j-s-bach/> [<https://perma.cc/FD8G-42ZU>].

<sup>8</sup> Joe Fassler, *Can the Computers at Narrative Science Replace Paid Writers?*, The Atlantic (Apr. 12, 2012), <https://www.theatlantic.com/entertainment/archive/2012/04/can-the-computers-at-narrative-science-replace-paid-writers/255631> [<https://perma.cc/W77M-7D55>].

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

<sup>10</sup> U.S. Copyright Office, *Compendium Of U.S. Copyright Office Practices* § 306 (3d ed. 2017).

<sup>11</sup> *Id.* § 313.2.

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

<sup>13</sup> *Id.*

<sup>14</sup> 17 U.S.C. § 102(a) (2012).

<sup>15</sup> 1 Nimmer on Copyright § 2.01[A] (2017).

<sup>16</sup> See, e.g., *Feist Publ'ns, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340, 345 (1991) (“Original, as the term is used in copyright, means only that the work was independently created by the author (as opposed to copied from other works), and that it possesses at least some minimal degree of creativity.”).

creativity,<sup>17</sup> which can be satisfied, for example, by a “copyist’s bad sight or defective musculature, or a shock caused by a clap of thunder.”<sup>18</sup> Work is “fixed” when it is captured—either by or under the authority of an author—in a sufficiently permanent medium so the work can be perceived, reproduced, or communicated for more than a transitory period.<sup>19</sup>

Works generated by both Kulitta and Narrative Science meet the basic originality requirements for copyright protection. A work generated by either program is independently created by the computer and possesses a modicum of creativity due to the pseudorandom factor, which can be equated to a defective musculature. The works created by both programs are also fixed in a tangible medium for more than a transitory period of time because they are stored on the computer’s storage device and can be reproduced on paper on command.

Currently, however, U.S. Copyright law has been interpreted only protect a work if it was created by a human author<sup>20</sup> since copyright law only protects “the fruits of intellectual labor” that “are founded in the creative powers of the mind.”<sup>21</sup> Similarly, if the Copyright Office determines that a human did not create the work, it will refuse to register the work because copyright law is limited to “original intellectual conceptions of the author.”<sup>22</sup>

This potentially disqualifies works generated by AI programs that act as fully independent actors, such as Narrative Science, from obtaining copyright protection because one may argue that the final output is not an original intellectual conception of a human author. On the other hand, while a work that is solely created by a machine is not eligible for copyright protection, the law is silent as to the issue of copyrightability of work

created jointly by a machine and a human. AI programs that humans use as tools, such as Kulitta, can potentially evade this disqualification.

### Works Protected by Copyright Law

Works that are eligible for protection under copyright include literary works; musical works, including any accompanying words; dramatic works, including any accompanying music; pantomimes and choreographic works; pictorial, graphic, and sculptural works; motion pictures and other audiovisual works; and sound recordings.<sup>23</sup> Most of the works created by Kulitta and Narrative Science-type programs will fall into either literary or musical works. However, other computer programs can generate works that fall into any of the abovementioned categories, including sculptural works with the aid of a computer numerical control machine.

### Rights of a Copyright Owner

Generally, copyright law grants copyright owners five exclusive rights—the right to reproduce the copyrighted work, prepare derivative works based on the work, distribute copies of the work to the public, perform the copyrighted work publicly, and display the copyrighted work publicly.<sup>24</sup>

### Who is Eligible for a Copyright

The author(s) who create a work are the initial owners of the copyright in the work.<sup>25</sup> However, the copyright can be assigned.<sup>26</sup> Two or more authors are considered joint authors if they created a single work with the intent of merging their contributions into inseparable or indivisible parts of the work as a whole.<sup>27</sup> On the contrary, if multiple authors contribute to a collective work, then each individual author’s contribution is

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<sup>17</sup> See *id.* at 346.

<sup>18</sup> *Alfred Bell & Co. v. Catalda Fine Arts, Inc.*, 191 F.2d 99, 105 (1951).

<sup>19</sup> *Cartoon Network, LP v. CSC Holdings, Inc.*, 536 F.3d 121, 127 (2d Cir. 2008).

<sup>20</sup> U.S. Copyright Office, *supra* n.10, § 306; cf. *Naruto v. Slater*, 888 F.3d 418, (9th Cir. 2018) (“Animals have neither constitutional nor statutory standing. . . . [With one exception] no case has held that animals have constitutional standing to pursue claims in federal court.”) (citations omitted).

