

FEATURE

unjust enrichment and unfair competition - is appropriation per se wrongful

Professor Harvey S. Perlman discusses the US tort of misappropriation and why it has received such little support.

December 23 1993 marked the Seventy-fifth anniversary of the United States Supreme Court's decision in *International News Service -v- Associate Press*, 248 U.S. 215 (1918). That decision, in the view of many, purported to apply a general cause of action for "misappropriation" in favour of market competitors against those who are unjustly enriched from the efforts of others or, as the Court put it, those who "reap where they have not sown".

In broad and passionate language the Court discovered a legally protected, quasi-property interest in the intangibles associated with a business enterprise, in this case a news service, beyond the protections available under the copyright and patent systems.

During these past 75 years, the case has resembled the shirt-tail relative who periodically arrives unannounced for dinner, to the surprise of all but the delight of only a few. Notwithstanding the efforts of some distinguished judges and scholars to give it a polite burial, the case has been utilised by courts infrequently but importantly, to support cases creating new or extended property rights for intangible assets of businesses.

Most recently, the American Law Institute considered and approved Tentative Draft No.4 of the new Restatement (Third) of Unfair Competition. Section 38 restates the common law in such a way as to foreclose a general tort of misappropriation, at least in disputes between market competitors. As one of the Reporters for the Restatement, my bias should be clear, but the purpose of this article is to describe briefly the American experience with a general tort of misappropriation and the reasons why it has received such little support.

The INS -v- AP decision

During World War I, British censors prevented the Hearst news service ("INS") from using the transatlantic cable. In order to

provide Hearst newspapers with news from the European theatre, INS acquired an early morning edition of an Associated Press newspaper in New York and transmitted that news to its own subscribers. Because of time differences, INS subscribers on the West coast would often print the news before AP subscribers. Although there were other allegations against INS, such as bribery of AP employees to obtain advance copies of the news and failure to inform readers that their news was from AP, the Supreme Court did not consider these traditional claims of wrong. Limiting itself to the question "whether defendants may lawfully be restrained from appropriating news ... for the purpose of selling it to defendant's clients," the Court declared in broad language:

In doing this defendant, by its very act, admits that it is taking material that has been acquired by complainant as the result of organisation and the expenditure of labor, skill, and money, and that defendant in appropriating it and selling it as its own is endeavouring to reap where it has not sown, and by disposing of it to newspapers that are competitors of complainant's members is appropriating to itself the harvest of those who have sown. Stripped of all disguises, the process amounts to an unauthorised interference with the normal operation of complainant's legitimate business precisely at the point where the profit is to be reaped, in order to divert a material portion of the profit from those who have earned it to those who have not; with special advantage to defendant in the competition because of the fact that it is not burdened with any part of the expense of gathering the news. The transaction speaks for itself, and a court of equity ought not to hesitate long in characterising it as unfair competition in business.

In dissent, Justice Brandeis argued that any property right accorded to the news should be accompanied by corresponding obligations and that only a legislature could draw a proper balance between the extension of property rights and the curtailment of the free use of knowledge:

But the fact that a product of the mind has cost its producer money and labor, and has a

value for which others are willing to pay, is not sufficient to ensure to it this legal attribute of property. The general rule of law is, that the noblest of human productions - knowledge, truths ascertained, conceptions, and ideas - become, after voluntary communication to others, free as the air to common use. Upon these incorporeal productions the attribute of property is continued after such communication only in certain classes of cases where public policy has seemed to demand it. These exceptions are confined to productions which, in some degree, involve creation, invention, or discovery. But by no means all such are endowed with this attribute of property.

Justice Holmes also dissented, arguing that a cause of action for unfair competition required some misrepresentation and that the only wrong here was failure of INS to give AP credit for the news.

undermining of the decision

Although the INS decision acquired considerable fame, the broad tort of misappropriation it announced was not widely applied. Early lower court decisions interpreted the case narrowly or cited the decision to support liability in cases, such as trademark infringement, where it was unnecessary or duplicative of other well established law. Judge Learned Hand, one of the most respected judges of his time, in a 1929 case involving imitation of dress designs, refused to apply the INS doctrine beyond its peculiar facts in order to avoid rights that would "flagrantly conflict" with Congressional action establishing the patent and copyright systems.

The INS decision was further undermined in 1938 when the Supreme Court held that the federal courts should no longer decide matters of common law but should apply the law of the state out of which the controversy arose. Because INS had been decided as a matter of federal common law, this new limitation on the federal courts deprived the decision of its precedential value. State courts and federal

courts interpreting state law could still find the decision's reasoning persuasive and some occasionally applied the misappropriation doctrine.

In 1964 the Supreme Court handed down two decisions that had an even greater impact on the viability of the misappropriation doctrine. The Court made explicit what Judge Hand had urged decades before - that under our federal system, a state law doctrine of misappropriation may not interfere with the protective regime of the copyright and patent systems enacted by Congress. Such interference occurs when the states protect items not eligible for protection by a copyright and patent.