<sup>21</sup> *Trade-Mark Cases*, 100 U.S. 82, 94 (1879).

<sup>22</sup> U.S. Copyright Office, *supra* n.10, § 306 (quoting *Barrow-Giles Lithographic Co. v. Sarony*, 111 U.S. 53, 58 (1884)).

<sup>23</sup> 17 U.S.C. § 102(a) (2012).

<sup>24</sup> *Id.* § 106.

<sup>25</sup> *Id.* § 201(d).

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

<sup>27</sup> *Id.* § 101.

separate and distinct from the copyright ownership in the collective whole.<sup>28</sup> The “work made for hire” doctrine is an exception to the copyright ownership mechanisms.<sup>29</sup> When a work is made for hire, the employer or person for whom the work was prepared is considered the author for the purpose of the copyright.<sup>30</sup>

### Duration of Copyright

Generally, a copyright term is the author’s life plus seventy years.<sup>31</sup> There are two exclusions for joint works and works made for hire. For joint works, the term is the last surviving author’s life plus seventy years.<sup>32</sup> In the case of a work made for hire, an anonymous work, or a pseudonymous work, the copyright term is the shorter of 95 years from publication or 120 years from creation.<sup>33</sup>

## ISSUES WITH APPLYING THE TRADITIONAL COPYRIGHT LAW FRAMEWORK TO COMPUTER-GENERATED WORKS

There are several issues when applying the traditional copyright framework to computer-generated works. As previously mentioned, the Copyright Office does not protect works that are produced by machine without input or intervention from a human author. This interpretation does not address the issue of authorship of work created jointly by a human with a computer nor how much human input or intervention is required to be eligible for copyright.

### Granting Authorship to the Computer

Applying the traditional copyright framework to grant authorship to the computer that generated

the work raises serious legal issues. Although under the traditional copyright framework, originality and fixation exist in computer-generated works, and such works meet the traditional goal of awarding copyright to the “actual creative force behind the copyrightable work”<sup>34</sup> because the computer actually generated the work based on its own creative process, a computer lacks a legal personhood.<sup>35</sup> As a matter of public policy, granting authorship to a computer would create further uncertainty in copyright law by creating more questions than answers and enabling the argument to allow other non-human authors to become eligible for copyright protection.

### Granting Authorship to the End-Users

Similarly, there are issues with applying the traditional copyright framework to grant authorship of a computer-generated work to the end-user. Granting the copyright right to the end-user seems to make the most sense. Under Congressional authorization, the National Commission on New Technology Uses of Copyrighted Works (CONTU) found as part of its final report that, in most cases, the author of a work created with a computer’s assistance would be the end-user.<sup>36</sup> However, CONTU made this assertion assuming that a human would be doing most of the actual work.<sup>37</sup>

Technological developments nullify the abovementioned assumption for Narrative Science-type programs because there is little to no human role in the creation of works generated by Narrative Science. A tenuous argument can be made by claiming that the Narrative Science-type programs are akin to a camera or

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<sup>28</sup> Id. § 201(c).

<sup>29</sup> Id. § 101.

<sup>30</sup> Id. § 201(b).

<sup>31</sup> Id. § 302(a).

<sup>32</sup> Id. § 302(b).

<sup>33</sup> Id. § 302(c).

<sup>34</sup> Robert Yu, Comment, *The Machine Author: What Level of Copyright Protection is Appropriate for Fully Independent Computer-Generated Works?*, 165 U. Pa. L. Rev. 1245; see *Acuff-Rose Music, Inc. v. Jostens, Inc.*, 155 F.3d 140, 143-44 (1988) (denying copyright to an author because the work was previously used and lacked originality due to “widespread popular usage of the phrase”).

<sup>35</sup> See, e.g., U.S. Copyright Office, *supra* n.10, § 306; Pamela Samuelson, *Allocating Ownership Rights in Computer-Generated Works*, 47 U. Pitt. L. Rev. 1185, 1199 (1986) (“In the long history of the copyright system, rights have been allocated only to humans.”); see also Cindy Alberts Carson, *Laser Bones: Copyright Issues Raised by the Use of Information Technology in Archaeology*, 10 Harv. J.L. & Tech. 281, 300 (1997) (suggesting that either “we do not believe a non-human is capable of making choices, or that we have made a policy decision that only human-generated work is protectable.”).

<sup>36</sup> See Miller, *supra* note 3, at 1045.

<sup>37</sup> See *id.* (“The computer, like a camera or a typewriter, simply was being employed as a tool to assist a human author. . . . [So] a human author always would be using the computer and program to do his bidding.”).

other recording device, which give copyright protection to the end-user. However, this argument is likely to fail because in a camera or similar device, the end-user chooses all of the parameters and sets the camera placement and the camera simply preserves the end-user's inputs. By comparison, a Narrative Science-type computer-generated work is an entirely new work based on the programmer's predefined inputs and not any end-user input. Kulitta-type programs have a stronger argument supporting the grant authorship to the end-users because they require creative input from the end-user, but this argument is likely to fail because the creative qualities of the work primarily come from the computer itself, not the human defining the inputs and executing the program.

### **Granting Authorship to the Programmer**

An alternative is to grant authorship to the programmer. A programmer can be viewed as the author of all the works that are generated by their program because the program itself is the foundation for all works. Nonetheless, there are issues with this approach. Although the program itself may be both original and creative to the programmer, the works generated by the computer program cannot be directly attributable to the programmer, unless the programmer actually executes the program themselves and defines the parameters for every program execution. This is unlikely to be true in most circumstances, particularly if a program is developed for commercialization since the program will be licensed to end-users and corporations who will be executing the program.

Both Kulitta-type and Narrative Science-type programs have distinct end-user or programmer inputs for each individual computer-generated work and a

pseudorandom generator, which generates the work based on either the specified parameters and/or an analysis of the inputted data. Consequently, these works do not directly reflect the programmer's work and are a derivative work at best, although derivative works require that the new work be "based upon" one or more preexisting works,<sup>38</sup> meaning it must be non-trivial and original relative to the underlying work on which it is based.<sup>39</sup> It is hard to categorize computer-generated works as derivative works because they are not related to the underlying copyrighted work—program source code—but the inputted parameters. The end-user simply utilizes the programmer's copyrighted work merely as a vehicle to create the new work. Furthermore, as a matter of public policy, the programmer is entitled to the copyright of the program source code, and we do not want to reward the programmer more than once for the same work.

### **Granting Joint Authorship to the Computer and Programmer or End-User**

On its face, joint authorship between the computer and programmer or end-user seems to be a great workaround when deciding authorship of a computer-generated work, especially, since both authors play a significant role in the creation of the final work. However, the joint authorship approach in this context also raises issues. Joint authorship is not defined in the Copyright Act but it is equated with joint work.<sup>40</sup> The legal standard to determine when a work is a joint work requires each author to make an independent copyrightable contribution to the work, and "the authors must intend their contributions be merged into separable or interdependent parts of a unitary whole."<sup>41</sup> Implicit in the independent copyrightable

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<sup>38</sup> 17 U.S.C. § 101 (2012).

<sup>39</sup> See, e.g., *Durham Indus. v. Tomy Corp.*, 630 F.2d 905, 909 (2d Cir. 1980) ("Derivative works are explicitly included in the subject matter of copyright as defined by the Copyright Act. 17 U.S.C.S. § 103. But this principle is subject to two important and related limitations. First, to support a copyright the original aspects of a derivative work must be more than trivial. Second, the scope of protection afforded a derivative work must reflect the degree to which it relies on preexisting material and must not in any way affect the scope of any copyright protection in that preexisting material.").

<sup>40</sup> 1 *Nimmer on Copyright* § 6.03 n.2 (2017) ("[The definition of joint work] should be understood as a definition of joint authorship.").