The Court held that federal law preempted any state law purporting to prohibit the copying of anything that is within the general class of subject matter of writings or inventions eligible for protection under the copyright or patent statutes. Because these statutes tend to be broad in their subject matter coverage, the range of opportunity for applying a common law misappropriation cause of action has been considerably narrowed. In recent years the Supreme Court has continued to reaffirm the preemption doctrine and in the 1976 Copyright revision, Congress enacted a preemption provision that is largely consistent with the Court's views.

applications of the decision

Notwithstanding these limitations, lower courts have found a misappropriation periodically in factual situations similar to the taking of news without permission. For example, the unauthorised broadcasting of a sporting event from a vantage point outside of the stadium or arena was enjoined on the basis of INS [*Ed. cf. Victoria Park Racing*]. However, even this view was not universal; for example, in 1991, a federal court in Massachusetts refused to enjoin the unauthorised broadcast of the Boston Marathon holding that INS was not applicable.

The INS decision briefly protected sound recordings against unauthorised use or appropriation. In a line of famous cases, the Pennsylvania state courts held that INS prohibited the unauthorised radio broadcast of a sound recording of plaintiff's orchestra. Judge Learned Hand, sitting as a federal judge applying New York law, denied an injunction on similar facts finding INS inapplicable.

Subsequently, the New York Court of Appeals expressly adopted the misappropriation doctrine when it enjoined the sale of unauthorised sound recordings

of the Metropolitan Opera's radio broadcast. The INS decision was also employed in the late 1960's to enjoin tape and record pirates from making unauthorised copies of hit sound recordings. These decisions survived any conflict with the copyright statute because sound recordings were not protected under the copyright law. However, beginning in 1972, Congress extended copyright protection to sound recordings.

The INS decision also had a momentary importance in regulating an infant cable television industry. Cable operators profited by appropriating broadcast signals and selling them in remote areas, sometimes in competition with the broadcaster. The analogy to the facts of INS are striking. Although the misappropriation tort was initially applied to cable operators by some courts, the relationship between broadcasters and cable television shortly became the subject of extensive preemptive regulation, both under the Copyright laws and by the Federal Communications Commission (the FCC).

The Restatement (Third) of Unfair Competition

The purpose of the American Law Institute's series of Restatements of the Law is to clarify and give coherence to the decisions of the various courts at both the state and federal level. The first edition of the Restatement of Torts, published in the 1930's had considered elements of the law of unfair competition but in the late 1960's, the Institute began the undertaking of a Restatement of Unfair Competition as part of its "third" series of restatements. Section 38 of the Restatement (Tent. Draft. No.4, March 25, 1993) introduces the final chapter of the Restatement which is devoted to the rules governing appropriation of trade values. Section 38 restates the law of appropriation as follows:

One who causes harm to the commercial relationships of another by appropriating the other's intangible trade values is subject to liability to the other only if:

- (a) the actor is subject to liability for an appropriation of the other's trade secret under the rules stated in SS 39-45; or
- (b) the actor is subject to liability for an appropriation of the commercial value of the other's identity under the rules stated in SS 46-49; or
- (c) the appropriation is actionable by the other under federal or state statutes or international agreements or under the doctrine of common law copyright as preserved by federal copyright law.

This black-letter recognises two major branches of appropriational law: the appropriation of trade secrets and the appropriation of the commercial value of another's identity (the new, evolving right of publicity). The section acknowledges that in addition there may be legislatively created causes of actions and a narrow area of protection provided by what remains of common law copyright. However, beyond these specifically mentioned doctrines the section rejects a general cause of action for misappropriation.

the instability of the doctrine

As Reporters for the Restatement, my colleague Robert Denicola and I arrived at this result from our analysis of the case law as well as the broader systemic policies that define the law of unfair competition. Particularly telling was the fact that since the INS decision, courts had been unable to fashion a coherent cause of action for misappropriation. In the discreet contexts in which the doctrine had been applied, the results were quickly replaced with legislative regulation.

This history seems to suggest the instability of the idea that appropriating another's effort is *per se* wrongful.

The line of cases recognising the preemptive effect of the patent and copyright laws suggests that a general misappropriation doctrine would have a very narrow field on which to play. The patent system prevents the development of a state misappropriation theory with regard to almost all utilitarian "inventions" and designs. The only category of constitutional "writings" not accorded copyright protection are those that are not fixed in a tangible medium of expression, hardly an area of vast importance.

If it is clear that one may copy the design of a pole lamp unprotected by a patent or copyright (as the Supreme Court has held), then it seems equally plausible that one may copy a street dance or an impromptu performance in a park. And, although the copyright statute specifically preserves state laws that provide protection "not equivalent to" that protected by copyright, there seems little doubt that a cause of action based on "taking" or "misappropriation" or "copying" another's efforts is equivalent to a cause of action for copyright infringement.