<sup>41</sup> *Aalmuhammed v. Lee*, 202 F.3d 1227, 1231 (9th Cir. 2000); see also *Greene v. Ablon*, 794 F.3d 133, 150-51 (1st Cir. 2015) (explaining the meaning of the second prong of the joint authorship requirement) ("'Inseparable' contributions 'have little or no independent meaning standing alone,' as might frequently be the case with collaboration on a written text like a play or a novel. 'Interdependent' contributions, on the other hand, 'have some meaning standing alone but achieve their primary significance because of their combined effect, as in the case of the words and music of a song.' For a work to be 'joint,' the authors must have intended, 'at the time the writing is done,' that their contributions be merged into 'an integrated unit.'") (citing *Childress v. Taylor*, 945 F.2d 500, 505 (2d Cir. 1991)).

requirement is that each author's contribution should be more than a *de minimis* amount.<sup>42</sup>

It is likely that joint authorship by the computer and the programmer or end-user of computer-generated work would not pass muster. As to the first requirement, it is unclear what contribution, if any, a programmer directly contributed to the final work. Similarly, an end-user's contribution to the work may be seen as *de minimis* in comparison to the computer's contribution, which is insufficient for copyrightability. As to the second requirement, it is difficult to argue that all of the future end-users were known by the programmer and that the programmer intended to collaborate with the end-users on a work. Even if both requirements for joint authorship were satisfied, the work would be precluded from copyrightability under this theory because a computer does not have a legal personhood.<sup>43</sup> While joint authorship is an attractive solution to enable copyright protection for computer-generated works, it is a relatively impractical solution.

### Public Policy Reasons

Courts have analyzed the purpose of copyright law in several cases and determined that copyright law should promote both the creation and dissemination of creative works.<sup>44</sup> Viewed another way, copyright law is grounded in utilitarian philosophy because authors are granted a limited monopoly to incentivize the production of original expressive works for the benefit of society.<sup>45</sup> Without that protection, authors would have less of an

incentive to continue to create works and the public at large would suffer due to lack of creativity.<sup>46</sup>

Some may consider that granting protection to works generated by AI clashes with the purpose of copyright law because the economic reality of producing computer-generated works places human authors at a significant disadvantage.<sup>47</sup> Specifically, computer-generated works have a major advantage over human-generated works because the marginal costs and fixed costs of production are effectively zero.<sup>48</sup> On the contrary, authors generally bear large costs to produce works.<sup>49</sup>

### INTERNATIONAL APPROACHES

Countries around the world are divided in deciding whether to grant computer-generated works of art copyright protection. While some countries are beginning to transition to standards that would grant copyright in works that are exclusively computer-generated,<sup>50</sup> many countries have yet to formally recognize or even declined to recognize any copyright protection for computer-generated works of art. By way of example, under German copyright law, the author is the creator of the work,<sup>51</sup> and all work resulting from a personal intellectual activity is eligible for copyright protection.<sup>52</sup> Spain only recognizes authors that are purely human created.<sup>53</sup> Like U.S. Copyright law, this law is antiquated because technology has made significant developments since its enactment. Australian courts declared that a work generated with the intervention of a computer is not entitled to copyright protection

<sup>42</sup> See, e.g., *Green*, 794 F.3d at 150 ("It is not necessary that the authors' contributions be quantitatively or qualitatively equal, only that each author's contribution be more than *de minimis*.").

<sup>43</sup> See, e.g., U.S. Copyright Office, *supra* n.10, § 306

<sup>44</sup> See, e.g., *Golan v. Holder*, 565 U.S. 302, 326 (2012) ("Congress made 'federal copyright contingent on publication, thereby providing incentives not primarily for creation,' but for dissemination") (alterations in original).

<sup>45</sup> See, e.g., *Mazer v. Stein*, 347 U.S. 201, 219 (1954) ("The economic philosophy behind the [Copyright] [C]ause . . . is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors").

<sup>46</sup> See Peter S. Menell, *Envisioning Copyright Law's Digital Future*, 46 N.Y.L. Sch. L. Rev. 63, 163 (2002) ("Copyright law has traditionally centered on economic interests—assuring content creators and distributors means of appropriating sufficient return in the marketplace in order to promote investment in creative endeavors.").

<sup>47</sup> Yu, *supra* note 34, at 1248.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> See, e.g., Japan Moves to Protect 'Copyrights' of AI Creations, *The Japan Times* (May 10, 2016), <https://www.japantimes.co.jp/news/2016/05/10/national/japan-moves-protect-copyrights-ai-creations/> [<https://perma.cc/BW5J-QZJU>] ("The Japanese government plans to develop a legal framework to protect copyright on novels, music and other works created by artificial intelligence.").

<sup>51</sup> Urheberrechtsgesetz [UrhG] [Copyright Act], Dec. 20, 2016, BGBl I at 3037, § 7 (Ger.).

<sup>52</sup> Gruber: *Gewerblicher Rechtsschutz und Urheberrecht*, 2nd Ed., Altenberge 2008, p.73 (Ger.).

<sup>53</sup> Ley ordinaria (L) 22/1987, de 11 de noviembre, de Propiedad Intelectual, RCL 1987, 2440 (Spain).

because it was not produced by a human.<sup>54</sup> Similarly, the European Court of Justice established that an “author’s own intellectual creation” is the sole criteria for establishing eligibility for copyright protection.<sup>55</sup> In any of the abovementioned countries, any works of art created by either Kulitta or Narrative Science would not be eligible for copyright protection.

Nonetheless, there are many that have adopted a standard for recognizing computer-generated works. For example, the United Kingdom has rules that allow copyright protection for literary, dramatic, musical and artistic works which are computer-generated by giving authorship to “the person by whom the arrangements necessary for the creation of the work are undertaken.”<sup>56</sup> Under UK copyright law, computer-generated work is defined as a work that “is generated by computer in circumstances such that there is no human author of the work.”<sup>57</sup> Hong Kong, New Zealand, India, and Ireland have identical laws in place for computer-generated works<sup>58</sup> with similar definitions for computer-generated works.<sup>59</sup> However, India does not have a statutory definition for “computer-generated” under copyright law. The approach taken by these countries grants the copyright of the computer-generated works to either the computer programmer that developed the program that generated the works or the end-user. The rights granted to these individuals are limited in scope to literary, dramatic, musical and artistic works<sup>60</sup> and limited in duration to 50 years from the date of the calendar

year in which the work was created, except in India and Ireland.<sup>61</sup> Computer-generated works are entitled to 60 and 70 years in India<sup>62</sup> and Ireland<sup>63</sup> respectively.

## PROPOSAL FOR COPYRIGHT IN COMPUTER-GENERATED WORKS

### Granting Rights to Employer Through Work Made for Hire Doctrine

Generally, the person who creates a work is considered its author and is the owner of the copyright in that work.<sup>64</sup> Under the work for hire doctrine, an employer or a company that commissions a work within the categories listed in the statute is considered the author of the work.<sup>65</sup> There are two ways to qualify, but the more relevant way for this proposal is that employers will own any work within the scope of employment of their employees.<sup>66</sup> For copyright purposes, “employee” means an employee under the agency common law,<sup>67</sup> which is determined by weighing factors in three general categories—control by the employer over the work, control by the employer over the employee, and status and conduct of the employer.<sup>68</sup>

Currently, the definition of “employee” is generally constrained to “a person usually below the executive level who is hired by another to perform a service especially for wages or salary and is under the other’s control.”<sup>69</sup> By expanding the definition of employee to categorize a computer as an employee under the work for hire doctrine, copyright can be granted to the employer

<sup>54</sup> See, e.g., *Acohs Pty Ltd v Ucorp Pty Ltd* [2012] FCAFC 16, 10 (Federal Court of Australia).

<sup>55</sup> See, e.g., Case C-5/08, *Infopaq International A/S v Danske Dagblades Forening*, 2009 E.C.R. I-06569 (Austl.).

<sup>56</sup> Copyright, Designs and Patents Act 1988 c. 48 § 9(3) (Eng.).

<sup>57</sup> Copyright, Designs and Patents Act 1988 c. 48 § 178 (Eng.).

<sup>58</sup> See *The Laws of Hong Kong: Copyright Ordinance*, (1999) Cap. 528, 8, § 11(3); Copyright Act 1994, s 5(2)(a) (N.Z.); Copyright Act, No. 49 of 1999, India Code (1999), s. 2; Copyright and Related Rights Act 2000 s. 21(f) (Act. No. 28/2000) (Ir.), <http://www.irishstatutebook.ie/eli/2000/act/28/enacted/en/html>.

<sup>59</sup> See *The Laws of Hong Kong: Copyright Ordinance*, (1999) Cap. 528, 108, § 198; Copyright Act 1994, s 2 (N.Z.); Copyright and Related Rights Act 2000 s. 2 (Act. No. 28/2000) (Ir.), <http://www.irishstatutebook.ie/eli/2000/act/28/enacted/en/html>.

<sup>60</sup> See, e.g., Copyright, Designs and Patents Act 1988 c. 48 § 9(3) (Eng.).