Moreover, courts are incapable of fashioning a generally applicable and socially responsible principle for deciding cases involving the appropriation of intangible business values. For tangible assets, a general rule against appropriation

is likely to enhance social welfare. For example if B steals A's automobile, A is deprived of its use. As between A and B the automobile is a scarce resource. In order to assure that the value of B's use is higher than A's, we acknowledge A's property rights and require B to purchase the automobile at a negotiated price. However, with intangible values such as ideas, the appropriation by B does not prevent a continued use by A. These intangible values are what economists call "public goods"; once produced they can be shared widely at little if any marginal cost. Once the idea is produced, society is clearly better off if both A and B can exploit the idea rather than if A has a monopoly in its use. The catch is, of course, that unless A is granted protection for the ideas A creates, A has less incentive to produce ideas in the first place.

The creation of property rights in writings and inventions through the copyright and patent systems is justified precisely on the ground that protection will encourage inventors and authors to invent and write. But how much encouragement should be given to writing and inventing over other important social activities such as farming and lawyering. The scope of the property right we grant an inventor or author will determine, at least at the margin, the extent to which resources flow into inventing and writing. But how much incentive is enough? Policy makers must balance the claims of those who invent against the claims of those who would (at no marginal cost, remember) benefit from an absence of property rights.

The copyright and patent systems of most countries reflect very hard fought and intensely negotiated compromises, usually of an ad hoc nature, regarding the scope of protection for particular classes of writings or inventions. This balancing does not lend itself to the principled decision-making associated with judicial decisions but rather the give and take of the legislative process.

misappropriation and competition

The theory of unjust enrichment cannot provide a rational basis for measuring the metes and bounds of the property right at issue in these cases. To be sure there is a powerful moral imperative to the abstract idea of "reaping only what one has sown" which animates the decision of INS. But on closer analysis, one recognises that the advance of civilisation has depended on both the development of original ideas and their appropriation by others. In both the arts and sciences, progress comes by the accretion of modest originality onto the accumulated efforts of others.

Copyright and patent systems recognise this by limiting the scope of the right and the time in which the right can be exercised. On a more mundane level, the gains derived from most economic activity are attributable, at least in part, to the efforts of others - a "reaping" of unsown grain. The small shop at a shopping mall directly profits from the customer traffic generated

by the investment of the larger department store. Book publishers profit from the invention of electric lights. Hot dog vendors outside a stadium profit from the investment of the football team. In a multitude of interdependent ways, one's economic activity "appropriates" or builds upon the sowing of others.

The flip side of "misappropriation" is competition. Competition requires that multiple sellers offer to sell similar goods to the same buyers. Competition is accordingly reduced to the extent that a doctrine of misappropriation confers exclusive rights in ideas, styles, and designs. A rational legal system will attempt to balance the societal returns from increased investment in development resulting from the grant of property rights against the social gains derived from an increased competition resulting from allowing others to freely copy. In our view the INS case has not served as a springboard for achieving such a balance.

Whether the Courts will explicitly accept the analysis of the Restatement and applaud the burial of the INS decision remains to be seen. In practical effect, however, they have already done so for the decision is seldom acknowledged and even less frequently applied. It stands as a stone monument to a pitched battle between two news agencies against the backdrop of World War I. It seems to have little practical relevance to the modern world.

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Continuous Disclosure - an additional legal obligation

David Williams describes enhanced disclosure obligations and their impact on film investments.

On 4 March 1994 the *Corporate Law Reform Act 1994* ("the Act") received Royal Assent after wide debate associated with its passage through the Houses of Parliament (since 1992).

The Government's intention in passing the Act was to apply "enhanced" disclosure obligations on all entities (not just entities listed on the Australian Stock Exchange) in which the public invest with the aim of enabling investors to make informed investment selections.

The Act has very significant implications not just for listed companies and trusts but also for fund managers who have unlisted products in which the public is invited to

invest or has been invited in the past to invest.

The changes to the Corporations Law made by *the Act* of most relevance are those relating to continuous disclosure (including financial reporting) and to the prospectus provisions of the Corporations Law. These provisions commenced on 5 September 1994. In addition, the Corporations Regulations implement certain aspects of the continuous disclosure regime.

This article looks at the continuous disclosure implications of *the Act* from the point of view of a manager of unlisted products. This article does not cover the altered reporting requirements.

who is affected?

The enhanced disclosure provisions of *the Act* apply to "Disclosing Entities".

A Disclosing Entity is a body or undertaking which issues securities which are "ED Securities" (a shorthand term used in *the Act* for enhanced disclosure securities).

Units of a unit trust and other prescribed interests (together "prescribed interests") will be ED Securities if:

- they are listed; or
- a prospectus in relation to those prescribed interests has been lodged