<sup>61</sup> See Copyright, Designs and Patents Act 1988 c. 48 § 12(7) (Eng.); *The Laws of Hong Kong: Copyright Ordinance*, (1999) Cap. 528, 10, § 17(6); Copyright Act 1994, s 22(2) (N.Z.);

<sup>62</sup> Copyright Act, No. 49 of 1999, India Code (1999), s. 22.

<sup>63</sup> Copyright and Related Rights Act 2000 s. 30 (Act. No. 28/2000) (Ir.), <http://www.irishstatutebook.ie/eli/2000/act/28/enacted/en/html>.

<sup>64</sup> 17 U.S.C. § 201(a).

<sup>65</sup> *Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 738 (1989).

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 740-41.

<sup>68</sup> *Id.* at 751-52 (listing a non-exhaustive list of factors to consider whether someone is an employee) (citing Restatement (Second) of Agency § 220 (2010)).

<sup>69</sup> “Employee.” Merriam-Webster Online Dictionary. 2017. <https://www.merriam-webster.com/dictionary/employee> (23 Nov. 2017).

without having to redefine authorship to include non-human machine authors. This is because copyright in works created by employees is automatically granted to the employer. This new definition of employee would allow computer-generated works that are created by both types of AI programs to be copyrightable since the copyright in the work would be automatically granted to the employer, without having to decide whether a computer can be an author or not.

Presently, “employer” can be defined as “one that . . . makes use of something or somebody,”<sup>70</sup> but the definition can be interpreted to include someone’s use of a computer for the purpose of achieving a goal or completing a task. A programmer, owner of a computer, or end-user can satisfy this definition of employee because they employ the computer for the purpose of generating a new creative work.

This approach of reinterpretation of words is not new to copyright law.<sup>71</sup> The courts and the Copyright Office have acknowledged reinterpretations of both “author” and “writings” in the Constitution to encompass more than their original meaning. Previously “author” was viewed as an individual who creates an original composition.<sup>72</sup> However, “author” has been construed to mean an “originator”<sup>73</sup> and now includes entities such as an individual, a firm, or an organization.<sup>74</sup> Similarly, “writings” was previously interpreted and limited to a script or printed material, but has become a catch-all term that includes “any physical rendering of the fruits of creative intellectual or aesthetic labor.”<sup>75</sup> Today, “writings” is being interpreted to include “books, sound recordings, films, images, and even computer code.”<sup>76</sup>

A reinterpretation of the work made for hire doctrine is well-suited for the U.S. Copyright system and is similar to the approach taken by the United Kingdom, Hong Kong, New Zealand, India, and Ireland. The approaches are similar because the copyright laws in the abovementioned countries expressly protect computer-

generated works and confer ownership of copyright in the “person by whom the arrangements necessary for the creation of the work are undertaken,”<sup>77</sup> which can be analogized to an employer-employee relationship.

Copyright protection can be expanded beyond the categories protected by the abovementioned countries—literary, dramatic, musical, and artistic work—to include motion pictures, sound recordings, and other audiovisual works since AI programs are now fully capable of generating these types of works. This does not include an expansion of the definition of author to include non-humans. Like the abovementioned countries, a reduced copyright term for computer-generated works can be defined. However, the work made for hire doctrine already incorporates a reduced copyright term, and a further reduction may result in deceptive practices by copyright holders to retain a higher copyright term.

Some critics may claim that this approach seems to favor property over creativity because granting copyright protection to computer-generated works places human authors at a competitive disadvantage due to the disproportionate costs of producing works between computers and humans. However, this approach enables a larger volume of works to be introduced to the public and allows them to use traditional copyright mechanisms—licensing and fair use doctrine—to use these works for the public’s benefit. In the end, this approach would further increase inspiration to create and allow for the enjoyment of new works that may not have existed but for the copyright incentive.

### **Granting Rights to End-Users through Quasi-Property Rights**

A modified version of copyright protection for computer-generated works can be given to end-users through a quasi-property right. A quasi-property right is a form of non-property interest that is nonetheless a status between an entity and the thing that is worthy of recognition and protection by law.<sup>78</sup> A quasi-property right enables legal

<sup>70</sup> “Employer.” Merriam-Webster Online Dictionary. 2017. <https://www.merriam-webster.com/dictionary/employer> (15 Nov. 2017).

<sup>71</sup> Hristov, *supra* note 3, at 446.

<sup>72</sup> See, e.g., *Goldstein v. Cal.*, 412 U.S. 546, 561 (1973) (quoting *Burrow-Giles Lithographic Co. v. Sarony*, 111 U.S. 53, 58 (1884)).

<sup>73</sup> *Id.*

<sup>74</sup> Kalin Hristov, *Artificial Intelligence and the Copyright Dilemma*, 57 IDEA 431, 446 (2017).

<sup>75</sup> *Goldstein*, 412 U.S. at 561.

<sup>76</sup> Hristov, *supra* note 71.

<sup>77</sup> See, e.g., Copyright, Designs and Patents Act 1988 c. 48 § 9(3) (Eng.).

<sup>78</sup> *Quasi-property*, Bouvier Law Dictionary (2012).

standing for a lawsuit and equitable relief, even though as a matter of policy the product is not given value and is therefore not subject to damages for its loss per se.<sup>79</sup> A traditional example of a quasi-property right can be found in *International News Service v. Associated Press*.<sup>80</sup>

In *International News Service*, Associated Press (AP) filed suit against its competitor, International News Service (INS), for unfair competition because INS was copying news from bulletin boards and early editions of AP's newspapers and selling the copied or rewritten versions of the work to AP's customers hours later.<sup>81</sup> INS claimed that the underlying facts in AP's news stories were unprotected and that their rewriting did not infringe on the particular expressions of AP's copyrighted works.<sup>82</sup> The court found there was a quasi-property right in the published news because AP created the work as a result of the expenditure of labor, skill, and money, and appropriating the published news gathered by another for further commercial purposes constitutes unfair competition in trade.<sup>83</sup> The court's rationale of the quasi-property concept was to prevent unauthorized interference that was particularly harmful to AP because it occurs at the exact point in the chain of business where AP would make a profit—the act of selling gathered news to consumers.<sup>84</sup> Policy drove this decision because competitor news sources owe a duty to one another in

order to conduct their own business in a manner that would not unnecessarily or unfairly injure the business of others.<sup>85</sup> This case was the foundation for what later became known as the “hot-news” doctrine.<sup>86</sup>

Allowing computer-generated works to be eligible for a quasi-property right would provide the owner with standing to sue in case of infringement. An important distinction to note is that protecting computer-generated works is not like protecting “hot-news” because not all of the information that can be generated is cost and time sensitive. Nonetheless, this should not preclude computer-generated works from receiving similar protection because, despite this distinction, public interest is advanced by protecting the fundamental value proposition of computer-generated works.

The effect of *Associated Press* has been undermined in multiple ways since it was decided. First, the quasi-property doctrine in *Associated Press* is federal general common law, but the Supreme Court's decision in *Erie Railroad v. Tompkins* substantially weakened its effect because the courts were ordered to apply state substantive laws in diversity cases.<sup>87</sup> Nonetheless, the *Erie* issue is a minor inconvenience in this proposed solution since state copyright laws are preempted by the federal copyright law.<sup>88</sup> Furthermore, courts no longer protect “sweat of the brow” works.<sup>89</sup> However, computer-generated works are

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<sup>79</sup> *Id.*

<sup>80</sup> *Int'l News Serv. v. Associated Press*, 248 U.S. 215 (1918).

<sup>81</sup> *Id.* at 231.

<sup>82</sup> *Id.* at 233.

<sup>83</sup> *Id.* at 236, 242. (“[N]either party has any remaining property interest as against the public in uncopied news matter after the moment of its first publication, it by no means follows that there is no remaining property interest in it as between themselves. . . . [N]ews matter . . . is stock in trade, to be gathered at the cost of enterprise, organization, skill, labor, and money, and to be distributed and sold to those who will pay money for it, as for any other merchandise. . . . [I]t must be regarded as quasi property, irrespective of the rights of either as against the public.”).

<sup>84</sup> *Id.* at 242.

<sup>85</sup> *Id.* at 236 (citing *Hitchman Coal & Coke Co. v. Mitchell*, 245 U.S. 229, 254).

<sup>86</sup> See, e.g., *National Basketball Association v. Motorola, Inc.*, 105 F.3d 841, 845 (2d Cir. 1997) (holding that a “hot-news” INS-like claim exists in “cases where: (i) a plaintiff generates or gathers information at a cost; (ii) the information is time-sensitive; (iii) a defendant's use of the information constitutes free riding on the plaintiff's efforts; (iv) the defendant is in direct competition with a product or service offered by the plaintiffs; and (v) the ability of other parties to free-ride on the efforts of the plaintiff or others would so reduce the incentive to produce the product or service that its existence or quality would be substantially threatened.”).

<sup>87</sup> See *Erie R.R. v. Tompkins*, 304 U.S. 64, 78 (1938) (holding that there is no “federal general common law” and mandating that federal courts apply substantive state law to resolving claims under state law); see also Paul Goldstein, *Federal System Ordering of the Copyright Interest*, 69 *Colum. L. Rev.* 49, 49 (“It has been suggested that the credence due the *International News Service* case today is minimal: that subsequent decisions have restricted its doctrine to the news context and that, in any event, it is but a derelict of the federal common law, untenable after *Erie R.R. v. Tompkins*.”).

<sup>88</sup> 17 U.S.C. § 301 (2012).

<sup>89</sup> See *Feist*, 499 U.S. at 359-60 (“the 1976 revisions to the Copyright Act leave no doubt that originality, not “sweat of the brow,” is the touchstone of copyright protection in directories and other fact-based works . . . the revisions explain with painstaking clarity that copyright requires originality.”).

not being protected under a “sweat of the brow” theory in contrast with *International News Service* because computer-generated works meet the modern originality requirement. Consequently, a quasi-property right is a valid proposed solution for enabling copyright protection of computer-generated works.

### **No Copyright in Computer-Generated Works**

Another possible solution would be to deny eligibility to all computer-generated works and place them immediately in the public domain, which is essentially the current scenario for computer-generated works. For example, a photograph of a vehicle taken by a red light camera would enter into the public domain because its copyright cannot be assigned to anyone. Although this option seems extreme on its face, it has several practical benefits and has relatively few disadvantages. Since the computer is the true author of the work, it would not be deprived of any legal rights because a computer is currently not entitled to any legal rights. Additionally, the programmer would be compensated and protected for their work through the copyright for the software source code. Although the end-user will be prevented from obtaining a copyright from any computer-generated works, they will still be entitled to copyright protection for a derivative work based on the computer-generated work. This approach of placing all computer-generated works in the public domain increases the volume of creative content and promotes the public interest in accessing these works, without excessively burdening the authors of the works.

However, there is one major criticism that applies with equal force to all previous solutions, but most prevalently to this solution—the practical difficulty of enforcement. It is difficult to distinguish between human-created and computer-generated works. Proving that a work is human-generated and not computer-generated may be a difficult task. End-users may claim to have independently created a work to avoid copyright ineligibility and public domain status. This method of deception will be difficult to rebut since computer-generated pieces are hard to distinguish. If this deceptive practice becomes common practice, it

will dissuade copyright infringement or at least make settlements more appealing to infringers due to the high burden of proof to establish that a work is in fact computer-generated. Although programmers can potentially place a digital watermark in their works, it is easy to imagine that there will be workarounds for the watermark.

### **CONCLUSION**

Recent developments in AI have resulted in an increased number of computer-generated works and have shown that humans are not the only source of creativity and innovation. The Copyright Office and Congress have antiquated laws in place that have not kept up with the times, which rely on now-invalid presumptions. Currently, computer-generated works are entering the public domain, which does not benefit programmers, end-users, or their employers. Direct entry into the public domain can act as a deterrent due to the lack of incentive to invest resources in future AI technology or general content creation, which is inherent in the copyright system.

The consequences can have important and widely applicable implications, such as a decrease in new works available to consumers, artists, researchers, and academia. This issue has yet to be formally addressed in the United States, and there is a practical need for a legal solution, especially if we want to ensure AI technology’s long-term role as a driver of creativity and innovation. Of the four proposed solutions, the reinterpretation of the work made for hire doctrine is the most practical and widely supported since several other countries have adopted a similar model. Under this reinterpretation of the doctrine, authorship of computer-generated works is given to the programmer, end-user, or their employers. This legal incentive would benefit those responsible for AI development or those responsible for the demand of the AI systems, both of which will result in a significant boost in the research and investment of AI technologies. Consequently, this solution brings the Copyright law into the modern era and provides new works to consumers, artists, researchers, and academia.

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